



By Saxton Birdsong,
MBA

What You Should Expect From Your Advisor

Disappointment occurs when you expect one thing and get something else. Disappointment in the service we receive from businesses occurs all too frequently these days. So, what should

you expect from your financial advisor?

Here are the basics:

1. Your advisor should be available to respond promptly to your inquiries—usually right away, but certainly within a couple of hours. Occasionally, providing high-quality answers to your questions may take some research and additional time, but you should be given a specific time by which you will have answers.
2. You should receive simple, direct, and understandable answers to your questions. Sometimes, it's challenging for BWFA's advisors to reduce complex information to simple terms that promote good understanding, but that's our job.
3. You should have confidence in the advice you are given. There are many reasons why you might not have confidence in what you're told: you don't feel like the advisor understands your concern; the answers don't make sense to you; you feel like there may be a better solution to your situation, and so on. But in the end, you need to be confident that the advice is correct and appropriate for your circumstances.
4. You should have the "right" amount of communication from your advisor. The right amount of communication differs for each individual. Some clients want to hear from us often, while others want virtually no contact. Some clients like advisors to proactively call them or send e-mail, while others prefer to call the advisor when they have a question. Every firm and every advisor struggles with trying to find that sweet spot between too little and too much contact. This is very difficult to achieve. As a simple rule, you should hear from your advisor at least quarterly (and perhaps more often in difficult times).

Beyond the Basics

Beyond the basics, your relationship with your advisor is harder to quantify. It's more subtle than getting a response to your questions and getting regular e-mail updates. Yet, these other aspects are the source of a genuine, long-term working relationship that will separate an average experience from a superior experience.

1. Look for courage and humility in your advisor, not arrogance and fear. We sometimes have to look closely to distinguish between these characteristics. It is impossible to invest the hard-earned life savings of clients carefully and wisely in the face of extreme uncertainty without a lot of courage...and a healthy dose of humility. Arrogance and a lack of humility might lead an advisor to invest without the proper amount of care and thought. Fear, exhibited by statements like, "I'm afraid of this market right now," is a veiled admission of inexperience that leads to overreaction to events and mistakes. Is your advisor courageous and humble?
2. Expect your advisor to help you achieve *your* goals, not those that he or she chooses for you. Advisors are generally expert at evaluating money matters, and they can usually lead clients to the best financial decision. However, because they are experts about money, they have a tendency (and clients have a tendency to let them) substitute their goals for yours. Does your advisor regularly ask you about your goals?
3. Expect your advisor to seek help from other experts, when needed. No one is expert at everything. Your advisor should have a network of experts to whom he or she can turn for detailed knowledge of specific situations that are outside of his field, or which require highly technical knowledge. Your advisor should be willing to get "second opinions" on important matters from his network. Just as importantly, your advisor should work cooperatively with other professionals who you already work with and trust.

Clients are entitled to get the very best from their advisors. Make sure you are satisfied on each of these points, and speak to your advisor if you are not.



Retirement & Estate Planning



By Mark Stinson, MBA



On June 9, 1978, Bob Specas attempted to topple 100,000 dominoes at New York's Manhattan Center. Unfortunately, his effort to break the world record was thwarted during the preparations when a television cameraman dropped his press badge—and set off 97,500 dominoes.

Retirement Planning in Turbulent Times

During October and November, many people felt like their retirement accounts were falling like Bob Specas' dominoes. Minds raced to understand what was happening. What do I do in times like these? Can I still retire when I planned? Can I stay retired? Can I maintain my lifestyle in retirement? Will I outlive my money?

Financial planning is designed to help people handle difficult times. Here's how BWFA answers the critical questions.

Can I retire now?

One of the hardest concepts to implement in investing is "buy low and sell high." Our minds tell us to sell when markets fall and to buy when markets are up. Retirement planning is much the same way. People want to retire when the market is up, and they feel that they must keep working when the market is down. However, retiring during a downturn may be a great time.

