



Swisher & Walker Financial Grp  
David Walker, CFP, CSA  
2150 Manchester Road  
Suite 210  
Wheaton, IL 60187  
630-510-9500 203  
dave@swisherwalker.com  
swisherwalker.com

Hi Everyone,

Happy tax season!  
Here is my February  
edition of my newsletter. I hope  
that you enjoy it.

Dave

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# Financial Foresights

Practical Insights For Your Financial Goals

February 2007

## Hybrid Cars: Being Green May Take More Green

When it comes to safeguarding the environment, hybrid cars (vehicles that combine gasoline engines and rechargeable batteries) do have a positive impact. But how does owning one affect your wallet? While it may be too soon to tell, it seems that being green may take more green than you'd expect.

### Higher prices

The sticker prices for new hybrids average several thousand dollars higher than those for comparable cars with conventional engines. As a result, your initial out-of-pocket cost to purchase a hybrid can be significantly higher than for a conventional car. If you finance the purchase, that can translate into higher monthly loan payments or longer-term loans.

### Tax credits offset the cost ... for now

The federal government offers a tax credit (up to \$3,400) for purchasing a new hybrid vehicle; the amount of the credit you receive depends on the car's make and model. While this credit can at least partially offset a hybrid vehicle's higher purchase price, timing is everything: Once a carmaker sells 60,000 hybrids (of any model), the credit for all that manufacturer's vehicles begins to phase out. At least one manufacturer (Toyota) has already exceeded the 60,000 mark.

The credit won't reduce your tax liability below zero and, if you're eligible for other credits, must be taken last in line. If the amount of the credit exceeds your tax liability, the difference generally can't be carried over to another year. And the credit won't reduce your alternative minimum tax (AMT) liability, if you're subject to it.

### Saving at the pump

One of the biggest selling points for hybrid cars is their fuel economy--more miles per gallon, which means you'll save a bundle at the pump, right? Well, not always. It depends on how and where you drive. While you'll get good gas mileage, real-world results indicate that hybrids don't always get the significantly

better numbers claimed by the Environmental Protection Agency, especially if you're a low-mileage, short-trip urban driver. And fuel savings are a function of gas prices: The higher the price per gallon, the more (and the faster) you'll save. At lower gas prices, it takes longer to recoup your higher investment in the car.



### Maintenance costs

Since maintaining a hybrid is essentially the same as maintaining a conventional car, these costs aren't a significant variable in the savings equation. However, hybrid car batteries can cost \$1,000 to \$3,000 or more. While they're covered by generous warranties (up to eight years), should you keep the car beyond the warranty, you might have to replace an expensive part.

### Resale value

An important consideration in the cost-effectiveness equation is the resale value of the vehicle you purchase; if the car holds its value, it'll cost you less in the long term. Because hybrids are relatively new, the jury is still out in terms of whether they'll deliver greater relative resale values than their conventional counterparts. If they do, owning a hybrid may offer significant savings. However, hybrid technology is still improving, and this may adversely affect the resale value of the current models: Will a buyer want a used hybrid when new model hybrids may be more fuel efficient?

### It's not all about the money

In the final analysis, deciding to purchase a hybrid car won't be all about the money you could save. Each gallon of gas you burn puts 19 pounds of carbon dioxide into the atmosphere, and carbon dioxide is linked to global warming. So, if you go hybrid, you may not save enough money to burn, but you will save gas, and the planet you save may be your own.



### **Planning for uncertainty**

*New tools for financial forecasting use a methodology called a Monte Carlo simulation. By examining thousands of possible outcomes, a Monte Carlo simulation can give you a detailed picture of how likely it is that a given retirement planning and investing strategy will meet your needs. Facing up to uncertainty can help you see how adjusting your goals and your plan for achieving them might improve your chances of having the kind of retirement you want.*

## **Retirement: Does Your Game Plan Need a Second Look?**

Calculating what you'll need for retirement involves making an assumption about the return you'll earn on your portfolio. Typically, assumed rates of return are based on historical average returns for various types of investments. You'll also need to estimate how long you'll need income after you retire. Whether you are on track to meet your goals depends in part on the accuracy of those assumptions.

### **Question your assumptions**

It might be time to revisit your retirement calculations. "Past performance is no guarantee of future results" has always been true, but many investment professionals have begun to question whether stocks will match the returns they have had in the past. It's not unusual to see forecasts for long-term stock returns that are 1 to 2 percentage points lower than the 7% to 9% inflation-adjusted figure often used to plan portfolios. That may not sound like much, but even a 1% difference can be costly over time. For example, getting a 4% real return on \$100,000 over 20 years would give you roughly \$50,000 less than a 5% return.

