

THE ECONOMY AND THE FINANCIAL MARKETS

Another positive year! Our overall situation in early 2005 has certain similarities to last year's.

- ◆ Conflict in Iraq rages on
- ◆ Inflation is still a concern
- ◆ Terrorism is a wild card
- ◆ The U.S. current-account deficit (the balance of imports and exports) continues to be high
- ◆ The dollar continues to depreciate, fortunately at a steady pace rather than a collapse
- ◆ The federal deficit is growing
- ◆ The global economic growth is near a 30-year high
- ◆ Productivity gains continue to be positive
- ◆ Credit card delinquencies declined
- ◆ Household assets rose, thanks to rising home prices
- ◆ Corporate earnings were strong
- ◆ Most corporate balance sheets are healthy
- ◆ Commodity prices continue to rise

While the economy is strong, there are still concerns. We depend on foreign capital to fund our current-account deficit. Foreign governments, particularly in Asia, have been huge buyers of Treasuries in recent years, but at some point their willingness to add to their Treasury positions will wane, and the resulting reduction in demand could also lead to higher interest rates.

With many consumers already facing high household debt levels, including a lot of variable-rate debt, higher rates could depress spending as consumers lose disposable income to higher debt payments. When consumers reduce spending the economy slows down.

Quarterly Newsletter,
4th Quarter 2004,
1/24/2005

For Clients and Friends of Financial Connections

We redesigned our quarterly letter to provide more diversity of subjects. We've incorporated sections on:

Economics
Financial Markets
Investments
Tax Planning
Financial Planning

Please let us know about specific subjects you would like us to discuss.

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DONATIONS TO HELP TSUNAMI VICTIMS MADE IN JANUARY 2005 MAY BE DEDUCTIBLE ON YOUR 2004 TAX RETURN

Below are the latest rules (at the time of this writing) for deducting donations on your 2004 tax return, even though the gift takes place this month.

- ◆ The gift *must* be a cash donation (including donations by credit cards over the Internet). Non-cash items (clothing) or stock donations do not count for tax year 2004.
- ◆ Donations must be made to qualified charities “specifically for the relief of victims in areas affected” by the tsunami.
- ◆ Contributions to foreign organizations are generally not deductible.
- ◆ State tax return - California has not agreed to this rule (yet)

Web sites to check on your charity of choice are

- ◆ www.usaid.gov
- ◆ www.usafreedomcorps.gov

Other Web sites for basic research on charities are

- ◆ www.guidestar.org (GuideStar)
- ◆ www.give.org (Better Business Bureau Wise Giving Alliance)

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Small company stocks outperformed large company ones. Over the past few years, value has outperformed growth. International outperformed the domestic market. With the depreciating dollar, unhedged international funds (bonds and stocks) performed well. Commodities also had another good year.

After two solid years in the stock market, it is easy to feel good and forget the risks, especially after the bear market (2000-2002). However, we continue to try and design portfolios for up and down markets—adjusting around the fringes to take advantage when we see opportunities.

REPORTS

Included in this package are your performance reports for 2004 and your Realized Gains/Loss Report for 2004 for your tax preparer. We printed it on yellow paper so that it stands out.

Jill and Brian suggest you call or e-mail us to review your current finances.

FINANCIAL CONNECTIONS

This newsletter is written quarterly by Financial Connections. Please contact Financial Connections if there are any changes in your financial situation or investment objective(s). Remember, past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this newsletter, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Information herein should not be construed as legal advice.

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THE SCOOP ON FREE CREDIT REPORTS

California is one of the first 12 states to allow their residents to order a free credit report from each of the three major credit bureaus (Experian, Equifax, and TransUnion). As part of the Accurate Credit Transactions Act of 2003, the program will phase into all 50 states by September 2005. For a reasonable cost, the credit bureaus are also to offer a copy of the credit score that the bureaus report to lenders.

A credit scoring system assesses your credit experiences to predict how likely you are to repay a loan and make payments due; the number of points it assigns you is your credit score. Fair Isaacs developed a credit scoring system (known as FICO) that Equifax is willing to sell to consumers. The other bureaus have their own scoring systems.

The California Public Interest Research Group found that 25% of credit reports contained serious errors that could result in denial of credit. Credit reports span years. I had problems with my credit report. We moved from Mill Valley to San Rafael in 2001. When I looked at my credit report in 2003, I found they still showed a home equity loan that we paid off years earlier. Also, it still showed the mortgage from the house we sold!

Caution: If you want only your credit report and score, the bureaus should not contact you again. However, if you purchase a product they offer (such as ongoing credit monitoring for a fee), you become a customer. You will probably be blitzed with enticements to buy related products for a fee, so be careful.

Recommended Strategy

1. Order your free reports one by one, over several months, from Experian, Equifax, and TransUnion.
2. We recommend starting with Experian because it is based in California.
3. You can request reports on the web, by phone, or by mail.
 - a. www.annualcreditreport.com
 - b. 1-877-322-8228
 - c. P.O. Box 105281, Atlanta, GA 30348-5281

Little Known Facts of Interest

Fun Fact

In 1893 Whitcomb Judson, an American mechanical engineer, patented the “clasplocker,” a forerunner of the zipper. The clasplocker kept jamming and in 1917 yielded to the “hookless” or “separable fastener”—patented by a Swedish American engineer, Gideon Sundback—which got a big boost when the U.S. military bought the improved version in quantity.

Financial Fact

\$1 of every \$5 of U.S. Treasury debt is owned by Japan or China (*New York Times*).

Between 1975 and 2003, the number of defined benefit (pension) plans declined 70% (Employee Benefit Research Institute).

PLANNING FOR HEALTH BENEFITS FOR RETIREES

Calculating how health insurance benefits in retirement will change over time is one of the most difficult parts of retirement planning. Even if the company or institution you retire from says you have health benefits for life, the economic climate may lead it to pare away subsidized benefits sometime later.

Witness the results of a joint survey by the Henry J. Kaiser Family Foundation and Hewitt Associates:

- ◆ 79% of employers raised the premiums retirees pay in 2004, and 85% expect to do so in 2005
- ◆ 53% raised the co-payments for covered services
- ◆ premium increases of pre-65 retirees rose 27% higher in 2004 than in 2003
- ◆ premium increases of over-65 retirees rose 24% higher in 2004 than in 2003

The survey indicated that more companies were eliminating subsidized health benefits for future retirees. "You tie that all together and what you see is retiree coverage is slowly becoming a vanishing species," said Drew Altman, president of the Kaiser Family Foundation.

If your employer offers medical benefits for employees after they retire, we can help you develop a contingency plan in the event that you incur a larger portion of medical expenses in the future.

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