Why? Well, if your retirement plan indicates that you can retire when the market is down, you will be sitting pretty when the market recovers. It's likely that the market recovery will give you above-average returns on your assets in the future because markets tend to pull out of tough times with strong performances.

What about the extraordinary volatility in the markets this fall? Our retirement plan assumes that the market will be volatile during at least part of your retirement. We run Monte Carlo simulations with different values each time for the performance of your investments and your life expectancy. We simulate your retirement 500 times to determine the "strength" of the plan—to see if it can withstand volatility and years when investment returns are negative.

I am retired. Am I OK?

BWFA's ongoing planning process includes performing annual financial plan reviews. The reviews consist of the following:

- A comparison of actual asset and liability balances, with the balances projected in the plan;
- A review and discussion of the action items identified in the plan; and
- Identification of new issues which affect the plan.

Based on our discussion with you during the financial plan review, we determine whether your plan needs to be revised in light of new information. The new information could be external (losses on investments) or internal (a substantial inheritance or a significant health problem). If the plan needs to be revised, we will perform an update for a fee. In the update, we will revisit the assumptions in the plan and will update investment accounts to their current balances. Then, we will perform Monte Carlo simulations to determine the strength of the plan. Finally, we will suggest ways to make your retirement more secure, if the simulations indicate that tactical changes are needed.

When performing financial plan reviews, we find that most people are willing to make adjustments in difficult times. For example, some of our clients have decided to postpone major expenditures, such as automobile purchases, home improvements, or big vacations. This enables them to reduce withdrawals from investment accounts and to keep those funds invested until the market recovers.

Conclusion

There is an old military saying: "If you fail to plan, you plan to fail." We find that, especially during difficult times, there is tremendous comfort not only in having a plan, but in being able to review your progress against the plan. If you would like to find out more about retirement or estate planning, please contact Baltimore-Washington Financial Advisors at 888-461-3900 or send an e-mail directly to Mark Stinson at mstinson@bwfa.com.

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Investment Management



By Robert Wasilewski

Equity-Indexed Annuities: Are They Too Good to Be True?

Have you heard of equity-indexed annuities (EIAs)? They promote the dual benefits of a guaranteed, minimum return (limited downside) with market returns (upside potential) based on an equity index. On top of that, you can even defer taxes for years until you withdraw funds. For the highly risk-averse investor who doesn't want to miss out on possible stock market gains, an equity-indexed annuity certainly sounds attractive.

However, there is no free lunch in investing, and that's especially true with EIAs. These products require considerable research, and they are appropriate only for investors who don't need to withdraw the money during the long life of the contract. They also require careful analysis of the risk of the issuer. And that tax break is great only until you withdraw from the annuity and pay ordinary income taxes on the gains, rather than the lower capital gains tax rates available on other investments.

Equity-Indexed Annuities (EIAs)

EIAs are contracts with insurance companies that are designed to give a low, fixed rate of return, plus the potential for higher growth if a designated stock market index rises. Like many things, the devil is in the details, so let's look at some unique features of indexed annuities:

Equity Index. Typically, EIAs use Standard & Poor's Composite Stock Price Index (S&P 500) as their index. This is a widely respected and useful index, but it lacks international diversification that a portfolio should contain. Furthermore, dividend payments from S&P 500 companies play an important role in the performance of the S&P 500 index, but these dividends might not be included in the calculation for crediting the return on the purchased annuity. Without dividends, EIAs often underperform the S&P 500 by one to three percentage points per year.

Rate of Participation. You'll never receive the whole market index return with an EIA. For example, if the participation rate is 80% and the index gains 10%, then the interest rate on the index-linked annuity will be 10% multiplied by 0.8, or 8%. Read the fine print, because it might get worse: your participation rate

might not be fixed for the term of the annuity. Find out how it will be adjusted.

Cap on Interest. Some EIA contracts put a ceiling or cap on the rate of return to an investor. For example, if the cap is 7.5%, then the holder of the annuity in the previous example will get credited with 7.5%, not the 8% indicated by the participation rate.

Minimum Rate of Return, or a "Floor" on Interest. Typically, the lowest rate that an EIA can earn is 0%.

