



BWFA Advisor

FINANCIAL PLANNING ♦ INVESTMENT MANAGEMENT ♦ TAX PLANNING

Baltimore–Washington Financial Advisors, Inc.

Clients' Bill of Rights

Over the years, it has become increasingly clear to us what our clients expect in their dealings with Baltimore-Washington Financial Advisors. We think it is so important that we have developed seven **Operating Principles** which, taken together, express the goals we strive for in operating our firm. We hope that by articulating these principles, our associates and our clients will understand what guides us. We would like to share them with you:

1. Individual attention to your needs — We genuinely enjoy the opportunity to meet with our clients. Each time we do, we strive to help that person tackle a problem. If we can demonstrate the value of what we do by discovering potential problems the client may face in the future, we are gratified. Everyone enjoys being important to someone.

2. Clarity counts — We know that good communication takes effort and care. Our clients are entitled to clear answers and understandable information. Simple explanations of complex issues do not just happen. Organizing and presenting difficult financial subject matter and new information in a straightforward way requires intense preparation and scrutiny. Our job is to make things as effortless as possible for our clients.

3. Looking beyond the numbers — Our clients are entitled to high-quality analysis in the work we do for them. Most often, our analysis involves the use of numbers and quantitative techniques. But we also focus on more intangible issues such as our clients' dreams, ambitions and lifestyle. We owe each client the best of what we have, even when the issues and answers might be difficult for both of us.

4. Meeting expectations — We take responsibility for delivering our services accurately, on time, and in a way that is consistent with our clients' expectations. In all interactions between people, there is room for misunderstanding, and misunderstanding can lead to frustration. We will always take special steps to minimize the possibility of miscommunication and disappointment.

5. Acknowledging our limitations — It is up to us to make sure that our clients' expectations about our firm and what we can deliver are accurate. Our clients should never be surprised in their dealings with us. Therefore, we should never hesitate to

point out what we cannot deliver. While we are equipped to handle almost every financial issue that may arise, some matters are best left to other types of professionals, and it is important to identify these situations as early as possible.

6. Easier access to answers — It should be easy for clients to deal with our firm, in a variety of ways. We are constantly developing and restructuring our internal systems and procedures to help our clients to get the answers they need when they need them.

7. Trust engenders obligations — We recognize that we are important in the lives of our clients. They have entrusted us with their most sensitive and confidential information. We take the responsibility seriously. Our clients have the right to expect that we will honor the confidence they have placed in us by delivering the best service that we can, with care, skill and intelligence.

What's Happening at BWFA

We always try to keep everyone up to speed with changes in our firm, so here they are:

Kevin Condon is cutting back at the firm. Since the beginning of the year he has been working in a "sales only" capacity for the firm. Kevin's advisory responsibilities will now be shared by Saxon and Bob. This change was done to give Kevin time to pursue his other passion, the church. This will still be "home base" for Kevin, so you can contact him here if you need to. Feel free to contact Saxon, Bob or any of us here at the firm if there is anything we can help you with.

Annette Simon left the firm at the end of February. Annette was facing an arduous daily commute which made it very difficult to balance her workload and her responsibilities as a mom at home. We wish Annette the very best.

Greg Milsom is assuming a more visible and active role with clients of the firm. He is leading the firm's effort to implement our enhanced retirement/estate planning software tools, and will be active in providing financial planning services to our clients. Greg has his MBA, and is completing the Certified Financial Planning program. Greg is reporting to Saxon.

Taxes & Tax Planning



By Bob Cassel, EA 

The Parade of Corrected 1099 DIVs — What should you do with them?

Every year, many of our clients express displeasure about how they continue to receive “Corrected” Form 1099s, even into late April.

These corrected 1099s complicate and delay completion of tax returns, so people are understandably upset. We thought we might take this opportunity to explain why this happens.

The 1099 DIV is the IRS form on which your income from stock dividends, capital gains, cash liquidation, nontaxable distributions and foreign taxes are reported. The first set of 1099 DIVs are required by law to be mailed to clients of all brokerage firms, banks and insurance companies by January 31 of each year. This date is supposed to give all of us plenty of time to calculate our tax returns and file them by April 15th. Why then do we receive corrected 1099 DIVs even as late as April?

