Bedel Financial Consulting, Inc.

Financial Planning and Investment Management

Fall 2006

Retirement Planning and the Pension Protection Act of 2006

By: Kathy Hower, CFP®

The Pension Protection Act of 2006 (PPA) signed into law by President Bush this August 17th is fairly comprehensive and primarily covers funding provisions of pension plans provided by corporations. However, a number of changes apply to you, as the plan participant, as well as your beneficiaries. Here are some highlights from the PPA regarding employer-sponsored retirement plans.

Automatic enrollment. Beginning in 2008, employers can automatically enroll employees in the company 401(k) or 403(b) plan when they become eligible. In addition, if enrollment is initiated by the company, contributions are automatically invested for capital preservation and/or long-term capital appreciation. Employees must be given the opportunity to “opt out” of the plan. If the employee indicates that he/she does not want to participate, then the automatic enrollment will not take place.

This automatic enrollment can provide significant benefits to individuals who tend to procrastinate when faced with money decisions. Even though they may wish to participate, it is possible that they might miss the enrollment opportunities for several years. Missing the opportunity to save can greatly impact your financial security at retirement, particularly if matching contributions by the employer are also forfeited.

Hardship withdrawals. In 2007, hardship withdrawals from 401(k) or 403(b) plans will be extended to beneficiaries of the plan. This new provision will allow a plan participant to withdraw funds to provide assistance to domestic partners or other non-dependent individuals listed as plan beneficiaries. Currently, such withdrawals can only be made on behalf of the participant and/or his/her spouse or legal dependents without incurring a 10-percent penalty on the amount distributed.

Rollover to IRA by non-spouse beneficiaries. In the past, a non-spouse beneficiary of an employer retirement plan was not allowed to roll the inherited plan to an inherited IRA. In addition, the non-spouse beneficiary of the employer retirement plan was generally required to take full distribution of the plan within five years, either in lump sum or in varying amounts over the five-year period. In 2007, this new legislation will allow non-spouse beneficiaries to roll the employer retirement plan to an inherited IRA which preserves the tax-deferral aspect of retirement plans. Minimum annual distributions will still be required for non-spouse beneficiaries; however, they can now be extended over the beneficiary’s life expectancy. Rolling the plan to an inherited IRA also gives the beneficiary control over how the funds are invested.

Roth conversions. You currently cannot convert funds in a 401(k), 403(b) or government retirement plan to a Roth IRA without first rolling them into an IRA. Beginning in 2008, you will be able to directly roll the funds from your employer retirement plan to a Roth IRA. Keep in mind that all normal taxation will occur as with any Roth conversion.

The impact on your personal IRA. The Economic Growth and Tax Relief Reconciliation Act (EGTRRA) of 2001 put into place several provisions that were scheduled to sunset in the year 2010. The PPA made many of these provisions permanent. Here are a few of them:

Increased IRA contribution amounts. The 2006 and 2007 IRA contribution limit is $4,000. In 2008 it increases to $5,000 and will continue to be adjusted for inflation each year thereafter.

IRA catch-up contributions. Currently taxpayers age 50 and over can contribute an additional $1,000 to their IRAs each year. The PPA makes this catch-up provision permanent.

Rollover rules. EGTRRA provided for the rollover of after-tax contributions from an employer retirement plan to an IRA, as well as the ability to roll IRAs into an employer-sponsored plan. These provisions are now permanent; thus giving employees the advantage of consolidating retirement plans to simplify investing and monitoring of investment performance.

The PPA also covers a range of provisions beyond pension legislation. As these provisions are implemented, we will take them into consideration when reviewing your financial plan. It is important to take advantage of these improvements to help secure your financial future.

Contact Kathy if you have questions or would like additional information regarding this topic

In This Issue

From Elaine

Moving Fast-Forward in the Fourth Quarter

As we always say this time of year, where did the time go? The holidays are rapidly approaching and all too quickly, it will be year's end.