Administrative Fee. Annuities normally have annual fees of 1.5-3% (sometimes more), which further reduce the return paid to the investor at the end of the contract.

Are Equity-Linked Annuities Right for You?

In our experience, EIAs are rarely the best option for our clients. If you are thinking about buying one, consider these points:

- Can you lock up your funds for 10 years or so? Typically, there are hefty deferred sales charges and a loss of credited interest for accessing your principal prematurely. If you pull out of a contract early, you might get less than you invested.
- Are you comfortable with the trade-off of accepting potentially significant limits on an equity return, in exchange for downside protection?
- What other tax-advantaged choices are available to you? If you have not maxed out your IRAs, 401(k)s, etc., then you might want to use those strategies first.
- Gains in an annuity are taxed as ordinary income at your highest tax rate, not at the lower capital gains rate of other long-term investments.
- Annuity issuers usually pay concessions of 5-10% to the brokerage firms selling them, so beware of potential conflicts of interest.

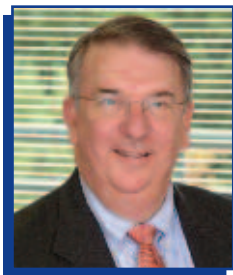
Bottom Line: Do your homework, comparison-shop, and seek advice from a Fee-Only advisor before purchasing an annuity.

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Tax Services



By Robert Cassel, EA



Mary is in Good Hands at BWFA

We have always told our clients that they benefit most when they use all three of our services: Retirement and Estate Planning, Investment Management, and Tax Services. Here is an example of how our services work together.

Meet Mary Client. She is 55 years old and living alone. She inherited some investments and an IRA from her father. Her husband's will created a trust that pays income to Mary.

Mary is still working, and she also has investment income from her own accounts and the trust. Her taxable income varies each year, depending on the results of investment activity in her own accounts and in the trust accounts. This creates some tax issues that Mary has to deal with.

The tax issues:

1. Mary must file two sets of tax returns—one for herself and a separate set for the trust.
2. Mary must pay quarterly tax payments (also referred to as estimated tax payments), and the amounts of these payments can fluctuate according to the investment climate.
3. Mary has Required Minimum Distributions (RMDs). She must calculate and take a distribution from her father's IRA. Mary also needs to know how much federal and state income tax to pay on these distributions.
4. Mary must calculate the cost basis on her investments. She receives a stepped-up basis in the investments she inherited from her father. She'll need to calculate that new basis and track it for purpose of paying capital gains.
5. Mary has carryover tax losses. Because Mary's investments have decreased in value in 2008, she has some losses generated by sales of assets in her accounts. These losses will be used to the extent possible on her 2008 tax return, and the rest will be carried over and used on future tax returns.

Integrating Services for Mary

BWFA coordinates tax concerns with Mary's financial planning and investment services. Our experts recommend solutions for each of these issues and work with her portfolio manager to

implement them. BWFA's coordinated, integrated services include:

1. **Reviewing her overall plan.** Each year during Mary's Financial Plan review, we discuss any changes to her financial situation.
2. **Preparing tax returns.** BWFA prepares both Mary's personal and trust tax returns. Because we prepare all of Mary's taxes, we are able to coordinate tax planning for 2009. This includes notifying her portfolio manager about the money that Mary will need to draw from her accounts to pay quarterly taxes.
3. **Paying quarterly estimated taxes.** BWFA calculates the amount of taxes that Mary should pay, both for herself and the trust. Our Estimated Tax Service revises these estimates each quarter so that Mary only has to pay what is necessary.
4. **Calculating and withholding Required Minimum Distributions.** BWFA calculates Mary's required distribution based on IRS rules. The Tax Department works with her portfolio manager to plan for the distribution, less the correct amount of taxes Mary should withhold.
5. **Accounting for cost basis of investments.** The Tax Department provides guidance to Mary's portfolio manager on the proper calculation of cost basis for the inherited assets. We continue to track cost basis for Mary into future years.
6. **Calculating carryover tax losses.** BWFA posts carryover losses in our client database. This enables Mary's portfolio manager to manage her investments in a way that minimizes her taxes.

