



Stephen Molyneaux

AUCTION-RATE SECURITIES

A Lesson in Balancing Risk and Reward

Perhaps the current era of prosperity has left many investors feeling lazy, or maybe we should blame it on the fact we have been afloat for so very long in an environment awash in liquidity. Whatever the reason, the recent failures in the Auction-Rate Securities (ARS) market should be a sharp reminder to all investors – *if any investment vehicle offers a greater reward, there must be a greater degree of risk.* Without delving into the financial minutia of what contributed to the avalanche of failed auctions, it is important all investors understand and remember a basic economic truism - risk and reward are inextricably entwined.

Auction-Rate Securities are securities with long-term maturities that reset interest rates at predetermined short-term intervals. At the end of each interval, a competitive bidding auction is held to determine the yield or dividend of the security for the next interval or holding period. Historically, the securities offer a slightly higher yield than money-market vehicles, and since the holding periods are very short (7 to 35 days) many investors have come to think of these securities as being fully liquid. The securities were marketed by numerous investment banks as being a safe, liquid, and higher-yielding alternative to money-market funds – after all, from their inception in 1984 through the end of 2007, a total of only 44 auctions had failed. Typically, in the past, when there were not enough orders to purchase all the shares being sold at an auction, the broker-dealers would bid on the securities on their own behalf to prevent failed auctions from occurring, but the investment bank brokers were not legally obligated to step-in and rescue a faltering auction.

(Continued on page 4)



Laurence Bumette, CFP

EVER CHANGING ESTATE TAX LAW

The Tax Man Cometh Goes And Returns

The tax gremlins in the nation’s capitol are back at work again. This time, they have their eye on reworking the estate tax law. The series of recent changes to estate tax law began in 2001, when the Economic Growth and Tax Relief Reconciliation Act triggered a gradual increase in the dollar threshold of estates subject to the estate tax. The details of the plan were as follows: In tax years 2007 and 2008, estates valued at more than \$2 million may be taxed as much as 45 percent, while in tax year 2009, the threshold will increase to \$3.5 million. In tax year 2010, the tax is scheduled to be repealed for a year. However, in 2011, unless Congress acts, the party will be over. The estate tax will be reset with rates as high as 55 percent on estates at a significantly lower threshold – \$1 million. While differing bills continue to swirl around Washington and many pundits expect a Band-Aid of some sort before 2011, no one appears to believe that the so-called “death tax” will be eliminated altogether. That makes it tough for individuals to set a clear course for their own estate planning. If you suspect your estate, or the estate of relatives you might inherit from, may fall prey to the estate tax, it makes sense right now to enlist the help of experts.

(Continued on page 3)

HIGHLIGHTS

Auction Rate Securities	Pg. 1
Estate Tax Changes	Pg. 1
401(k) In-Service Distributions	Pg. 2
Estate Tax Table.....	Pg. 3



Frank Johnson, CFP

A WELL KEPT SECRET

Empty Your 401(k) Into An IRA While Still Contributing To Your Employer's Plan

One of the best kept secrets within the 401(k) industry is a little known maneuver referred to as an “in-service” distribution. By using this particular distribution, workers 59½ and older, and in certain circumstances even some younger workers, can roll over their 401(k) funds into an IRA while still working and contributing to their current 401(k) company plan. IRS regulations permit 401(k) participants, age 59½ and older, to empty their 401(k) into their IRA while still contributing to their employer’s 401(k) plan. You can roll over the funds from your 401(k) into an IRA without any tax liability or penalty. If you withdraw funds from your 401(k) in virtually any other manner except to do a roll over to your IRA, you will have to pay income taxes on it. Keep in mind that since you are past the age of 59½, there is still no 10% early withdrawal tax penalty for making the transfer.

