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Does The European Union Matter To U.S. Investors?

You may not have noticed that the European Union is marking its 50th anniversary this year, and it probably doesn't seem like a big deal in any case. But for investors, the EU's metamorphosis from its original six-member country club to a confederation of 25 nations has growing significance. EU member countries, now with a population of close to half a billion people, are committed to creating a barrier-free trade zone and greater economic efficiencies, with the ultimate goal of operating under one official currency, the euro. Already, the EU is one of the world's three major trading blocks, rivaling those of the United States and China/Japan, says Campbell Harvey, an international business professor at Duke University's Fuqua School of Business. "Does this matter to U.S. investors? Yes, absolutely," Harvey says.

Geographic expansion of the EU, which recently added several central and eastern European members, is translating into financial opportunity and market clout. Last year, the gross domestic product for the eurozone, made up of the countries that have adopted the euro, rose 2.7%, while shares in European companies had a fourth consecutive year of gains, as increasing numbers of U.S. portfolio managers and individual investors take notice. "U.S. investors have tended to dismiss Old Europe as a place where nothing exciting is happening compared with the hype about China or India," says Dan Lefkovitz, a senior mutual fund analyst at Chicago-based Morningstar. "But that means overlooking many of the world's best companies. Western European companies have benefited from deregulation, increasing consumer demand, and other economic

reforms, and the European stock markets have been some of the world's best performers in recent years."

The Dow Jones Stoxx 600 Index, which tracks Europe's 600 largest publicly traded companies, was up 17.8% in 2006, Britain's FTSE 100, which tracks 100 companies with the largest capitalization on the London Exchange, gained 10.7%, Germany's DAX 30 index of blue-chip stocks rose 22%, and the French CAC 40 index of the largest stocks on the Paris Bourse climbed 17.5%.* U.S. investors nearly doubled their allocation to European stock mutual funds, to about \$6 billion last year, according to Boston fund consultant Financial Research Corp. And U.S. mutual funds devoted to international investing now have about two-thirds of their assets in European countries, says Lefkovitz, with many portfolio managers attracted by the relatively modest valuations of companies there. Whereas U.S. shares trade at an average of 16 to 17 times 2006 earnings, price-to-earnings ratios for Big European companies are in the 13 to 14 range, according to Standard & Poor's in New York.

Economic expansion, as well as a wave of merger and acquisition activity, has bolstered European companies' profits, says Lefkovitz, as has a U.S. dollar that has lost value against the euro. Yet the euro's rise, likely to continue, could ultimately have negative ramifications for European companies that have earnings in dollars, says David Wyss, chief economist at Standard & Poor's.

That's one reason Wyss and others expect eurozone growth to slow to about 2% this year. Climbing interest rates pose another challenge. "The biggest problems

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2007: Off To An Exciting Start So Far!

It has been a busy year. KCA and its wholly-owned subsidiary, Cross-Border Tax and Accounting, have survived another tax season, preparing well over 400 personal, corporate, and trust returns.

We are proud to have received two major awards this year. The first, for top volunteerism for a small Phoenix-area corporation, is a measure of KCA's commitment to hands-on community involvement. Each of our employees averages over 180 hours of volunteer work a year during corporate authorized time and personal time.

In addition, the Arizona Small Business Association has selected KCA as a "Company to Watch" in Arizona. This is a unique program designed to recognize and celebrate the contribution, innovation, and energy of the state's second-stage companies. Because it focuses on all of Arizona and not specific industries, Arizona Companies to Watch provides an opportunity to paint a realistic picture of a true statewide economy. Applicants are evaluated on more than growth, so the award includes companies that fly below the radar, and as such are not often recognized for the critical differences they make in their industry, region, and state.

Without the support of our clients and employees, KCA could not have achieved either of these awards. Thank you.

Bob Keats
President

Charitable Giving Through Insurance

The need for life insurance, once obvious as a way to protect your family, may decrease as your wealth expands. But rather than simply letting an old policy lapse, you could redirect the benefits from your heirs to a charity. Or you might want to buy new life insurance to compensate other beneficiaries for a philanthropic gift that reduces their inheritance. Here are several potential strategies.

Changing beneficiaries.

This is the simplest way to go, and it lets you call the whole thing off if you change your mind. But merely making a charity the beneficiary of an existing policy has several limitations. You don't get any tax benefit while you're alive, and the nonprofit you're supporting also doesn't gain until your death. Moreover, because you continue to own the policy, the proceeds will be potentially taxable as part of your estate, though your heirs should be able to deduct the value of the charitable gift.