In Good Hands

Mary is in good hands at BWFA. Our comprehensive services assure that nothing will slip through the cracks and that Mary is taking advantage of all appropriate tax strategies. Plus, when tax laws change in the future, BWFA will revisit Mary's financial plan and portfolio to make adjustments that are beneficial to her.

Do you know someone like Mary who could use our help? Please introduce us. We're ready to go to work for her.

Note: We have included a 2008 BWFA Tax Planner insert. Please use the checklist to help gather together your tax documents and the tables to look up key IRS deductions, rates, and limits.

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Tax Planner



By Robert Cassel, EA



Tax Preparation Checklist

Personal Data

- Social Security Numbers (including spouse and children)
- Child care provider: name, address, and tax ID or social security number
- Alimony paid: name and social security number of former spouse

Employment & Income Data

- W-2 forms for this year
- Unemployment compensation: Forms 1099-G
- Rental income: Form 1099-MISC
- Partnership, S Corporation, & trust income: Schedules K-1
- Pensions and annuities: Forms 1099-R
- Social Security/Railroad benefits: Forms RRB-1099
- Alimony received
- Miscellaneous income: jury duty, gambling and lottery winning, prizes and awards
- Scholarships and fellowships
- State and local income tax refunds: Form 1099-G

Homeowner/Renter Data

- Mortgage interest: Form 1098 for all residences (include home equity loans and boat loans)
- Sale of your home or other real estate: Form 1099-S
- Real estate taxes paid
- Moving expenses (if connected with change of employment)

Financial Assets

- Interest and Dividend income statements: Form 1099-INT, 1099-DIV & 1099-OID
- Proceeds from broker transactions: Form 1099-B
- Retirement plan withdrawal: Form 1099-R

Financial Liabilities

- Auto loans and leases if vehicle used for business
- Student loan interest paid
- Early withdrawal penalties on CDs and other time deposits

Expenses

- Gifts to charity (written statement from charity for any single donations of \$250 or more)
- Unreimbursed expenses related to volunteer work
- Unreimbursed expenses related to your job (travel expenses, uniforms, union dues, subscriptions)
- Investment expenses
- Job-hunting expenses
- Job-related education expenses
- Child care expenses
- Medical Savings Accounts
- Adoption expenses
- Alimony paid
- Tax return preparation expenses and fees

Self-employment Data

- Business income: Forms 1099-MISC and/or your own records
- Business-related expenses: receipts, related documents & your own records
- Employment taxes & other business taxes paid for current year: payment records

Miscellaneous Tax Documents

- Federal & state estimated taxes paid. List the date and amount of each payment.
- IRA, Keogh and other retirement plan contributions: Identify employer and employee contributions
- Casualty or theft losses
- Records for any other income or sales of property that may be taxable or reportable

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Tax Planner

2008 Key Tax Figures

Retirement Plans

IRA contribution limits

Under Age 50	\$ 5,000
Age 50 and older	6,000

SIMPLE IRA elective deferral limits

Under Age 50	\$ 10,500
Age 50 and older	13,000

401(k) elective deferral limits

Under Age 50	\$ 15,500
Age 50 and older	20,500

Profit-sharing plans/SEPs

Contribution limit	\$ 46,000
Compensation limit (for contributions)	230,000
Maximum contribution percentage (SE/employer)	20/25%

Section 179 Limits

Deduction	\$ 250,000
Qualifying property phase-out threshold	\$ 800,000

Education

Education Credits

Hope scholarship credit (maximum per student)	\$ 1,800
Lifetime learning credit (maximum per family)	2,000

Student loan interest deduction

	\$ 2,500
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Education savings account (ESA) contribution limit

	\$ 2,000/ben.
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Qualified tuition plan (QTP) contribution limit

	Set by QTP
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Health Savings Accounts