### **Assess the cost of uncertainty**

Whether or not those forecasts prove accurate, you may want to double-check your estimate of what it will take for you to retire. Let's say you were counting on a 10% average annual return on your stocks for the next 10 years. It might be a good idea to project what would happen if that figure turns out to be 5% to 6% a year. If you're counting on high returns to make up for insufficient savings, the impact of a lower figure could be eye-opening.

Realistic projections about your investment returns are especially important if you're recently retired. Why? Because if lower-than-expected returns in the early years of retirement force you to withdraw more to live on each month than you had planned, those withdrawals will reduce the benefits of compounding over time. That in turn would affect the future value of your nest egg for the rest of your retirement.

You already know that saving more can increase your chances of having an adequate nest egg. However, there are multiple ways you can rethink your retirement planning—just in case.

### **Review your asset allocation**

If returns for each asset class in your portfolio

turn out to be lower than you've projected, you may need more in your retirement kitty to give you the income you've been planning on after retirement. To try to increase the nest egg available to you at retirement, you may want to reconsider your overall asset allocation.

If you want to try to get back to a targeted level of return for your overall portfolio, one way might be to increase the percentage that is devoted to asset classes that carry more risk but also have greater potential for higher returns. You also could consider investing in new asset classes that you previously haven't included in your strategy. Diversifying into investments whose performance may be very different from those you already own might change your overall return.

Diversification doesn't ensure a profit or guarantee against a loss; what it does do is give you more options for balancing risk and potential rewards.

### **Consider your income needs projections**

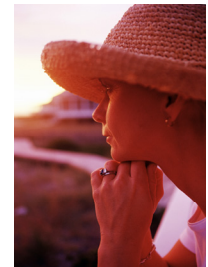
People are living longer than they used to, which means your nest egg might also need to last longer. Postponing full retirement can help your money last longer, especially if returns aren't what you had hoped. Also, look at whether your spending estimates for retirement

are realistic. Reducing the annual percentage of your savings you plan to withdraw to use as income after you retire will increase your nest egg's longevity. (However, remember that if your savings are in a traditional IRA or employer-sponsored retirement plan, you'll be required to take minimum distributions each year once you turn 70½.)

Another way to address your projected income needs is to consider investments that can provide a lifetime income stream.

### **Pay attention to expenses and taxes**

If investment returns sag, costs and taxes will have greater impact. Pay attention to the tax efficiency of your investments as well as their returns. If you actively trade stocks, be aware of trading costs. With mutual funds, understand the breakpoints that can help minimize sales charges the more you invest; also, check out a fund's expense ratios and fees.



## Successful Investors' Strategies and How You Can Apply Them

For golfers looking to improve their game, it can be useful to watch Tiger Woods. In the same way, investors can learn from acknowledged money masters. Though you may not have their experience or resources, understanding the philosophies they use can help you develop your own investing approach.

### Think like an owner, not like a trader

This philosophy is as commonsense as the investor who is famous for following it: Warren Buffett. Any list of successful investors includes the chairman of Berkshire Hathaway, and he's typically at the top of the list. The Oracle of Omaha is well-known for his down-to-earth approach to sizing up investments.

Buffett invests in businesses, not stocks, and prefers those with consistent earning power and little or no debt. He also looks at whether a company has an outstanding management team. Buffett attaches little importance to the market's day-to-day fluctuations; he has been quoted as saying that he wouldn't care if the market shut down completely for several years. However, he does pay attention to what he pays for a stock; as a value investor, he may watch a company for years before deciding to buy. And when he buys, he plans to hang on to his investment for a long time.

### Don't forget that markets can be irrational

Like Buffett, George Soros feels markets can be irrational. However, rather than dismissing their ups and downs, the founder of the legendary Quantum Fund made his reputation by exploiting macroeconomic movements. He once made more than \$1 billion overnight when his hedge fund speculated on the devaluation of the British pound (he no longer actively manages the fund).



Soros believes in capitalizing on investing bubbles that occur when investors feed off one another's emotions. He is known for making big bets on global investments, attempting to profit from both upward and downward market movements. Such a strategy can be tricky for an individual investor to follow. However, even a buy-and-hold investor should remember that market events may have as much to do with investor psychology as with fundamentals. Whether or not you apply Soros's philosophy in the same way he does, that can be a valuable lesson to remember.

### Use what you know; know what you buy

During his 13-year tenure at Fidelity Investments' Magellan Fund, Peter Lynch was one of the most successful mutual fund portfolio managers in history. He subsequently wrote two best-selling books for individual investors.

If you want to follow Lynch's approach, stay on the alert for investing ideas drawn from your own experiences. His books contend that because of your job, your acquaintances, your shopping habits, your hobbies, or your geographic location, you may be able to spot up-and-coming companies before they attract attention from Wall Street. However, simply identifying a company you feel has great potential is only the first step. Lynch did thorough research into a company's fundamentals and markets to decide whether it was just a good idea or a good investment.

