Fourth Quarter 2008

KNOPINSKI & FAUVER
FINANCIAL ADVISORS

303.666.6292 www.kffainc.com

When Times Are So Scary, Opportunities Emerge

As the nation struggles through a severe financial crisis, you're undoubtedly worried about your financial security and the safety of your nest egg. But this is no time to sell stocks or make wholesale changes to a well-balanced portfolio that is aligned with your goals and investment time horizon.

Remember that short-term volatility isn't a big worry when you are invested for the long term. And though stocks have underperformed bonds during recent years, over many decades equity investments have almost always come out on top.

Even if the nation is in a recession, there is a lot in the economy that is doing pretty well. Unemployment, though rising, hasn't exploded, interest rates are still low, and inflation remains under control despite higher energy and food prices. The economy is resilient and the federal government is taking steps to get past the credit crunch.

As for stock prices, much of today's and tomorrow's bad news already has been factored into the market. Selling stocks or mutual funds after a decline simply means getting out at a low point. Nervously entering and exiting the market heightens your risks and lowers your returns.

So what should you do? Stay the course and remain diversified, but ask your advisor about adjusting your portfolio to take advantage of investments more likely to produce solid returns during a bear market. Here are several potential opportunities:

- Before their recent declines, global growth trends had sent commodity prices soaring for energy, agricultural products, and precious metals. Now, lower prices can give volatility-tolerant investors a good entry point for gains once the economy stabilizes. Commodities can also serve as a hedge against inflation.
- Yields on Treasuries dropped as shell-shocked investors fled to the safety of government bonds. But the market fallout should reiterate the importance of broad portfolio diversification—and that includes low-yielding treasuries. Allocation back into stocks and corporate bonds, while prices are low is also important.
- Though not quite as safe as Treasuries, municipal bond funds can deliver income that's not subject to federal and, sometimes, state income taxes. Muni prices have fallen and yields have risen, in some cases nearing the yields of corporate bonds even before figuring in the munis' tax advantage. But tread with caution: there are concerns about the worsening financial health of local and state governments, along with municipal bonds' lack of liquidity.
- Yields on corporate bonds, too, may be attractive today, when companies must offer higher rates in order to get the financing they need. Though default risks are also high, taking well-considered risks can improve potential returns.

(Continued on page 4)

Inject Some Calm Into Your Stress-Filled Life

Stress is a factor in obesity, diabetes, high-blood pressure, heart disease, low-sex drive, and cancer. It hurts your family life and job performance and makes life less satisfying, and it's easy to feel overwhelmed by stress. So here's some help. Michael F. Roizen and Mehmet C. Oz, authors of *You: Staying Young*, offer tips for beating stress.

- **One Step At A Time:** Divide your workload into tasks to get a sense of accomplishment.
- **Get Organized:** Putting your worries on paper and out of your head lets you track responsibilities and feel less overwhelmed.
- **Don't Retire From Life:** Stay physically and mentally active. Force yourself to walk or run daily.
- **See Friends:** Play poker, hit the spa, or go out with friends. Such activities provide vital mental medicine, as can activities at your house of worship.
- **Get Zen:** Breathe deeply, do pushups, or escape to a place with calming music.
- **Don't Become Complacent:** Stress makes it hard for you to find time to get in shape, and then you feel worse because on top of being stressed, you're also out of shape. Ski, swim, go hiking, or do something fun and different to break the pattern.
- **Be Money Smart:** Financial problems are a major stressor. Creating a financial plan with a professional you trust is good way to tackle financial-related stress.

Colleen & Rob

Talking To Parents About Their Elder Years

As baby boomers age, they're being forced to confront problems of caring for elderly parents. Yet in many families, issues involving where and how parents would like to spend their later years are rarely ever discussed. Or the conversation is delayed until a crisis erupts, when options are limited. A much better strategy is for children and parents to approach the subject systematically and come up with solutions as a family.

A good way to start this process is to set aside an hour for a family meeting involving parents, children, and grandchildren, if they're old enough. If children live far away, it's especially important for them to attend. Doing this sooner rather than later—ideally before Mom and Dad retire, when they're still in their early 60s—will be to everyone's benefit. Your parents' intellectual capacity will still be sharp, and they'll be more open to new ideas. Also, starting early means planning opportunities will be greater.

Most people tend to have limited visibility when it comes to comprehending their own aging. It's difficult to imagine that we will go down the same path as our grandparents. Children, because they are further away from the end of life and can see the change in their parents, often have a more realistic perspective.

There are many questions to address. Where do your parents want to live as they get older? Do they want to stay right where they are? Would they prefer to live with one of their children? Or would an assisted living facility or other alternative be more acceptable to them? What does each of your parents want to do should he or she outlive the other?

Children and parents should approach the subject of aging systematically and reach solutions as a family

Many of the answers hinge on your parents' financial resources, and you might want to assist parents in marshalling what they'll need to achieve their goals. You may even want to help them conduct a financial inventory. Who owns what? Are savings bonds stuffed in drawers? Are stock certificates in safe deposit boxes? Where are the life insurance policies? Is beneficiary information up to date on IRAs and insurance policies? It's wise to collect the paperwork now and put it in a central place; this isn't a job you want to take on during a medical crisis or after a parent has passed away. Furthermore, if your parents are open to it, obtain PIN numbers and passwords for credit, debit, and online accounts. This will help you gather information more easily in a crisis.

