

Published by KMS Financial Services, Inc. \* March 2008  
 2001 Sixth Ave., Suite 2801 • Seattle, WA 98121 • <http://www.KMSfinancial.com>  
 \* Member: Financial Industry Regulatory Authority • Securities Investor Protection Corporation

## Has the Baby Boomer Bulge Been Over-hyped?

For two decades the financial press has lavished attention on the outsized Baby Boom generation – Americans born between 1946 and 1964 – and their effect on all manner of economic, political, and cultural trends. One area of concern has been the potential for Boomers to create a drag on residential real estate and financial markets as they slide inexorably into that phase of life when portfolios are tapped for living expenses, travel, etc., and living space is downsized for the exigencies of retirement and old age.

However, the U.S. population's age distribution is not quite so warped as all the hype might lead one to believe. Yes, folks had lots of babies in the two decades after World War II, but the population didn't stop growing after that, and it continues to grow today. Unlike Europe, the average birthrate in the U.S. did not drop very far below the "replacement" rate, and it recently returned to roughly that level. Immigration also has been important. These shores attracted 21 million new arrivals just between 1980 and 2000, and the average age of immigrants has skewed younger than the general population.

The accompanying table does not indicate an impending dearth of young-to-middle-age adults lining up to acquire the assets that Boomers may gradually shed through their retirement years. Moreover, the U.S. is projected to grow by another 100 million over the next four decades, which should continue to dilute the Boomer effect.

### A Subtle Yet Still Meaningful Shift

Age Cohort	Population in Millions		% of Total Population	
	in 2000	in 2007	in 2000	in 2007
0 – 14 yr	60.3 m	63.0 m	20.4%	21.4%
15 – 24	39.4 m	43.1 m	14.0%	13.9%
25 – 34	39.9 m	41.5 m	14.1%	13.4%
35 – 44	45.2 m	44.0 m	16.0%	14.2%
45 – 54	38.0 m	45.3 m	13.5%	14.7%
55 – 64	24.4 m	33.9 m	8.7%	11.0%
65 – 74	18.4 m	20.2 m	6.5%	6.5%
75 +	16.7 m	18.1 m	5.9%	5.9%

\* Source: U.S. Census Bureau; Social Security Administration

## Desperately Seeking Stimulus

This spring taxpayers are settling up with the IRS for tax year 2007. As in most years many will be due refunds of some of the tax they had withheld during the year. And about 130 million Americans will be watching for a *second* check: those "stimulus" payments that Congress and the President approved in February.

The payments are essentially a rebate on 2007 taxes for selected Americans. In most cases qualifying taxpayers simply need to have filed a 2007 tax return and then watch their mailboxes, or bank accounts for those who choose direct deposit for their regular refunds. The IRS will figure your payment based on your return, and they expect to start sending checks in May. Most of the payments should be distributed by midsummer, but they'll continue through year-end to accommodate those who file later.

Most folks will receive the *lesser* of their 2007 income tax liability or \$600 (\$1,200 for joint filers). Eligible taxpayers will receive an extra \$300 for each child who qualifies for the child tax credit, but the kids must have Social Security numbers. Higher income taxpayers will see their payments reduced by 5% of the amount by which their adjusted gross income exceeds

*[continued on page 4]*

The Boomer bulge certainly *is* more apparent when one views the scene *change* as well as the snapshot. In a growing country, the older groupings should be a progressively smaller share of the whole as they lose members at an accelerating rate. But during this decade, the number of 45-64 year-olds jumped from 22.2% to 25.7% of the total population. Meanwhile, the number of 25-to-44 year-olds has been pretty static, and their share of the whole slipped from 30.1% to 27.6%. The 65-and-over set is poised for *relative* growth over at least the next decade.

