

THE COMPASS CHRONICLE

Highlighting important financial planning and investment issues

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A client-focused financial advisory firm dedicated to providing objective advice to individuals, families, and retirement plans.

Our financial advisory services include:

- ◆ Investment Management and Consulting
- ◆ Retirement Planning
- ◆ Education Funding
- ◆ Family Budgeting

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Financial Resolutions For The New Year

With the dawn of every New Year, we make resolutions to lose weight, exercise more, and the like. But you may want to consider making resolutions that improve your financial health as well. Though you may already have a few financial resolutions in mind, we have compiled a Top 10 List for you to consider when making your New Year's resolutions.

Top 10 List

- 1. Don't overspend**—Whether you are retired or not, it is important to live within your means. *An increasing amount of credit card debt is a telltale sign that you need to curtail your spending.* If necessary, establish a budget to review your spending decisions and then realign them with your financial goals, which may include increasing your retirement contribution or funding a child's or grandchild's educational savings account. If you need assistance, COMPASS can help you craft a budget you can live with.
- 2. Pay off high interest rate debt**—Focus on the debt where you are paying the highest interest rate, such as credit cards and personal loans, and make sure you pay your bills on time. *A late payment to even one credit card company may result in a higher interest rate on all of your credit cards.*
- 3. Refinance adjustable rate mortgage with fixed rate**—Interest rates on which adjustable rate mortgages are based have been increasing over the past year and are expected to continue their upward migration. If you do not plan on selling your home within the next few years, it may be worthwhile to consider refinancing your adjustable rate mortgage with a fixed rate mortgage. *When refinancing, refrain from extending the payment term or taking out cash.*

Likewise, you may want to consider paying off your home equity line, which normally has a variable interest rate tied to the prime rate. The prime rate has risen from a low of 4.0% as recently as mid-2004 to its present level of 5.0%.

- 4. Establish separate savings accounts**—For reasonably predictable expenses, it often makes sense to establish separate accounts and regularly save to them. For example, you may want to save for holiday gifts, vacations, and home

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Financial Resolutions For The New Year

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improvements. *By saving in advance of your need, you are less likely to use your credit cards or home equity to finance purchases, thereby living within your means.*

Employers often provide for pretax savings accounts that can be established to meet health care-related expenditures (sometimes known as “flexible spending accounts”), as well as day care costs (“dependent care accounts”). You can sign up for these pretax accounts during the fall with your company’s benefits department.

In addition, you should always maintain an emergency cash reserve with an equivalent of at least three to six months’ worth of living expenses. The reserve can be relied upon if you were to lose your job or have an immediate cash need. An emergency cash reserve should normally be invested in a money market or similar account that provides safety of principal and liquidity.

- 5. Evaluate your investment strategy**—To make your money work for you, review your investment strategy, including your portfolio’s asset allocation and diversification, at least annually. If you don’t have one, then ask us and COMPASS can create a customized strategy for you. Remember to adjust your asset allocation to a more conservative mix as you grow older and your investment time horizon shortens.

Did You Know . . .

Most investors are unaware that stockbrokers are not held to the same high standards as investment advisers. Since 1999, brokers have been allowed to offer financial advisory services and fee-based accounts without following the stricter rules that investment advisers must adhere to. *Investment advisers have a fiduciary responsibility to act in their client’s best interests, whereas a broker only needs to determine whether a product is “suitable” for the client. Consequently, a broker may select a product that runs counter to a client’s best interests and for which the broker receives the highest compensation.* Don’t be fooled . . . in a recent survey released by discount brokerage firm TD Waterhouse, 58% of respondents incorrectly believed brokers were required to act as fiduciaries.

Part of your review should include rebalancing your portfolio so that it remains consistent with your strategy. *First look toward your retirement accounts when rebalancing, as adjustments to your taxable accounts may result in unnecessary tax consequences.*

- 6. Increase retirement contributions**—Studies indicate that most of us have not saved sufficiently for our retirement. If your employer provides a 401(k), 403(b), or 457 plan and matches your contribution up to some level, *it normally makes sense to at least contribute enough to obtain your employer’s “free” contribution.* Another suggestion is to increase your contribution level by the amount of your pay increase. Ultimately, you will need to determine exactly how much you should be putting away each year to retire comfortably at a reasonable age. COMPASS can assist you by performing a comprehensive retirement planning analysis.

- 7. Fund children’s or grandchildren’s educational savings accounts**—As with retirement, the sooner you begin, the less money you will need to contribute due to the compounding of returns. If you have a large estate, educational savings accounts can be an excellent estate planning tool, allowing you to move assets from your estate, but still retain control.