There are a number of reasons why Corrected 1099 DIVs must be mailed out:

1. **Foreign Taxes** — Foreign companies do not have to report on the same schedule as the U.S. and this leads to late reporting and corrections.
2. **Mutual Funds** — Frequently, mutual funds reclassify their payments between long-term gains, short-term gains and regular dividends, long after January 31.
3. **Nontaxable distributions** (such as return of principle on a mortgage owned by a mutual fund) — Nontaxable distributions reduce your cost basis in your investment and do not affect your tax liability.

Is there a better way to do this? Of course! It would make more sense for the brokerage firms to send out the first set of 1099 DIVs in January and then wait until April 1 to send out one (and only one) corrected 1099 DIV, if that were necessary. But the IRS would have to issue new procedural regulations.

All right, so we know now that Corrected 1099 DIVs are a fact of life. What do we do about them? We have four choices:

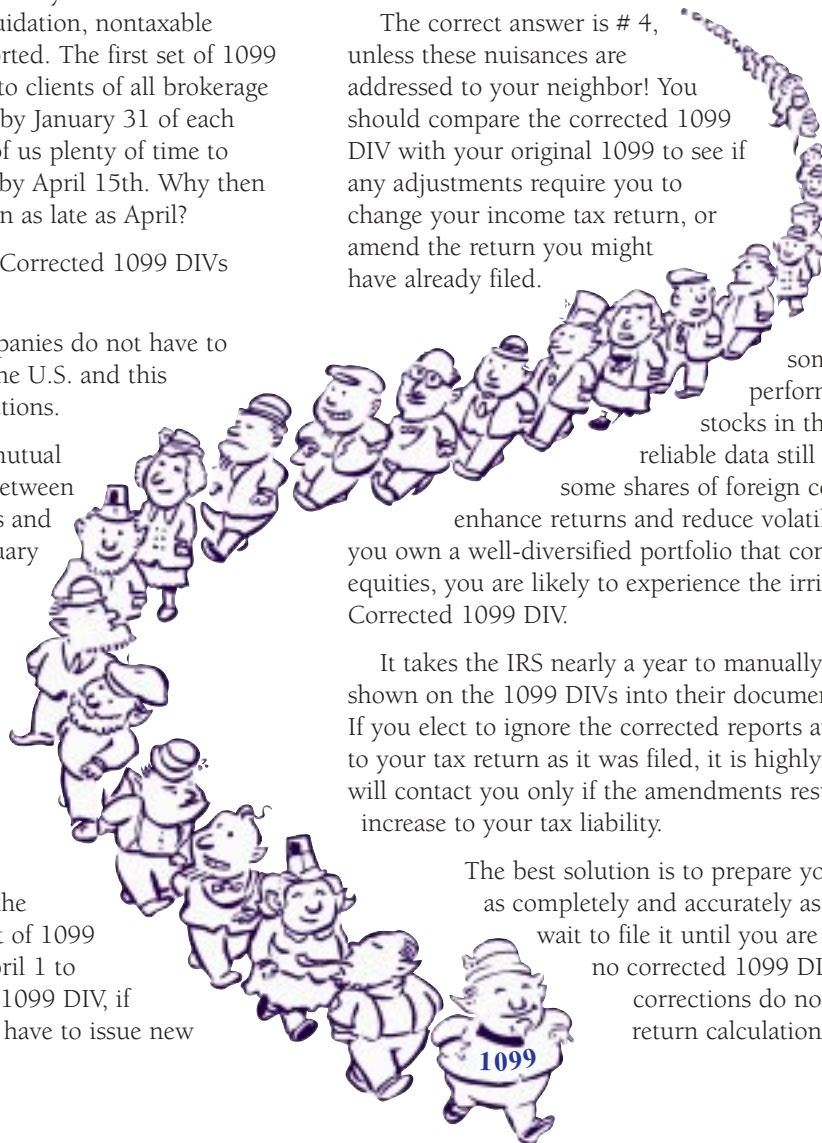
1. Ignore them.
2. Send them back.
3. Stuff them in our neighbor's mailbox.
4. **Compare them with the original tax return and see if a change needs to be made.**

The correct answer is # 4, unless these nuisances are addressed to your neighbor! You should compare the corrected 1099 DIV with your original 1099 to see if any adjustments require you to change your income tax return, or amend the return you might have already filed.

