Investor Insights & Outlook

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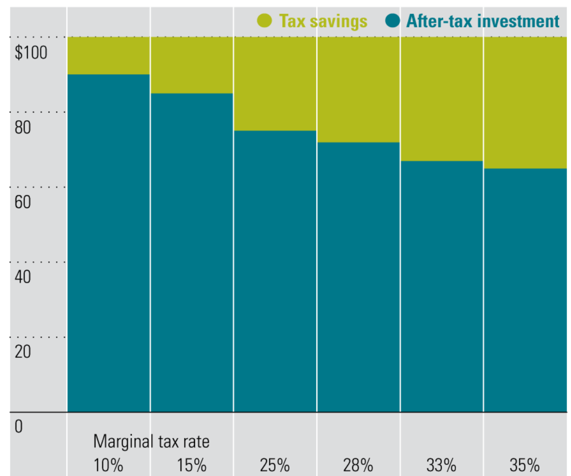
401k Contributions and Tax Savings

A commonly-overlooked benefit of 401k investing is that contributions can be made pre-tax, so that even a small contribution can go a long way. In this situation, 401k contributions are not taxed until you retire. Therefore, the more you contribute to your retirement account, the smaller your taxable income becomes, and the more federal taxes you are able to defer.

The image presents the tax savings (reduction in tax liability) achieved by a 401k contribution of $100 for six marginal tax rates. For example, if you are subject to a 35% marginal tax rate and you choose not to contribute, you will pay $35 in taxes and only have $65 available to invest in another account. If, however, you invest pre-tax in your 401k, you will have $100 that is yours and can grow tax-deferred until you retire.

Tax Savings from Investing in a 401k Plan



This is for illustrative purposes only and should not be viewed as tax advice. Be sure to consult with a financial advisor or tax professional for the latest rules and regulations.

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Bill Roller is experienced in financial planning and investment analysis. He focuses his consulting practice on estate, retirement, and financial planning for businesses and individuals. Bill started BR Capital Inc. in 2003. Before that he worked for a large Wall Street firm for over nine years. He served for seven years as a U.S. Army officer in Infantry and Special Forces (Green Beret) units. Bill is a Chartered Financial Analyst as well as a Certified Financial Planner. He is the VP of the Estate Planning Council of Southwest Washington. He earned a Bachelor of Science degree from the United States Military Academy at West Point in 1982, and a MBA from the Wharton School of Business in 1991. He provides the morning and afternoon market reports and financial commentary for AM 1360 KUIK. A link to Bill's articles and interviews is available at www.brcapitalinc.com/newsletter.

Closed-End versus Open-End Funds

The general term "mutual funds" usually refers to investment vehicles more specifically known as open-end mutual funds (the "mutual funds" denomination has become so mainstream that the open-end classification is commonly omitted). However, there exists a second mutual fund category identified as closed-end funds. This category is lesser known and much smaller: Closed-end funds total only $216 billion in net assets, compared to $8.4 trillion for open-end funds. Three important differences between these two categories of mutual funds are outlined below.

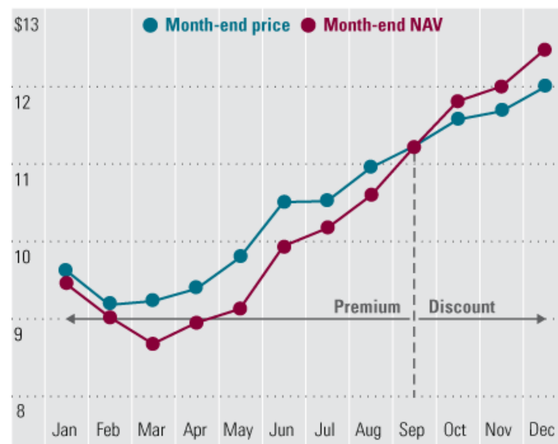
1.Share issuance: Open-end funds can issue an unlimited amount of shares and then redeem them on demand. Closed-end funds generally issue a fixed number of shares at inception in a process known as an initial public offering (IPO). These shares are then traded on an exchange, similar to stocks. A closed-end fund can issue new shares after the IPO, but this is rare. A closed-end fund can, if it chooses, convert itself to an open-end mutual fund and issue an unlimited number of shares.

2.Share transactions: Shares of an open-end mutual fund can be purchased directly from the fund at any given time. An investor can go directly to the fund company and buy shares, or sell shares back to the fund if he or she already owns them. In contrast, closed-end fund shares trade on an exchange, like stocks, and are normally purchased through a broker, who charges a commission. Closed-end shares can be bought and sold during normal market hours and, as a consequence, their market prices also fluctuate throughout the day. Open-end shares are only priced once a day at market close.

3.Share price: The price of open-end fund shares is equal to the net asset value, NAV (the value of all the fund's assets divided by the total number of shares). For closed-end funds, it's not that simple. Since closed-end funds are traded on an exchange, prices are established by the market, and shares can trade at prices different than the fund's net asset value. If the price is higher than the NAV, shares are said to be trading at a premium—investors are willing to pay more than the fund is really worth. Conversely, if the market price is lower than the NAV, the fund is trading at a discount. This can be considered an advantage of closed-end funds over open-end ones: who wouldn't want to buy something at a price lower than its true value?

The image shows how month-end price and net asset value can fluctuate for a hypothetical closed-end fund. From January through September, the fund's market price is higher than its NAV; the fund is trading at a premium. From October through December, however, the situation is reversed and the fund is now trading at a discount.