Self-only coverage

Contribution (deduction) limit	\$ 2,900
Plan minimum deductible	1,100
Plan out-of-pocket limit	5,600

Family Coverage

Contribution (deduction) limit	\$ 5,800
Plan minimum deductible	2,200
Plan out-of-pocket limit	11,200

Catch-up contribution (age 55 and older)

	\$ 900
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Estate and Gift Tax

Estate Tax

Exclusion	\$ 2,000,000
Maximum tax rate	45%

Gift Tax

Annual exclusion	\$ 12,000
Lifetime exemption	1,000,000

Social Security/SE tax

Maximum earnings subject to tax

Social Security tax	\$ 102,000
Medicare tax	No Limit

Maximum earnings and still receive full benefits

Under full retirement age (FRA) at year-end	\$ 13,560
Year FRA reached (months up to FRA only)	36,120
Month FRA reached and later	No Limit

2008 AGI Phase-Out Amounts/Ranges

Filing Status	Tuition and Fees Deduction	Student Loan Interest Deduction			Education Savings Bond Interest Exclusion	Hope Scholarship and Lifetime Learning Credit	Education Savings Accounts (ESA)	Traditional IRA Active Participant in Retirement Plan	
		No Child	1 Child	>1 Child				85,000 - 105,000	105,000 - 130,000
MFJ	\$130,000 / \$160,000	\$115,000 - \$145,000			\$96,000 - \$116,000	\$190,000 - \$220,000	\$85,000 - \$105,000	\$105,000 - \$130,000	
QW	65,000 / 80,000	55,000 - 70,000			48,000 - 58,000	95,000 - 110,000	85,000 - 105,000	105,000 - 130,000	
Single	65,000 / 80,000	55,000 - 70,000			48,000 - 58,000	95,000 - 110,000	53,000 - 63,000	63,000 - 73,000	
HOH	65,000 / 80,000	55,000 - 70,000			48,000 - 58,000	95,000 - 110,000	53,000 - 63,000	63,000 - 73,000	
MFS	Do Not Qualify	Do Not Qualify			Do Not Qualify	95,000 - 110,000	0 - 10,000	73,000 - 83,000	

Filing Status	Child Tax Credit	Earned Income Credit			Passive Loss in Active Rental Real Estate	Roth IRA	Personal Exemptions	Itemized Deductions	Saver's Credit
		No Child	1 Child	>1 Child					
MFJ	\$110,000	\$15,880	\$36,995	\$41,646	\$100,000 - \$150,000	\$159,000 - \$169,000	\$239,950 - \$362,450	\$159,950	\$53,000
QW	75,000	12,880	33,995	38,646	100,000 - 150,000	159,000 - 169,000	239,950 - 362,450	159,950	26,500
Single	75,000	12,880	33,995	38,646	100,000 - 150,000	101,000 - 116,000	159,950 - 282,450	159,950	26,500
HOH	75,000	12,880	33,995	38,646	100,000 - 150,000	101,000 - 116,000	199,950 - 322,450	159,950	39,750
MFS	55,000	Do Not Qualify			50,000 - 75,000	0 - 10,000	119,975 - 181,225	79,975	26,500

IRAs—Traditional vs. Roth (2008)

Contributions:	Traditional	Roth
Limit, under age 50	\$5,000	\$5,000
Limit, age 50 or older	\$6,000	\$6,000
Deductible	Yes, but may be limited if covered by employer retirement plan	No
Income (AGI) limitations:	Yes, for deductible contribution when covered by employer plan	Yes
Married, joint return	\$85,000 - 105,000	\$159,000 - 169,000
Single	\$53,000 - 63,000	\$101,000 - 116,000
	No limits if not covered by employer retirement plan or for nondeductible contributions	
Maximum Age	70½	No age limit
Distributions:	Traditional	Roth
Taxation	All ordinary income (unless nondeductible contributions made)	Nontaxable if qualified distribution
Age distributions must begin	70½	No age restrictions
10% penalty for distributions before age 59½	Yes, subject to certain exceptions	Yes; NA to withdrawal of contributions

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