In addition, it may be a good idea to locate investment assets at just one or two brokerage firms to make management easier later on.

Your parents may want to consult a financial advisor to help map out their financial plan. The advisor could even sit in on a meeting with your parents, as a way to fully understand the family dynamics. This may also provide a more comfortable forum for discussing issues such as durable powers of attorney for property and for health care. If your parents don't have a will or if it needs to be updated, connecting them with an estate planning attorney is also a good idea, although, given the sensitive nature of inheritance issues, you should probably encourage them to meet with their lawyer privately. ●

Five Year-End Moves To Cut Personal Tax

As the year draws to a close, there's still plenty you can do to reduce your personal tax liability for 2008. Consider these possibilities.

Manage your capital gains and losses. Losses realized on your investments can be used to offset capital gains (taxed for most people at 15%), and if you have more losses than gains, you can deduct up to an additional $3,000 against your ordinary income and carry forward to future tax years losses that exceed those limits. But resist the temptation to sell depressed holdings just to generate tax losses. One useful tactic is to sell a losing holding and move the money to another stock or fund in a similar sector or with a similar objective. That way you can harvest a tax loss but still keep your investment plan in place.

Avoid the kiddie tax. For taxpayers in the 10% and 15% brackets (your children, for example), 2008 brings the tantalizing prospect of a 0% rate on capital gains (instead of the usual 5%). But for 2008, investment income above $1,800 received by a child under age 19, or a child in school under age 24, is generally taxed at the parents' top rate (as high as 35%). This "kiddie tax" could make it counterproductive to give your kids appreciated investments to take advantage of their lower gains rate.

Minimize exposure to the AMT. Staying clear of the alternative minimum tax is more art than science, but in some cases year-end moves could make a difference. The AMT is a parallel tax system that excludes many items you could normally deduct, and exercising incentive stock options or taking large tax credits or deductions that aren't allowed

Ever Think About Investing In A Vineyard?

Lots of wine aficionados fall in love with the notion of owning a vineyard or winery. But adding a vineyard to your list of assets is about a lot more than pursuing a passion for the grape. Like any other business, this one takes hard work and lots of cash as well as patience, determination, and—did we mention?—lots of cash.

There's something about the idea of winemaking that often turns otherwise sensible business people into dreamers who want nothing more than to see their name on a wine label. Yet as intoxicating as that notion can be, you need to ask yourself several essential questions. How much do you really know about the winemaking business? Can you pursue this dream without endangering your other financial goals? And do you intend it to be a hobby or a business? (That last distinction can have tax implications.)

Becoming a winemaker tends to be pricey. According to Terry Pershall, a real estate agent and former wine industry professional in Santa Cruz, California, who has matched vineyard buyers and sellers, the going rate for California vineyards ranges from $1.2 million to $50 million. A recent Paso Robles, California newspaper ad offered 50 acres of working vineyard and winery plus a four-bedroom estate home, separate office, assorted storage buildings, and wine inventory for $1.8 million. In another ad, a 4.5 acre "custom" winery and vineyard in the Santa Cruz mountain foothills included a home, winery facilities, equipment, tasting room, cave site, expansion permits, and vineyard for $3.85 million. Trade publication Wine Business Monthly (winebusiness.com) lists wineries for sale across the world.

But before you start checking out prospective properties, make sure you know what you're getting into, and that starts with defining your terms. "Though people often think that running a winery and a vineyard are one and the same thing, they're actually two separate disciplines," says Pershall. A winery often has a lab as well as myriad equipment you need to know how to operate and maintain. In contrast, a vineyard is an agricultural investment, a one-crop farm highly exposed to various forms of agricultural risk including crop failure due to fungus, pests, or even climate change. And of course, running a winemaking business also requires the sales, marketing, maintenance, inventory control, personnel management, bookkeeping, and basic business skills that every other kind of enterprise demands.

Also like any other business, winemaking calls for planning that includes getting good legal, financial, and accounting advice. You'll need a business plan, a budget, and an exit strategy. And you'll need to consider the likely tax liabilities of your vineyard and winery. The Internal Revenue Service will want you to declare whether the venture is a business or hobby. The IRS defines a hobby as an activity one pursues without the intent of making a profit. If you're in this category, you're probably interested in winemaking for the pure joy and passion of it, whatever the cost, and you're not focused on the bottom line.

If profit is your goal, however, then the IRS may consider your winemaking venture a regular business. That's good news in that it means you should be able to deduct expenses and losses. But simply saying you mean business may not be enough. You might need to pass an IRS "profit test" that asks you to show that your business earned income during three of the past five years. If the business is brand new, you could instead be asked to undergo a "facts-and-circumstances" test that considers a list of factors. Is there an element of personal pleasure in the endeavor? How much time and effort are you devoting to it? Are you managing it in a businesslike manner?