If private primary or secondary schooling is in your child’s future, consider a Coverdell account, whereas a Section 529 account is normally best for college expenses. Keep parent and grandparent contributions in separate Section 529 accounts to obtain the most financial aid possible. If you have questions, COMPASS is available to help you establish the most appropriate account(s) for your circumstances.

- 8. Keep estate planning documents current**—Or, if you don’t have them, obtain them. *It is important that you indicate your desires in what are considered to be basic estate planning documents: a will, durable power of attorney, and health care proxy.* A newer document is a HIPAA release, which authorizes the release of your medical information. Once these documents are drafted, it is normally up to you to make sure that they contain your current wishes.

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Check 21

What Is It?

The Check Clearing for the 21st Century Act, popularly known as Check 21, became effective on October 28, 2004. The goal of the new law is to improve the nation's check payment system by making the check clearing process more streamlined and efficient. Previously, all checks were physically transported between banks for processing and, consequently, the clearing process could take days.

Under Check 21, banks may, but are not required to, create and transmit electronic images of checks. These electronic images are called substitute checks, which are the legal equivalent of the original which they replace. The use of substitute checks may allow checks to clear the next business day.

How Will This Impact You?

The most obvious impact is that you will lose the "float" that you had enjoyed as your checks meandered through the clearing process. Now you will need to have sufficient funds in your checking account when you write a check or risk bouncing it. According to Consumers Union, ". . . by mid-2005, consumers could be bouncing almost 7 million more checks and paying an additional \$170 million in fees each month." While you may also have quicker access to checks you deposit to your account, the law does not require banks to guarantee this.

The banking industry estimates that it could save over one billion dollars annually in postage and handling costs due to Check 21 and that fraud will be reduced since fewer checks will be transported between banks.

If you have historically received your cancelled paper checks with your monthly statement, you may begin noticing substitute checks instead. Banks do not need to seek your permission before they stop returning your cancelled checks. Prior to October 28, 36% of Americans received their cancelled paper checks with their statement each month.

Did You Know . . .

The sooner that you begin saving for retirement, the less you will need to save. Contributing to your retirement accounts earlier in life allows you to benefit from the power of compounding. According to The Vanguard Group, in order to replace 75% of your pre-retirement income over a 25-year retirement, *you would need to save 12% of your income annually if you began saving at age 27 versus 32% of your income annually if you began saving at age 47.* This analysis assumes you make \$75,000 per year; at greater income levels, you would need to save an even greater percentage of your income to meet your future retirement needs.

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9. **Review beneficiary designations**—As with your estate planning documents, *it is critical that you keep current the beneficiary designations that you have indicated on life insurance and retirement accounts.* If you wish to change your beneficiaries, contact the applicable financial services company.
10. **Assess insurance coverage**—Review your various policies (e.g., health, life, homeowner's, disability, long-term care) for applicability and adequacy. *Be especially mindful that your home is adequately insured for its full replacement cost.*

To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insights, or inside information. What's needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework. —Warren Buffett

Retirement Account Contribution Limits for 2005

The amount that you may contribute to an employer-sponsored retirement account has increased for 2005. For 401(k), 403(b), and 457 plans (offered by corporate, non-profit, and government employers, respectively), the maximum you may contribute via payroll deduction is \$14,000 for 2005, up from \$13,000 in 2004. If you will be 50 years of age or older by December 31, 2005, you may contribute an additional \$4,000 in 2005 (this was limited to \$3,000 in 2004 and is known as the “catch-up” provision). Contributions made on a pretax basis to your employer-sponsored retirement account have the benefit of lowering your taxable income, as well as assisting you in saving for your retirement.

The amount that you are able to contribute toward traditional and Roth IRAs has also increased for 2005. For a traditional IRA, you have until April 15,

2006 to contribute up to \$4,000 as your 2005 tax year contribution. If you are at least 50 years old at any time during 2005, you may contribute an additional \$500. You must be less than 70-1/2 years old to contribute to a traditional IRA.

For a Roth IRA, the same contribution limits apply. To make the full contribution, your adjusted gross income (AGI) must be \$95,000 or less as a single filer and \$150,000 or less as a married individual, filing jointly. You are ineligible to contribute to a Roth IRA if your AGI is greater than \$110,000 (single filer) or \$160,000 (married, filing jointly).

However, even if your income level prevents you from funding a Roth IRA during 2005, you may still contribute toward a traditional IRA. And remember, you still have until April 15, 2005 to make your 2004 tax year IRA contribution.

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