Giving away existing insurance.

This can work whether you have a term or whole-life policy, though the pros and cons vary by type of insurance. In either case, the basic strategy is the same. You transfer

ownership of a policy to a charitable organization, which can then name itself as beneficiary. With term insurance, this gift has little or no current value, greatly limiting your charitable deduction. But if you choose to keep paying the

premiums, you can deduct the amount you give each year, and assuming the policy remains in force, the charity gets the death benefit. The gift of a whole life policy, in contrast, will earn you an immediate deduction for the insurance's current cash surrender value, which

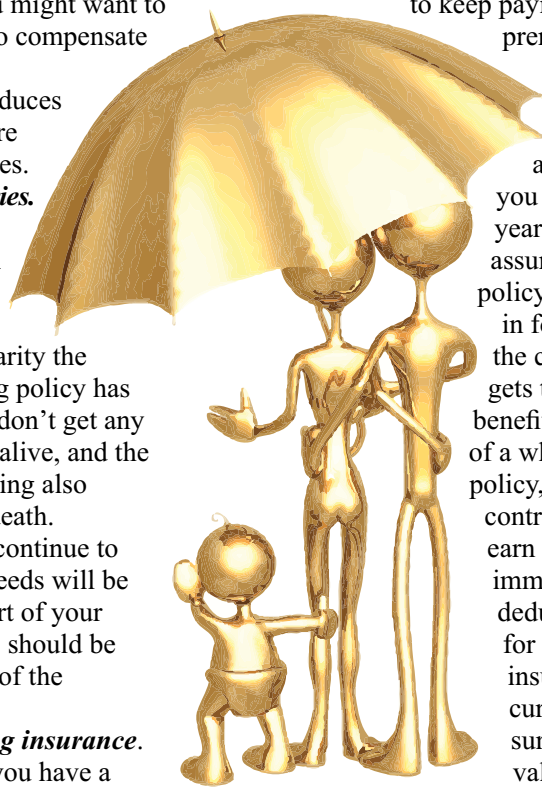
could be substantial. In addition, you could take responsibility for future premium payments, thus earning ongoing annual deductions.

Meanwhile, your chosen philanthropy benefits from greater flexibility than it would have if it had received a term policy. It owns an asset it could choose to cash in at any point, or it might be able to borrow against the policy.

Buying new insurance to offset

a gift. Suppose you'd like to make a big charitable gift during your lifetime—say, to endow a chair at your alma mater. The president of the college will be your new best friend, and you'll get a major charitable deduction, subject to IRS limits, for the value of the cash or securities you gave away. But to make sure your other heirs are none the poorer for your philanthropic splash, you could purchase a new life policy equal in value to the assets you gave away. And if you place the new insurance in an irrevocable life insurance trust, the proceeds won't be subject to estate tax.

There could be several creative variations on these basic themes—for example, creating a charitable remainder trust that pays you a lifetime annuity you use to fund an insurance policy for your heirs. We can work with you and your attorney to craft a philanthropic plan that fits your needs. ●



Selecting A Corporate Trustee Certainly Has Its Drawbacks

Does the idea of putting control over trust assets in the hands of a virtual stranger give you the shivers? Or maybe you've heard that corporate trustees are pricey, take longer to make decisions, and—due to personnel changes—may mean your beneficiaries will have to deal with a series of point people rather than one individual.

All are potential drawbacks. But before you opt for a friend or family member as trustee, consider the pros of choosing a corporate trustee.

● **Staying power.** The role of trustee can be demanding, and may span a long period. An individual could find that responsibility overwhelming, and if that

person dies or becomes mentally incapacitated, it could create problems for the trust and its beneficiaries. A corporate trustee, however, can administer the trust for as long as it endures.

● **Objectivity.** Friends and family members are likely to have emotional connections to beneficiaries, could cave in to unreasonable requests, and may not be able to balance the needs of current and future beneficiaries. A corporate trustee will follow the grantor's wishes to the letter.

● **Expertise and commitment.** The role of a trustee is complicated and time consuming. Trustees must not only collect, value, and safeguard assets, but

also invest and distribute them, as well as keep accurate records and follow complex accounting, legal, and tax regulations. And flubbing a filing or omitting a tax payment can have serious ramifications, and could leave the trustee liable to charges of fiduciary malpractice.

● **Conflict resolution.** An independent corporate trustee can serve as a buffer when conflicts arise and may be better equipped to resolve disagreements or make unbiased decisions.