By the time you receive this newsletter I will have returned from my last Board and Council meeting of the Financial Planning Standards Board, which takes place in Hong Kong. My year as Chair of the Board and my term as a board member will both end on December 31. This international organization establishes the global standards for financial planning and the Certified Financial Planner™ designation. With each meeting, the board and the twenty-country Council make great strides to further the global reach of financial planning. Serving as Chair has been a wonderful experience and I look forward to sharing the events of this upcoming Hong Kong meeting with you.

I hope you have enjoyed receiving our new video magazine. Creating it has been great fun. If you have not been receiving it via your email, check it out by going to http://bedelfinancial.watchourvideos.com. Once there, you can view past videos and sign up to receive future ones. These one to two minute financial planning and investment management tips are just one more way to share important information and our thoughts with you. If you like what you see and believe others could benefit from the information, feel free to email the video magazine to them. I hope you find the information and the format helpful.

Video Magazine

This newsletter features pertinent information on how the Pension Protection Act of 2006 could impact your retirement planning, the appropriate strategies for buying and selling investments, the deceleration in the residential real estate market and answers to several of your questions.

As always, if you want to know more about any of these topics, please contact us and we will be happy to discuss them with you.

Finally, we want to welcome Ryan Collier to our staff. Ryan joined us in August as an investment analyst. He will be supporting our investment management team in their efforts to serve you as effectively as possible. If you stop by the office, Ryan is easy to recognize—his height gives him away. A 1999 graduate of Centre College in Kentucky, he played basketball while he was there.

Sincerely,

Elaine

Elaine E. Bedel, CFP®

Industry News

The Market Rewards the Patient Investor

By: Bill Wendling, CFA, Portfolio Manager

How many times have you heard the "buy low, sell high" stock tip? Many times over, I'd bet. While the adage itself is trite, the message is as valid today as ever.

Asset classes, such as stocks and bonds, vary considerably in performance. While they may all perform as expected in the long-term, the returns of each individual one can be very different in the short-term. Unfortunately, until someone creates an all-knowing crystal ball, we cannot know with any certainty what the next best investment will be. This is why we diversify.

Diversification, spreading investment dollars among multiple investments, is a time-tested method for reducing risk. When diversification is implemented in its highest form, the risk-reduction strategy can yield similar or increased returns to the original portfolio. Higher returns and lower risk have a nice sound. It is almost too good to be true—and can be for the undisciplined investor.

For the disciplined investor, rebalancing is an important step in diversification. For example, when one asset (or asset class) performs very well and increases in value, it can actually put a portfolio at risk if it peaks and then decreases in value. Conversely, one asset (or asset class) may under-perform, but represent an incredible value.

This is where "buy low, sell high," that shopworn adage, becomes critical. If you reduce the size of the investment in the over-weighted asset and increase your investment in the undervalued asset, you have rebalanced your portfolio and improved its risk/return profile. In other words, you improved the potential return of the portfolio while lowering the potential risk. Sounds easy in theory, but most investors have a difficult time selling something that is doing well and buying something that is not.

If you own a mutual fund, its manager should also be rebalancing risks and rewards within the mutual fund, looking for assets that are poised to perform well in the future and selling assets that have already enjoyed a nice run. From a timing standpoint, the manager may not know when these assets will perform as expected, so there could be periods of underperformance until this strategy is rewarded. That is where being patient is important. In the long run, a good manager will reward a fund's long-term shareholders. A good manager will also be aware of the tax consequences of these actions and take them into consideration.

This is why we recommend diversification of your portfolio and maintaining patience with certain underperforming funds. A good fund that is currently underperforming may be positioning itself for a strong showing in the future. Sounds like a good time to buy, not sell.

Contact Bill if you have questions or would like to discuss the Pacers' chances in the coming season.

Client Dream — Client Reality

Caveat Emptor: Hot real estate markets are starting to cool

By: Matthew L. Roop, CFP®

Conventional wisdom amongst athletes and sports fans is that being on the cover of *Sports Illustrated* is generally bad luck. This wisdom may be well-founded. Featured athletes or teams often find this honor is followed by a monumental disaster—remember Ricky Williams, Heisman Trophy winner and first pick by the New Orleans Saints in the 1999 NFL draft? Sometimes something that initially appears to be a good thing can, and does, backfire. Unfortunately, this holds true in the world of investments.