A Closed-End Fund Can Trade at a Premium or at a Discount



Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. The closed-end fund represented in the image is a purely hypothetical example and does not represent an actual fund. The investment return and principal value of mutual funds will fluctuate and shares, when sold, may be worth more or less than their original cost. Closed-end funds are subject to unique risks, most notably liquidity risk. **Holding a portfolio of securities for the long term does not ensure a profitable outcome and investing in securities always involves risk of loss. Mutual funds are sold by prospectus, which can be obtained from your financial professional or the company and which contains complete information, including investment objectives, risks, charges and expenses.** Investors should read the prospectus and consider this information carefully before investing or sending money. Total net asset values from Morningstar's database as of April 27, 2011.

Major Stock Market Indexes

There are a number of stock market indexes that are frequently mentioned on television and cited in financial newspapers and magazines. They measure various slices of the stock market and can be used as performance benchmarks for both investment vehicles (such as mutual funds) and one's own portfolio returns. Here are three of the most popular and referenced indexes.

Dow Jones Industrial Average: The Dow Jones Industrial Average was first unveiled by Charles H. Dow on May 26, 1896, and consisted of 12 stocks. In 1916, the industrial average expanded to 20 stocks and in 1928 was subsequently bumped to 30, where it currently stands. The index constituents are 30 of the world's largest, most influential and well-known companies. Whenever you hear someone referring to what "the market" did in any given day, they are most likely referring to the Dow.

Changes to the index are rare and usually take place, according to Dow Jones Indexes (www.djaverages.com), "when a current component is going through a major change, such as a shift in its main line of business, acquisition by another company, or bankruptcy. There is no review schedule."

Standard & Poor's 500 Stock Index: When you hear that a portfolio has "beaten the market" it is most likely being compared with the S&P 500, which was first published in 1957. The index is composed of 500 leading companies in leading industries of the U.S. economy, focusing on the large-cap segment of the market but also serving as a proxy for the total market—covering approximately 75% of the U.S. equities market.

The S&P Index Committee follows a set of published guidelines for maintaining the index (complete details of these guidelines are available at www.indices.standardandpoors.com). Some of the criteria for addition include a market capitalization (share price multiplied by shares outstanding) in excess of $3 billion, adequate liquidity (how easy it is to buy and sell shares) and reasonable price and financial viability. Those that substantially violate the criteria are dropped.

Nasdaq Composite Index: Launched in 1971, the Nasdaq Composite Index measures all Nasdaq domestic- and international-based common type stocks listed on the Nasdaq Stock Market. The index includes nearly 3,000 securities. While it is best known for its large portion of technology stocks, it also contains stocks in other industries.

To be eligible for inclusion in this index, securities must be listed on the Nasdaq Stock Market and they need to be of a specific type. For more information, visit www.nasdaq.com.

Please keep in mind that a company can be a member of more than one of the three indexes described above. Microsoft is an example of a company that has a place in all three.

Stock Market Index Comparison

Stock Index	Dow	S&P 500	Nasdaq
Year Introduced	1896	1957	1971
Constituents	30	500	2,900*
Types of Companies	Large, well-known, influential.	Leading companies in leading industries. Focuses on large-cap segment.	Large number of technology stocks. Also stocks in other industries.
Index Modifications/ Eligibility	Companies undergoing a major change can lead to a modification.	Market cap in excess of $3 billion, adequate liquidity/ reasonable price, financial viability.	Listed on Nasdaq Stock Market and needs to be specific security type.
Examples of Current Constituents*	Walt Disney, Johnson & Johnson, Coca-Cola, McDonald's, Walmart	AT&T, Boeing, General Mills, Procter & Gamble, Google	Apple, eBay, Cisco, Dell, Yahoo!

*As of 12/02/2010

Stocks are not guaranteed and are more volatile than other asset classes. The information above is provided for illustrative and information purposes only. The indexes noted are unmanaged and can not be directly invested in. References to specific securities should not be viewed as a recommendation to buy or sell the mentioned security.

Borrowing from Your Retirement

Barbara is 40 years old, has a child in college, and needs to take out a loan to help with tuition. She is considering either a home-equity loan or a loan from her 401(k), and is not sure which would be the better choice. She has heard that taking out a loan from a 401(k) is painless, since "you don't pay penalties and pay the interest to yourself, not to a bank." What should she do?

Many 401(k) plans offer a loan provision and the process is fairly easy. There is no credit check (since you are borrowing from yourself); the interest rate is usually low (maybe a percentage point or two above prime); you can generally borrow up to 50% of your vested account balance to a maximum of $50,000; you have up to five years to repay the loan (longer for loans used to purchase a primary residence), and the plan administrator usually deducts the loan payments automatically from your paycheck.

However, the real cost of borrowing from your 401(k) is not the rate you pay yourself in interest, but the amount you would have earned on your balance had you just left the money in the account. This is called an "opportunity cost," and it can be significant. In addition, if Barbara loses or changes jobs, a 401(k) loan will most likely come "due in full" within a limited amount of time, while a home-equity loan will not. The balance is taxed as if it were ordinary income and, unless she is at least 59½ years old, failure to pay the 401(k) loan back by the due date triggers a 10% penalty.

So, what are Barbara's choices? In general, if she can take out a home-equity loan at a lower after-tax cost than the return she expects to receive on her 401(k), she should choose the home-equity loan.

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