Of course, it's essential to choose corporate trustees with care. Plan to talk to several candidates. Consider factors such as how long the trust department has been in business, the number and the

How Long Should You Plan To Live For?

Is age 95 the new 85? With Americans living longer than ever before, experts now say you should build a retirement plan that lasts well into your 90s.

Consider these actuarial realities: A 65-year-old man today is likely to live to 81; his 65-year-old wife, to 84. And the math doesn't stop there. There's an almost 40% chance one of those 65-year-olds will be alive at 95.

"You need to plan through your mid-90s," says Dan Veto, senior vice president of Age Wave, a think tank focusing on adult life stages. "But most people still just kind of show up for retirement. They spend more time planning a trip to Disneyland."

The longevity bonus comes as 78 million baby boomers, who have redefined every other life stage, approach retirement. "If we start taking care of ourselves in our 40s and 50s, the chance of being well during our 80s, even our 90s, is very high," says Howard Stone, founder of 2young2retire.com. "That means taking a grown-up look at the money you have, the way you're living now, and how you want to live the next 30 years. The traditional idea of retirement, created in the 1930s, is no longer relevant. What used to be retirement is now a fulfilling third of your life, a time when you still have vitality, flexibility, and curiosity."

But living longer means your income has to live longer, too. As a result, experts are reassessing financial planning fundamentals. Here's what that could mean for you:

A new approach to retirement income. Historically, people have tended to convert to an income-based strategy when they retire—essentially jettisoning stocks for bonds. Today, though, a retirement portfolio may require significant growth, and that could mean living with more volatility. "The classic 'just buy bonds' math doesn't work anymore," says Veto.

At the same time, simply keeping more stocks, with their potential to provide higher returns, isn't the whole answer. For stocks to work in a portfolio, they need to be held over a long period, and that begs the question of where to find income. With private-sector pensions blowing up and Social Security in doubt, there's a new focus on "longevity protection," with insurance and annuity products that can substitute for pensions. With a typical annuity, you trade a lump sum for an insurance company's promise to provide lifetime income.

"Annuities are complex, and for years they were overpriced and oversold," says Moshe A. Milevsky, Executive Director of the non-profit Individual Finance and Insurance

Decisions Centre in Toronto. "So you have to ask tough questions. But the right products can help you manage the unique risk you face in retirement. They've morphed into pensions."

Different ideas about spending, too. Traditionally, retirement planners have started with a guess about the income you'll need each year, multiplied it by the average number of years you're expected to live, factored in inflation, and come up with an estimate of what must be saved for retirement. But that formula no longer adds up, suggests Bob Curtis, who heads MoneyGuidePro, a maker of financial planning software.

First, it doesn't make sense to plan for life expectancy averages, Curtis says. Just because the average healthy 65-year old today might live 20 years does not mean that such a person should plan to live until 85. Even though only a small percentage of today's 65-year olds may live until age 95, you may still want to fund your expenses and plan to live that long.

Further, your financial plan should be built around you and your spouse as a couple, with assets designed to last through the surviving spouse's life span. Next, keep in mind that interests, activities, and priorities are likely to change as you age. Also, spending tends to jump a lot from year to year, so you can't just base a plan on withdrawing the same amount every year and increasing it for inflation.

Also misleading is the popular assumption that you'll need only 70% of your pre-retirement income to live on. Veto, in fact, says it's likely baby boomers' income needs will rise when they enter retirement. "The healthiest, wealthiest, and most educated generation ever is about to retire," he says. "To think they are going to watch 43 hours of TV a week, as today's retirees do, is foolish. This is about biking across Europe or starting a business. There is no magic number. It's incredibly important to come up with numbers that fit an individual's particular ideas about retirement." We're here to help you. ●

But It Can Also Give You Peace Of Mind

average size of the trusts it manages, and the experience level of its employees. Because you're looking for someone you'll be comfortable talking to about your personal relationships, you'll probably want to meet with your top choices in person.

Delve into the financials by comparing investment returns, fees—including when the last increase took place and how much of a bump it was—and services. Ask for samples of trust statements or reports to see whether they're written in language a lay-person could understand. Find out what restrictions, if any, limit the corporate trustee's investment options; some

conservative firms provide only internal investment options, which significantly reduces a trust's investment opportunities.