It is hard to precisely spec the impact of one such variable on financial markets, given all the other cross currents of global proportion. There is a rising tide of newly affluent younger generations in a host of emerging countries who may be buyers, in one form or another, of the financial assets Boomers have accumulated over the years. And as the python said after swallowing the pig, "This too shall pass." §

## The Deleveraging Rolls On

A year ago we noted the extent to which the creation of credit had loosed the bonds of traditional bank and balance-sheet financing. We also noted that investor psychology supporting that trend could turn quickly. Now we are eight months into a financial earthquake that seems to shake, rattle, and roil some new corner of the credit markets almost weekly.

Touring the damage provides a retrospective on some of the flashier financial engineering of the past 20 years. The epicenter, of course, is the deflating bubble in U.S. home prices, felt first by sub-prime borrowers. Aftershocks have rippled through the lattice work of global debt, spilling out an alphabet soup of arcane financial structures – CDOs, CDSs, SIVs, VIEs, ARPs, and... oh, never mind.

A common thread is the complex, granular re-packaging of home mortgages, auto loans, credit card receivables, syndicated corporate loans, leveraged buyout financing, etc. Slicing, dicing, and reselling these cash flows grew over the years from a back-of-the-store novelty corner into a lucrative core business for investment bankers. In theory, default risk could be separately assigned and so broadly disseminated that credit considerations became an afterthought.

Another familiar feature is the use of short-term borrowings to carry longer term, higher yielding, but less liquid assets. This is patently profitable as long as one can refloat that short-term paper at a favorable spread, and the longer term assets perform. Established rating services obliged with favorable ratings for many of these securities, enhancing their appeal to a broader range of institutional portfolio managers and individual investors. That helped move it off the balance sheets of the creative financiers, which meant it didn't impinge on their regulatory capital reserves.

As with much financial innovation, there were benefits in terms of the availability and cost of capital to individuals, businesses, and even governments. But the process appears to have run ahead of itself. High-profile firms are taking write downs, bringing troubled debt conduits back onto their balance sheets, and seeking significant new capital infusions. Yield differentials between higher and lower rated debt have widened dramatically, and some areas of the credit markets have had acute liquidity problems. For now, the premium is clearly on greater financial transparency, accountability, and prudence. §

## Roth IRA Conversion Strategies May Be a Hot Topic the Next Few Years

Roth IRAs burst onto the scene a decade ago, and they've become an increasingly popular tax-favored savings vehicle. But converting assets from a traditional IRA to a Roth is currently limited to those whose adjusted gross income is less than \$100,000, not counting the taxable conversion amount. Starting in 2010 that cap comes off; investors will be able to convert *regardless* of income level.

Some are promoting the strategy of making *non*-deductible (after-tax) contributions to a traditional IRA in the interim with an eye toward converting in 2010 or later. The idea is that only the *gains* on those contributions would be taxed in the conversion. But there's a catch if you also have IRA balances that are *pretax*: derived from deductible contributions or earnings on earlier nondeductible contributions.

On a conversion, as with any IRA withdrawal, calculation of the nontaxable amount is based on your after-tax contributions *as a share of your total IRA balances*. For example, suppose you make a \$5,000 nondeductible, traditional IRA contribution for each of the years 2007, '08, and '09. And suppose that by 2010 that \$15,000 investment has grown to \$20,000. If that represents *all* your IRA assets, you could convert and pay tax only on the \$5,000 of gain.

But suppose you also have \$80,000 of *pretax* IRA assets. In that case your \$15,000 of after-tax contribution represents just 15% of *total* IRA assets, so 85% of *any* amount you decide to convert would be taxed as

[continued on page 3]

### Performance Summary: Major Mutual Fund Categories\*

Mutual Fund Category	Total Return w/ Dividends and Capital Gains Reinvested			
	---- Annualized through March 6, 2008 ----			
	1 yr.	3 yr.	5 yr.	10 yr.
Large-Cap Stocks (Core)	- 4.7%	3.4%	10.6%	3.0%
Mid-Cap Stocks (Core)	- 6.0	5.1	14.6	7.5
Small-Cap Stocks (Core) †	- 12.6	2.0	14.5	6.2
Foreign Stocks †	2.2	11.7	20.2	7.1
Emerging Market Stocks †	29.0	25.6	34.2	13.1
Flexible Portfolio	3.7	6.7	11.9	6.2
General Bond	0.1	3.2	5.4	5.0
Int'l Income (non-U. S.) †	13.7	4.8	6.6	6.1
High-Yield Taxable Bond †	- 4.0	2.9	7.8	3.4
General Municipal Debt	- 1.2	2.2	3.0	3.9

\* Source: Lipper, as reported in the *Wall Street Journal*, March 7, 2008.