In the end, questions of whether and how to follow your winemaking dream are likely to be highly personal. You may feel that after working long and hard to build your wealth you deserve a chance to do something you've always wanted. You may decide to become a winemaking expert and throw yourself into the details of viticulture and enology—or you may prefer to leave all that to experts you hire while you run the business side. Speaking with people who are currently and/or formerly in the business to discuss their experiences will help you to decide what path you want to take. But however you pursue this idea, it's crucial to plan carefully and make sure that owning a vineyard and winery won't torpedo your larger financial plans. We can help you consider your options. ●

under the AMT could make you subject to the tax. If your accountant thinks you're likely to pay the AMT, you may want to minimize those deductions and credits or try to defer them to the following year.

Get credit for your charitable donations. You can generally deduct the full amount of monetary gifts to charity, including donations made by check or credit card. But the tax law imposes stringent record-keeping requirements, and for each deduction, you'll need a receipt or other written communication from the nonprofit showing how much you gave and when. To beat the end-of-year deadline, you can charge a gift with your credit card in December even if you don't pay the bill until January or later.

Estimate whether you can deduct medical expenses. Doctor bills, prescription costs, and other expenses are deductible only to the extent the annual total exceeds 7.5% of your adjusted gross income. If you're at or near the 7.5% mark for 2008, you could schedule routine exams or other elective expenses in December to put you over the top. But if you have no shot at a deduction this year, you may as well postpone these expenses to January and try again next year. ●

They Don't Call 'Em Trusts For Nothing

Maybe you heard the story about the 60-year-old oil heiress who died and left everything to her husband. He was 71 and died just two months after remarrying a much younger woman, who inherited his first wife's fortune. The heiress' children got none of it. Or perhaps you heard about the man who left his son $500,000, which he used to buy a house with his wife. Two years later, they divorced, and she got the house in the settlement.

Then there's the one about a couple that inherited $250,000 from an uncle but received none of it because the IRS exercised its right to take the inheritance to satisfy back taxes.

Obviously, these aren't the kinds of stories that you want people to tell about your family. To avoid the possibility of such trouble, you may need to establish a trust.

A trust is an agreement in which you transfer ownership of property to a trustee of your choosing, who then manages it for the benefit of your loved ones. The trust can be funded during your lifetime or at your death if your will provides for it. Typically, it costs between $1,000 and $2,000 to set up a trust, although you might spend more depending on where you live, the legal advisor you use, and the complexity of the trust.

Life is full of surprises, but experts say that you can trust a trust.

Trusts have long been used by the wealthy to reduce estate and income taxes, but more and more middle-class people are finding trusts can benefit them, too. Appreciation in real estate values over the long term, stock market gains for astute investors, and the slow march of inflation have thrown many middle-class individuals into higher income tax brackets and left them facing the prospect of estate taxes that could decimate the value of bequests to their loved ones.

A bypass trust can ensure that a married couple maximizes its combined estate tax exemption of $4 million (for 2008); a charitable remainder trust can reduce estate taxes while allowing you to do good for your community; and a life insurance trust can help guarantee the amount your heirs will receive. You can also use a trust to direct how the assets you leave behind will be managed, and to ensure that your bequests end up with the intended heirs.

The oil heiress, who had thought she was too young for estate planning and had feared that her 25-year-old son and 27-year-old daughter would squander the money, could have used a trust. She might have set aside some assets in the trust for her children until they were older, or she could have appointed a trusted friend or advisor as trustee to disburse the assets.

A trust also would have left the divorcing son in a better bargaining position to keep his house. Had his father left the money in a trust, allowing a trustee to buy the house for the son, the wife wouldn't have been able to get it. And the IRS could not have seized the assets in a trust established for the beneficiary with tax problems.

Life is full of surprises, but you can trust a trust. ●

Opportunities Emerge

(Continued from page 1)

- With the Federal Reserve likely to keep interest rates low, inflation could continue to be a concern, and Treasury Inflation-Protected Securities, or TIPS, can help insulate you against that risk. TIPS' principal increases in step with rises in the Consumer Price Index, and at maturity the buyer receives either the adjusted principal or the original principal, whichever is greater.

- Domestic stocks began their fall before international stocks and could be first to recover. Also, as overseas economies weaken, the dollar may resume its recent climb, reducing the value of foreign holdings for U.S. investors.
- European bonds may be a good bet as European countries drop interest rates in order to boost ailing economies. Declining interest rates favor bond holders.
- U.S. small-cap stocks may be preferable to large-caps because larger, multinational companies tend to have more exposure to international financial woes. Also, small caps tend to rebound first after a recession.
- Investing in surviving financial services firms might be worth considering, though only for those who can tolerate risk in a sector undergoing profound, unpredictable changes, and who have an advisor that has studied this sector significantly. ●

Knopinski & Fauver Financial Advisors 315 S. Boulder Rd. Ste 207, Louisville, CO 80027 303.666.6292 www.kffainc.com
A Colorado Registered Investment Advisor.