Even now, after some pretty poor performance by foreign stocks in the past two years, reliable data still shows that owning some shares of foreign companies will enhance returns and reduce volatility. Accordingly, if you own a well-diversified portfolio that contains foreign equities, you are likely to experience the irritation of receiving a Corrected 1099 DIV.

It takes the IRS nearly a year to manually enter the changes shown on the 1099 DIVs into their document matching system. If you elect to ignore the corrected reports and make no changes to your tax return as it was filed, it is highly likely that the IRS will contact you only if the amendments result in a substantial increase to your tax liability.

The best solution is to prepare your income tax return as completely and accurately as possible and simply wait to file it until you are sure that you have no corrected 1099 DIVs or that the corrections do not impact your tax return calculations.



Investment Management



By Saxon Birdsong,
MBA

Stepping from Behind the Shield

Over these past two and a half years, we have gotten a good taste of the psychological difficulties of investing. Market uptrends have consistently followed periods of downtrends, again and again. For example, in the four-month period between May 21, 2001 and September 21, 2001, the S&P 500, the leading

index of large stocks, lost over 26% in value. But in the next six months, the S&P jumped over 19%. The short duration and wide extremes of these movements demonstrate the futility of trying to guess what is going to happen over the short term.

Some years ago, I heard John Bogle, founder and leader of the Vanguard Group of mutual funds for some 25 years, speak to a group of investors. He said, "The problem is not the financial markets, it's the behavior of individual investors." He went on to say that the performance of most Vanguard *funds* was fine, but that the firm's research showed that the performance of the *participants* in the various Vanguard funds was pretty bad. He then demonstrated to us, an audience of rather savvy investors and professionals at an annual conference, how investors consistently poured money into the funds when markets were near the top, and just as consistently sold, or "cashed out of," funds when market prices were near the bottom. The data was clear and convincing: individual investors' reactions to the ups and downs of the market contributed to their own poor performance.

Why is it so hard for most investors to avoid this behavior? Perhaps it is because we are less comfortable in the role of business owner than in that of employee. Consider this concept:

Most of us enjoy fairly secure jobs, receiving a predictable income stream from our employers. Our employers, however, are not so lucky. Many of them are subject to influences most of us are only minimally aware of — unpredictable revenue streams, large unanticipated expenses, a competitive environment that changes constantly, product obsolescence, changing demand patterns, and many more variables. We hardly ever stop to think about how well our employers are "shielding" us from the effects of our free market economy's ups and downs. Not, that is, until we become owners of stocks.

What we begin to experience once we own stocks is what our employers live with every day — the full impact of economic trends coupled with the fears and greed of other investors. As owners of equity securities, we are stepping out from behind the shield someone else (namely, our employer) provides for us and participating directly in our free marketplace, coming face to face with its inherent risks. We feel the anxiety that accompanies this participation whenever we see stock prices rise or fall. And sometimes it is pretty unpleasant.

But...enough of the difficult side of being a business owner...Let's get back to the more lucrative side of stock ownership!! We at BWFA have confidence that the uptrend which began in mid-September 2001 is continuing. The economic numbers are increasingly positive and point to a solid rebound. The market, however, has decided to follow the beat of a different drum for the moment. We do not expect this to continue for long; rather we anticipate positive returns in 2002.

Important!! Changes in Your Retirement Savings and Investment Options

continued from back page

What should you know before you execute a rollover?