Past performance is NOT indicative of future results.

† Small-cap stocks and high-yield (lower rated) bonds pose greater risk and price volatility than securities of larger, well-established companies. Securities of companies based outside the U.S. may be affected by currency fluctuations and political or social instability to a greater extent than U.S.-based companies.

## As Life Goes Along, Risk Management Changes Too

Tired of watching the market rollercoaster through the week? This may be a good time to check a couple other areas of financial risk control: disability income protection and long term care insurance.

The risks of suffering an injury or illness that disrupts our ability to earn a living are quite real. According to employee benefits consultant Milliman Inc., even among white collar workers between 35 and 65, the chance of becoming disabled for 90 days or longer is 27% for men and 31% for women. Yet disability premiums are relatively affordable, especially if they're locked in at a fairly young age.

About a third of full-time workers have disability income coverage through their employers. But such policies typically cover 60% or less of one's regular salary. To the extent an employer pays the premiums, disability benefits are taxable. There's also Social Security Disability Insurance. But fewer than 40% of those who apply are approved, and monthly benefits run less than \$1,000. Even if one has sizable savings to withstand a disruption in earnings, tapping a nest egg years earlier than expected undermines its ability to grow toward a secure retirement.

In reviewing policies, key features include waiting periods, limitations or exclusions for hard-to-diagnose conditions, and the issue of whether coverage is for the loss of the ability to work in one's own occupation or is limited to an inability to work *at all*.

About the time you start questioning the need for disability income protection, it may be time to consider long-term care insurance. Today about nine million Americans over the age of 65 need care, either at

home, in an assisted-living facility, or in a skilled nursing home. The U.S. Department of Health and Human Services projects that by 2020 that number will be 12 million with 70% of those spending an average of two-and-a-half years under such care. Studies suggest that a significant number of older Americans could not afford even a single year of such care.

Mindful of the demographics, insurers are making long-term care coverage more flexible and affordable. As with disability income policies, younger buyers lock in lower premiums and are more apt to qualify for "good health" discounts. Insurers are flexing on policies' length of coverage or allowing the terms and benefits to be increased as policyholder circumstances allow. You may want to check different insurers' rate tables to get an idea of the age at which the potential cost of waiting really starts to climb.

Long-term care features are finding their way into "combination" annuity and life insurance contracts. And the coverage is making some inroads as a workplace benefit. Conventional wisdom is that those whose income and assets could support long-term care expenses needn't buy the coverage. But again, even if a particular risk would not decimate your finances, it may still make sense to insure against it. It's another one of those personal risk management decisions. §

### Roth IRA Conversion Strategies... [continued from page 2]

ordinary income.

The strategy might still have some appeal, especially if you anticipate a year in the not-too-distant future when you'll have relatively little income. For example, that year you plan to quit work and sail around the world might be a good time to convert some traditional IRA assets to a Roth, assuming you aren't funding the trip with lots of taxable interest and dividends.

Otherwise, converting to a Roth is inherently problematic in that it forfeits long-term investment capital today for *potential* tax savings over some indefinite future. A fundamental tenet of saving and investing in an unpredictable world is to control as *much* capital as possible for as *long* as possible.