There is no blanket answer in determining whether or not rolling over your 401(k) into another investment vehicle is the correct strategy for a particular investor. A roll over raises many complex questions which can probably be best answered by seeking the help of a professional all the various tax and estate planning implications based upon your personal situation. One observation distribution for nearly everybody would in has very high fees or mediocre performance. that often 401(k) plans offer only a limited not provide you with the option of investing may want to consider moving your money to another investment vehicle. Industry statistics report that barely 15% of company 401(k) plans offer a brokerage window which gives the investor access to an extensive variety of bonds, funds and stocks.



financial advisor or tax planner able to discuss tions of such a move. Much of the determination vious scenario which would mandate an in- be if the 401 (k) plan you are currently enrolled Another possible reason for doing a roll over is menu of investment choices. If your 401(k) does your retirement funds where you want them, you

IRS rules and regulations are another consideration before taking any action on an in-service distribution. Tax laws treat IRAs and 401(k)s very differently in certain areas (for example, sale of employer’s stock within your 401(k), etc.) and can result in an investor either gaining a tax advantage or suffering a tax liability if the wrong decision is made. Without delving into the minutia of various IRS codes, suffice it to say – *please consult a financial advisor or tax planner before doing anything.*

Your estate planning desires may also influence your decision regarding an in-service distribution. If you plan on leaving retirement money to your children, grandchildren, or any other non-spousal heir instead of a spouse, rolling over your 401(k) plan into an IRA before your death is probably a good idea. Some employer’s plans don’t permit rolling over a 401(k) into an “inherited” IRA and thereby may interfere with your last wishes and impact your heirs. As a general rule, the “inherited” IRA offers your non-spousal heirs certain advantages and more tax deferral flexibility than a 401(k).

In-service distributions can be great maneuvers if you find yourself trapped in either an overly expensive, poorly performing 401(k) or you have specific concerns regarding your future retirement needs. Consult a financial planner or tax adviser and compare the current and long-term advantages and disadvantages of doing a distribution, but most importantly; keep in mind you can do an in-service distribution while still working and contributing to your present 401(k) plan. Should you have any questions or wish to review your current 401(k) plan, please give us a call.



Blog Now Available On Hanover Advisors' Website

Hanover Advisors is pleased to announce a blog is now available on our website. The blog will be updated on a regular basis with pertinent, up-to-date investment commentary regarding portfolio adjustments and unfolding events in the financial markets. Please visit our website at www.hanoveradvisorsinc.com to view our newest feature.

Assets may be expected to grow over time, and your estate may turn out to be larger than you may think. You should be talking to estate and tax specialists as well as financial advisors such as Certified Financial Planner™ professionals.

Here are some things to keep in mind as you plan those conversations:

Think about a life insurance trust: Whether you need it for estate liquidity or for other purposes, an irrevocable life insurance trust can be created to keep the proceeds of the insurance out of your taxable estate. An added benefit is that such trusts may permit spousal access to the cash value of the policy. Yet note the word “irrevocable” – it means a decision that cannot be changed.

If your assets are expected to increase: A grantor-retained income trust (GRIT), annuity trust (GRAT), or a unitrust (GRUT), are irrevocable trusts that are popular among some families with high value assets who would like to maintain an income stream for a given period of years. At the end of this period, following certain guidelines, these appreciated assets could be passed on to heirs with minimal tax consequences.

Prepare a gifting strategy: Under current law, unlimited amounts can be left to a spouse or to charity free of federal estate tax. Other heirs can receive a total of \$2 million, tax-free, when deaths occur in 2007 or 2008. If your assets are over the estate tax limit, it might make sense to devise a gifting strategy that spends down your total taxable estate while still allowing you a comfortable lifestyle. You might, for instance, consider making direct payments for someone else’s medical bills or education tuition. No gift tax applies for these items, so payments can be unlimited.

This column is provided by Laurence C. Burnette, CFP, a member of the Financial Planning Association.

ESTATE TAX RATES AND THRESHOLD LIMITS



<u>YEAR</u>	<u>TOP TAX RATE</u>	<u>THRESHOLD</u>
2008	45%	\$ 2 Million
2009	45%	\$ 3.5 Million
2010	Repealed - No Tax	Repealed - No Tax
2011	55%	\$ 1 Million

Hanover Advisors, Inc. Announcement



Hanover Advisors, Inc. is pleased to announce that Larry Burnette, CFP has recently completed the required course study and passed the final exam to earn his professional designation of CRPC (Chartered Retirement Planning Counselor). The CRPC program is sponsored and administered by the College for Financial Planning and represents a comprehensive study of pre-retirement and post retirement planning objectives which are crucial in facilitating our client’s retirement needs and goals. The achievement will further Hanover Advisors’ ability in assisting our clients in meeting all their personal retirement needs.