1. **Do you have pre-taxed contributions in the retirement account?** You may roll over these already-taxed contributions, but the new trustee must be prepared to account separately for the after-tax rollover and the associated earnings. Before you authorize the rollover, you need to make sure that the new trustee will accept after-tax money.
2. **Will you want to move the money back into an employer-sponsored retirement plan (such as a 401(k))?** If so, you must keep this money segregated in a "rollover" IRA account. Do not mix ("commingle") the money with other regular IRA money.

In many cases, there will be significant advantages to moving money from an employer-sponsored plan to an IRA. By enacting this legislation, the government has taken a significant step toward giving individuals more control over how their retirement savings are invested, an important and welcome gain in autonomy for any employee. But, as in many other situations in life, greater control and better options mean that it is more critical than ever to make sure you are doing the right thing.

There is no substitute for objective professional advice when it comes to something as important as your retirement and the assets that will fund it. Feel free to contact your BWFA advisor if you have any questions about this topic.



Financial Planning

Important!! Changes in Your Retirement Savings and Investment Options

For years, the government and private industry have been trying to hand off responsibility to individuals for their own retirement planning. The shift that was enacted from defined benefit pension plans to defined contribution plans (401(k), 403(b), etc.) was a significant step in this direction, and now Congress has taken the next step.

You can now move your retirement account nearly anywhere you want. The Economic Growth and Tax Relief Act of 2001 permits you to move your retirement money almost anywhere and back again! And the big news is that *you can do this while you are still working*. Of course, there are some restrictions but in general it is fairly straightforward. Here is how it works:

The new law says that your employer *must* provide you with the opportunity to roll over your retirement money from your employer-sponsored plan to any other plan you choose. For example, you can now roll over your 403(b) retirement plan to an individual retirement account with any firm you choose. You can also execute another rollover from that same IRA into a 401(k) plan at any time in the future if you so choose. You can roll over your assets from a 401(k) plan to a 403(b) plan, or to a Federal or State government deferred compensation plan, as well as to an individual retirement account (IRA). *The portability of your retirement money is almost unlimited.*

What are the advantages of this new legislation?

1. **Better management of your money.** Unfortunately, many employees have been stuck for years in retirement plans that have not been administered or managed particularly well. Now, if you don't like the options your company has, you can move your assets. And you don't have to change jobs or retire to do so.
2. **Less Cost - Higher Earnings** - In many cases, employees will be able to lower the cost of investing significantly, and keep more of the earnings from their investments. Up until this tax law change, if your money was held in a 403(b) plan, you were restricted to investing in options sponsored only by insurance companies or mutual funds. In many cases, these options had hidden

costs that plan participants paid, thereby lowering the value of their overall retirement nest egg.

3. **More Investment Choices** - If you roll over your money to your individual retirement account, you can begin purchasing individual stocks or bonds and avoid some of the inherent problems of mutual funds (such as higher investment expenses or poor timing of cash flows in and out of the funds).
4. **Better for Your Spouse** - Your employer's plan probably requires your surviving spouse to distribute the money within five years. An IRA has no such requirement.
5. **Easier** - An IRA is easier for most people to administer and track than your employer-sponsored plan because the mutual funds in that plan are often not publicly traded and information about them is not easily obtained.

What are the potential disadvantages of a rollover?

1. **Too Many Choices** - Once you've moved your money into an IRA, you will have lots of investment options, far more than the selection of mutual fund companies that your employer offers. We actually think this is an advantage but it can be a little daunting at first.
2. **No Loans Against Your Assets** - You will not be able to borrow money from your IRA. Employer-sponsored retirement plans sometimes offer you the opportunity to borrow money against your assets (limited to \$50,000 payable in five years). We at BWFA do not recommend taking loans from your retirement plan under most circumstances so we don't see this as a disadvantage.
3. **Over 66 and Still Working?** - If you are, you give up lump sum distribution treatment. This is not a significant disadvantage.
4. **Holding Employer Stock?** - In some limited circumstances, you might give up capital gains treatment if you hold your company's stock in your retirement plan. This has important tax consequences, and you should seek the advice of an objective advisor.

continued on page 3