Even a casual observer cannot help but notice that the hot topic in financial media for the past few years has been the sky-rocketing price of homes nationwide. Stories abound of people buying homes or condos still under construction and selling them for a hefty profit, sometimes before construction is even completed. Reality television shows, such as "Flip This House," glorify real estate investors who buy homes in disrepair, renovate them and then "flip" or sell them in a short amount of time for a tidy profit.

But before you join the ranks of those investors, take a reality check based on the facts. The Office of Federal Housing Enterprise Oversight (OFHEO) House Price Index Report for the second quarter of this year (September 2006 issue) showed the largest deceleration in home price appreciation in three decades. Previous hot spots were particularly hard hit. The South Atlantic Census Division (Florida, Delaware, the District of Columbia, Virginia and Maryland) experienced its most significant price deceleration since the 1980s. California saw a decline in appreciation of over five percent. Even Arizona, the state that continues to lead all others in year-over-year appreciation, saw a deceleration of more than eight percent. OFHEO Director James B. Lockhart noted in the report: "These data are a strong indication that the housing market is cooling in a very significant way. Indeed, the deceleration appears in almost every region of the country."

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Your Questions

Laying groundwork for the future

By: Julie Scheers, CFP®

Q: ***Should I do a Roth IRA conversion?***

A: A Roth IRA conversion is the process of converting all or a portion of an existing Traditional IRA into a Roth IRA. There are no age restrictions, but your adjusted gross income this year must be less than $100,000. You must pay income tax on the amount converted, but after-tax contributions will not be taxed again, and no further taxes will be owed on the funds in the Roth IRA as long as you follow Roth distribution rules. If you are currently in a marginal tax bracket of 25 percent or less, and you expect your tax bracket to increase in future years, consider converting a portion of your IRA this year. Close to the end of the year, when you can estimate your taxable income with more accuracy, determine how much additional taxable income you can create before you reach the next tax bracket. We can help you through this process.

Q: ***My children are getting older, and I want them to start learning about investments. What resources are available to help me with this?***

A: Sharing your own investing experiences—both positive and negative—can provide instructional value. Many books, Web sites and seminars are also helpful. Some of our clients have requested that we meet with their children to discuss investment basics, which we are happy to do.

Q: ***I get a Social Security Benefits statement in the mail each year. What do I need to do with it?***

A: The government sends these statements to verify the information. This information can directly affect your future Social Security benefits. Check your birth date and the spelling of your name. Then confirm that the number of "credits" listed is correct. You can earn up to four credits per year of work, so in years you worked full-time, you likely earned the full four credits. In 2006, each $970 of earnings is worth one credit. Earnings required per credit for prior years are available at: http://www.ssa.gov/OACT/COLA/QC.html. Credits are used to qualify you for Medicare and future Social Security disability or retirement payments. You are considered "fully insured" if you have accrued 40 or more credits. Especially important: Be sure to check the annual earnings record. It is generally easier to make changes within three years of the time the information was originally reported. After a thorough checking, file this statement with your other important papers.

Contact Julie if you have questions or would like additional information regarding these topics.

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Caveat Emptor

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The "take home" message from this report is that real estate markets, much like stocks and bonds, are cyclical. A short-term focus can prove to be very risky. The people who bought properties over the past few months may find their hopes of flipping them for a quick and substantial profit dwindling as these hot markets continue to cool. However, real estate has historically had a low correlation to the stock and bond markets, and can be a good diversifier for many client portfolios.

When real estate investments are included in our client portfolios, we utilize mutual funds that invest in real estate investment trusts (REITs). This strategy avoids the risk of a large investment in a single property, and can provide a cost effective means to building a diverse real estate portfolio.

Contact Matt if you have questions or would like additional information regarding this topic.

Quarterly Corporate Calendar

Bedel Financial Consulting will be closed for business on the following days:

November 23 - Thanksgiving

November 24 - Day after Thanksgiving

December 25 - Christmas Day

Year 2007

January 1 - New Year's Day

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