This past February, the ARS market nearly collapsed when in essence, they held auctions and no one showed-up to bid on the securities. Many investors believed the broker-dealers would step in and save the day, but several of the largest investment banks refused to do so - citing their current over-exposure to a variety of subprime securities. When the banks declined to act as bidders of last resort on the securities, the auctions failed at a spectacular rate. In a single day, February 20th, 395 out of 641 auctions failed. Currently, the failure rate (60% to 70%) shows no signs of abating and many investors have suffered either a loss of principal or a loss of liquidity.

The failures in the ARS market have resulted in hundreds of millions of dollars in losses for large corporations, wealthy investors, and shareholders in various leveraged mutual funds. Some blindsided investors weren't even aware their shares had failed at auction until they contacted their broker and discovered that what they once thought was a ready source of cash is now essentially frozen. Holders of certain auction-rate securities which are tied to CDOs may suffer a great deal more than just a loss of liquidity; they may be totally out of luck. Many analysts don't foresee how issuers of certain ARS investments backed by CDOs will ever be able to pay investors off.

The aftermath of the ARS debacle is now moving to the courtroom where a series of class action lawsuits have been filed against several of the largest investment banks. The lawsuits claim the banks deceptively marketed auction-rate securities as cash alternatives. It's too early to say how all the legal wrangling will turn out, but it's not too early for investors to edify themselves regarding the ARS meltdown and the lessons to be learned from it.

Many of these overly sophisticated financial instruments such as auction-rate securities are created and constructed by Wall Street in a fashion to enrich Wall Street, not the investor. If an investment vehicle attempts to bedazzle you with its complex design, or baffle you with its inscrutability, there is a good chance it was designed just for that purpose. You should not have to be a rocket scientist to be an investor. Wall Street knows there is a lot of room for profit to be found in these multifaceted, intricate investments. Yields on investments are based on a balancing act between risk and reward. Market forces are devoid of altruistic motives – a higher yield reflects the higher assessment of risk inherent in the investment. Regardless of how an investment is structured, layered, or otherwise described to an investor - a higher yield guarantees a higher exposure to risk. A basic understanding of the ARS investment market would have revealed to any inquisitive investor the fact that their investment's liquidity was solely dependent on the investor confidence of others bidding at a particular auction on a particular day. That fact alone creates a potential risk not present in many other investments and hence the reason why investors were offered a slightly higher yield.

The simple lesson to be learned from the ARS fiasco is that in an effort to gain a little more yield, investors seem to have forgotten or ignored the risk. Another good rule for investing is to always avoid any investment you don't understand - *keep it simple*. If an investment vehicle requires sifting through a mountain of indecipherable complexity, you can bet the mountain is there to shroud the risk or expense of the vehicle.

HANOVER ADVISORS

115 PERIMETER CENTER PLACE, SUITE 825
ATLANTA, GA 30346
(800) 874-5238 OR (770) 392-3998
VISIT OUR WEBSITE AT: www.hanoveradvisorsinc.com



The content of this newsletter is based on information from sources believed to be reliable. However, accuracy and completeness can not be guaranteed. We recommend clients consult their legal or tax advisor before making any investment. Nothing herein should be construed as an offer, or the solicitation of an offer, to buy or sell any security. The publisher and its associates, directors or employees may have positions in and may from time to time make purchases or sales of securities mentioned herein. We cannot guarantee, and you should not assume, that future recommendations will equal the performance of past recommendations or be profitable.

Mr. Molyneaux and Mr. Burnette are registered representatives of American Portfolio Financial Services Inc.
Securities offered through American Portfolio Financial Services, Inc. Member NASD, SIPC, MSRB