Each situation is different and depends on the interplay of tax rates over time, estate planning issues, etc. Your KMS Representative can help tune your IRA strategy to your unique variables and the occasional tweaks to the tax law. Happy sailing. §

## Don't You Wonder What He'll Do with His 401(k)?

On February 19<sup>th</sup> Fidel Castro announced he would step down as Cuba's president. That he was still serving in that capacity despite his age and poor health suggests an acute financial planning failure. You'd think the rickety revolutionary would have been able to retire *years* ago, having held Cuba's top job since 1959.

At this point Mr. Castro's prospects for a *quality* retirement don't look too good regardless of his finances. The 81-year-old underwent emergency intestinal surgery in July, 2006, and has had several operations since. He's rarely seen in public, and in his published farewell statement he said he could no longer muster the "mobility and dedication" required to lead Cuba.

That would seem to rule out playing a lot of golf, which the depleted dictator pretty much excised from the "people's paradise" after he was bested on the links by his compatriot, Che Guevara, in 1962. A cruise probably represents too much of a security challenge.

Meanwhile, Cuba's seat of power has officially passed to Mr. Castro's 76-year-old brother, Raul, who appears no more prepared for retirement than Fidel. **Note to Raul:** It's never too late to start planning and saving for that day when your colleagues decide they've seen about enough of *your* faded fatigues. §

## ***Desperately Seeking Stimulus [continued from page 1]***

\$75,000 (\$150,000 for joint filers). That makes for a pretty quick phase-out above those thresholds.

Certain taxpayers who owe *no* income tax may still be eligible to receive \$300 (\$600 on a joint return) if they had at least \$3,000 of qualifying income. This includes Social Security benefits, certain Railroad Retirement benefits, certain veterans' benefits and earned income from wages, salaries, tips and self-employment. But one must file a 2007 return to receive a payment even if one would not have to file otherwise. Internal Revenue Service's website ([www.irs.gov](http://www.irs.gov)) has a prominent link to the whole panoply of taxpayer scenarios, special forms, instructions, and frequently asked questions related to the stimulus payments.

### **OK, but Will It Stimulate the Economy?**

The rebates to individuals plus a handful of tax breaks for business may give the economy a temporary lift. And their timing may help bridge the gap to the eventual effect of recent Fed action to knock down interest rates. Consumer spending in June and July may see an \$80 billion boost, assuming recipients spend about two-thirds of their checks as they did with the last round of rebates in 2001. Consumer spending totals some \$10 trillion a year (about 70% of the economy), so the rebate boost may add 1.5% - 3.0% to the annualized rate of consumer spending in the second and third quarters, then peter out to a negligible effect by quarter four.

Along with the rebates, the stimulus package temporarily raises the cap on mortgages that the Federal Housing Administration, Fannie Mae, and Freddie Mac can deal with, from \$417,000 up to \$729,750. There's also a spur to businesses to accelerate investments in equipment. The legislation doubles, from \$125,000 to \$250,000, the amount of such expenditures that can be written off immediately. The effect of these provisions

is less predictable than the rebates and may not be significant in boosting business investment or reversing the ongoing correction in residential real estate.

One quite predictable effect of the \$168 billion package will be to make 2008's federal budget deficit look inordinately large. The government's fiscal 2008 ends September 30th after nearly all the rebates will have been booked but much too early for any positive effect on federal revenues to have appeared. This promises to make the deficit a contentious issue in the final weeks of the election campaign. The only real question is whether that debate will take place amidst a resurgent or recessionary economy. §

**For additional information on any of the items listed below, please call:**

**Your KMS Representative**

or the KMS Seattle Home Office:  
**(206) 441-2885, ext. 0**

- Mutual Funds, Unit Investment Trusts, & Exchange-traded Funds
- Individual Stocks and Bonds
- Private Portfolio Management
- Online Access to Your Accounts
- Fixed & Variable Life Insurance & Annuities
- IRAs and Tax-qualified Retirement Plans
- "529" College Savings Plans
- Insured Certificates of Deposit

***KMS Financial Services, Inc.***  
*2001 Sixth Avenue, Suite 2801*  
*Seattle, WA 98121*