When you've settled on a corporate trustee, consider when to introduce the trust officer to your family. Often, trustees are designated to take charge after the grantor's death—a time of great stress and instability for the family. A better bet may be to bring in a corporate trustee now and hold regular family meetings, giving the trustee and beneficiaries the chance to build a working relationship. And designate one or more persons to have the power to remove and appoint a corporate trustee if it becomes necessary. ●

State, City Fiscal Woes Hurt Muni Bonds

America's cities and states have a problem—and so could anyone who invests in them by holding municipal bonds. But, careful planning could help you continue to enjoy munis' tax-free income while minimizing your exposure to potential losses.

To understand the dimensions of the current trouble, consider New York City. Though New York has said its pension fund will have all the money it needs to meet future obligations—and has enhanced city workers' benefits—the calculations it uses don't comply with accepted government accounting rules. Gauged by other accounting methods, New York's pension fund could be as much as \$49 billion short, according to the city's chief actuary. Dozens of other major cities and state governments are in similar situations. The stock market plunge of 2000 through 2002 knocked a big hole in many public pension plans, and years of low interest rates have exacerbated the situation. Add in the expense of health care for future state and municipal retirees and matters get considerably worse. How bad is the problem?

- According to estimates by

Standard & Poor's, the pension shortfall for U.S. states, cities and counties totals more than \$280 billion.

- Also looking at Standard & Poor's data but applying different accounting methods, a report by Lord, Abbett & Co. of Jersey City, New Jersey, comes up with a much higher estimate: \$700 billion.

Meanwhile, other benefit costs are also putting pressure on state and local governments. Currently, they can simply pay health and other non-pension benefits as costs are incurred. But that will change in June 2008, when all states and most cities must begin to factor future costs into annual budgets. With the price of health care and other retiree costs expected to skyrocket, this shift could endanger the fiscal health of state and local governments.

How will these trends affect your municipal bond holdings? It depends on how officials respond. They could raise taxes or cut services. But neither of those moves are popular with voters, so state and local governments are more likely to flood the market with new debt, using higher yields to spur demand. That could hurt the prices of existing bonds paying

lower rates. Several states, including California, Illinois, and Kansas, have already issued new bonds to close gaps in pension funding.

Meanwhile, as the balance sheets of state and local governments begin to look less solid, bond rating agencies may downgrade some municipal bonds. That, too, generally hurts bond prices, as investors shy away from increased credit risks.

If you're buying the newly issued municipal bonds, you could benefit from higher yields. But not all new bonds are created equal.

- Bonds tied to specific projects, such as building roads, sewers, or a new stadium, may fare better than general obligation bonds issued to cover pension or health care shortfalls.

- Geographic diversity in a municipal bond portfolio can temper risks, particularly if it includes regions where growth is strong and government finances healthy.

If you're concerned about how state and city fiscal troubles might affect your muni portfolio, we would be happy to review your situation with you and see whether adjustments are needed. ●

European Union Matter

(Continued from page 1)

involve the EU's core economies—France, Germany, and Italy," says Wyss. The big three share common issues, such as high taxes that support generous welfare benefits and laws that make it costly and time-consuming to lay off workers. "The EU hasn't been an effective forum for working out those problems," says Wyss.

Nor will the addition this year of Romania and Bulgaria, two of the region's poorest countries, do much to spark growth in the EU. Meanwhile, other countries waiting to get in, including Croatia and Cyprus, also won't bring much economic clout. And the latest opinion polls in Turkey, a more significant potential EU entrant, show a majority now opposed to joining Europe's ranks.

The EU faces a wide-ranging political agenda this year. There is a push to deregulate Europe's energy markets and to form a new EU charter after France and Netherlands voted against ratifying a European constitution in 2005. But for investors, there's a bigger issue—whether the euro can become a major global reserve currency that will compete effectively against the U.S. dollar. Though launched in 1999, the euro has faced many hurdles in being widely adopted, Wyss notes. Several EU member nations have had persistently excessive budget deficits, new members have tended to be economically weak, and there have been ongoing questions about the effectiveness of the European Central Bank, which manages the currency and sets monetary policy. Only 12 of 25 EU members use the euro, while the United Kingdom and

several others continue to prefer their sovereign currencies, and recent opinion polls in Germany, which has the euro, show most citizens would like to return to the mark. "That's not going to happen," says Wyss, though he expects few other EU members to convert to the euro in the near future.

All of this clearly makes a difference for U.S. investors, who must weigh Europe's prospects against those of other leading international markets. We can help you determine how much of your portfolio might profitably be allocated to Europe, and how such investments may help you achieve your long-term financial goals. ●

***An individual cannot invest directly in an index and return may be worse than that of the index. Past performance is no guarantee of future return. Risks of foreign investment include currency fluctuations, economic, political or social instability.**