Lynch is a believer in finding unknown companies with the potential to become what he called "ten-baggers" (companies that grow to 10 times their original price), preferably businesses that are fairly easy to understand.

### Make sure the reward is worth the risk

Perhaps the best-known bond fund manager in the country, PIMCO's Bill Gross makes sure that if he takes greater risk—for example, by buying longer-term or emerging-market bonds—the return he expects is high enough to justify that additional risk. If it isn't, he says, stick with lower returns from a more reliable investment. Because bonds have historically returned less than stocks and therefore suffer more from high inflation, he also focuses on maximizing real return (an investment's return after inflation is taken into account).

### Choose a sound strategy and stick to it

Even though all these investors seem to have different approaches, in practice they're more similar than they might appear. Each of their investing decisions has specific, well-thought-out reasons behind it. They rely on their own strategic thinking rather than blindly following market trends. And they understand their chosen investing disciplines well enough to apply them through good times and bad.

Work with your financial professional to determine a strategy that matches your financial goals, time horizon, and investing style.



### Key investing lessons

- *Minimize risk by understanding what you're buying*
- *Know why you're making a particular investment and what you want to accomplish with it*
- *Minimize your losses, but recognize that no investor is right 100% of the time; just make sure that you're comfortable with the risk you're taking and that the potential reward is worth it*



**Swisher & Walker Financial Grp**  
David Walker, CFP, CSA  
2150 Manchester Road  
Suite 210  
Wheaton, IL 60187  
630-510-9500 203  
dave@swisherwalker.com  
swisherwalker.com

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## Ask the Experts



### Is it too late to make an IRA contribution for 2006?

You can make an IRA contribution for 2006 at any time up until the due date for filing your federal income tax return for the year. For most people, this will be April 16, 2007. This deadline isn't affected by any extension you may receive to file your return. So, if you obtain an automatic six-month extension, you'll have additional time to file your tax return, but you won't have any additional time to make an IRA contribution.

If you do make a contribution in 2007 for 2006, make sure you tell your IRA trustee (or custodian) that the contribution is being made for the prior year. Otherwise, the trustee may assume that the contribution is for 2007 (the year in which it's received) and report it as such.

Also, before you make a contribution, be sure you're eligible. Remember that if you're covered by an employer retirement plan, you may not be able to deduct your contributions to a

traditional IRA unless your income is within certain limits. And you can't contribute to a traditional IRA at all after you reach age 70½. You can contribute to a Roth IRA at any age, but again only if your income falls within certain limits.

If you are eligible to make a deductible contribution to a traditional IRA, keep in mind that you can file your 2006 tax return claiming the deduction before you actually make your contribution. Just be sure you meet the April 16 contribution deadline.

You can contribute up to \$4,000 to an IRA (traditional, Roth, or combination of the two) for 2006 (\$5,000 if you were age 50 or older by the end of 2006). You may also be able to contribute up to \$4,000 to an IRA for 2006 in your spouse's name (\$5,000 if your spouse is age 50 or older), even if he or she had little or no taxable compensation for the year.

If you haven't yet made your IRA contribution for 2006, why not do it now?

### How do I undo my 2006 Roth IRA conversion?

So you converted your traditional IRA to a Roth IRA in 2006, and now you've determined that the conversion no longer makes good tax sense, or that you were ineligible to make the conversion in the first place. What do you do? You may be able to reverse ("recharacterize") your conversion. When you recharacterize a Roth conversion, it's as though the conversion never occurred, and the funds are treated as having never left your traditional IRA.

Generally, to undo a Roth IRA conversion, you'll need to take the following steps:

1. Identify the traditional IRA that will "take back" the recharacterized contribution (plus any earnings allocated to the contribution) in a trustee-to-trustee transfer. This can be the same traditional IRA you converted from, or a new IRA.
2. Notify the financial institution that you intend to recharacterize your contribution. Your financial institution should have a specific form for this that contains all the information required by the IRS. If more

than one financial institution is involved, you must notify both financial institutions--the one servicing your present Roth IRA and the one that will accept the recharacterized funds. You must provide the notice on or before the date the assets are transferred back to the traditional IRA.

3. Meet all applicable deadlines. The deadline for recharacterizing a Roth IRA conversion is the due date for your 2006 federal income tax return, *including* extensions. So, if you file for an automatic extension to October 15, 2007, you also have until then to recharacterize your 2006 conversion. (A special procedure applies if you file your tax return by April 16, and then later decide to recharacterize.)
4. Report the recharacterization by attaching Form 8606 to your 2006 tax return.

Failure to comply with all the technical requirements for a recharacterization can have serious tax consequences, so be sure to ask your financial professional for assistance.