WISCONSIN LEGACY

Fall 2002

INVESTING IN UNCERTAIN TIMES

A Time to Reassess

When the Dow Jones industrial average plummeted more than 500 points in one day in October of 1987—about one-fourth of its total value—many investors were convinced the financial sky was falling; they sold on the strength of that bad news, only to see the market resume its steep upward climb that produced nearly an eightfold increase by the end of the 1990s.

But there have been other bumps on the road to financial utopia. Another dramatic drop in 1998 sparked another round of near-panic selling, again followed by a strong recovery that lasted into the first quarter of 2000.

But when 2001 ended, the Dow Jones and the Standard & Poor's 500 were significantly lower—although not without wide up and down swings throughout the period. As this volatility and the downward trend continue in 2002, the lessons of the past indicate it is prudent to review your investment strategies in order to maximize opportunities and minimize losses.

Redefining Your Goals

Any good investment plan is designed to address well-conceived financial goals. Those goals should be based on both a clear analysis of the present and a realistic assessment of the future. Simply stated, you need to know where you are before you can determine where you are going.

Before forging ahead with investment decisions for the future, however, you will want to examine each component of your financial picture. You may find that changes in your net worth have rendered your present strategies inadequate to achieve your financial goals. Or you may discover that you need to reassess how certain investments will perform.

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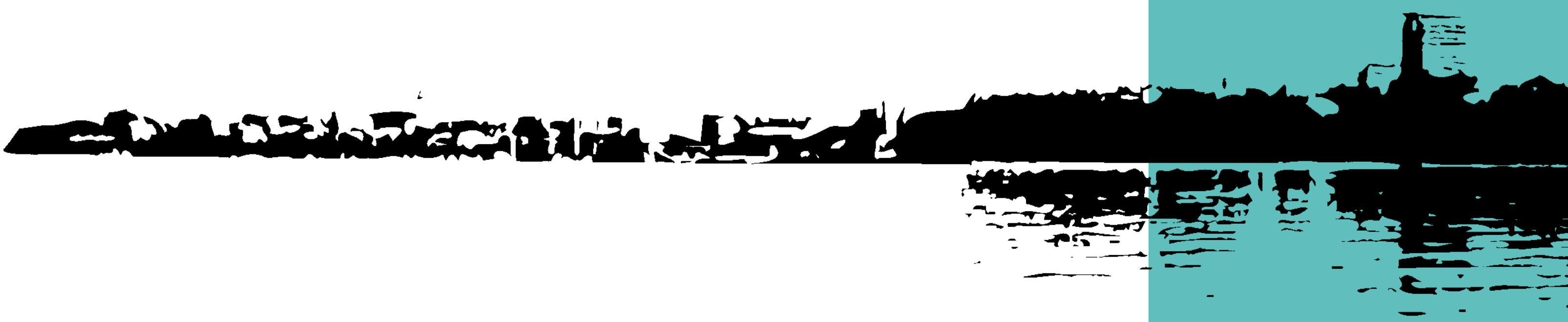
UNIVERSITY OF WISCONSIN FOUNDATION
Philanthropy makes the difference



The implications of such a review can be far-reaching. Perhaps your investment strategies have been based on assumptions of major career advancement. If so, you will want to see how the market's performance may have affected your career field.

Retirement: Probably the most important investing goal for most Americans is to provide for a secure retirement. Be sure to check your investing scorecard carefully in this crucial area as you conduct your financial inventory.

Statistics show that most persons do not invest directly in the stock market. Even among those who do, most are casual investors with relatively small percentages of their net worth invested in the market. But, on the other hand, many persons are participants in retirement plans that are heavily invested in the market.

If you do not already know, find out how the retirement plans you participate in have fared in the market recently. If you haven't checked for a while, you may discover significant changes in value, especially with a plan whose benefits are tied directly to the investment experience of the fund.

If the value of your fund has not grown as you had hoped or expected, you may need to explore what, if any, options you may have for directing the investment decisions about your funds and make appropriate changes. You also may need to consider adjusting your private investments to complement the investment strategies of your retirement funds. For example, if your retirement funds are invested rather conservatively, you may want to make more aggressive investments with your private funds.

Life insurance: Life insurance is another area of financial planning that you will not want to overlook. Persons acquire life insurance to achieve a variety of sound financial objectives: to provide estate liquidity, to "create" an estate in the event of early death or to ensure the availability of funds for a particular purpose, such as the education of a child.

The life insurance industry has been very creative in recent years, developing new products that are more investment-oriented to address such objectives. While they have filled the bill remarkably well, these new products are much more "market sensitive" than traditional life insurance policies.

Many of the newer investment-oriented policies produced handsome returns during the bull market of the '90s, resulting in markedly higher death benefits and cash values. However, these same policies may have taken it on the chin as the market dropped, so you will want to review your insurance policies to see how they have weathered the recent market swings—especially if you own policies that are highly market-sensitive. See if a restructuring of your goals is in order.

Charting a Cautious Course

There are nearly as many current opinions about the future of the market as there are investors. Even given recent rocky performance, some still see it teetering at unjustified heights while others see great upside potential. Only you can decide your own views and adjust your strategies accordingly.

Despite differences in individual opinions, nearly every investor is interested in limiting risk. Good risk management may dictate adherence to a few tested investment principles.

For most of us, at least some of our funds should be held in relatively liquid investments. While it is true that many staples of fixed-income investing such as CDs, money market accounts and Treasury bills may not carry the attractive rates of return they did in the past, it still makes sense to have some funds at your easy disposal.

Many investors also have found there is wisdom in buying quality—investments in the best-known companies with the longest histories of substantial earnings and consistent dividends. Although there can be exceptions, these stalwarts of the economy may be less likely to be swept up in a runaway bear market.

Regardless of how you view the future of the economy, diversification continues to provide a significant hedge against disaster. Investors with all their eggs in one basket court financial ruin in nearly every economic climate.

Why not take the time right now to re-evaluate your own holdings? Do they reflect your financial goals, both short-term and long-term? Are they consistent with your predictions about the future for various segments of the economy? Have you diversified sufficiently to spread your risk?

A balanced portfolio is likely to be allocated among a number of investments: equities, debt, real estate, tangibles. But many professionals recommend further diversification, even within certain types of investments. Take blue chip stocks, for example. Obviously, not all of these issues are headed in the same direction at the same time. While a conservative strategy could lead you to buy blue chips and T-bills, one could take a sharp drop while the other goes up smartly.

Sell or hold? The meteoric rise of the Dow Jones in the 1990s was spectacular and unprecedented. Despite recent ups and downs, many people still find themselves holding substantially appreciated securities.

Given recent history, many investors may be anxious about maintaining their current positions but are not quite sure about what course to pursue.

The decision is relatively easy if you hold securities that have decreased in value. When you incur a loss on the sale of securities, you can use the loss to offset taxable gain on a dollar-for-dollar basis. If you have more loss than gain, you can use the excess to offset other income on a dollar-for-dollar basis up to an additional $3,000 per year. Any loss that remains after that can be carried forward and deducted in the future on the same basis.

If you hold securities that have appreciated in value, decision-making becomes more complex. Perhaps you want to convert low-yielding stock to an investment producing more income. Or you may not see any upside potential for your holdings and want to protect your appreciation. Still, you may be reluctant to sell and realize a taxable gain.

Under current law, long-term capital gain is subject to a maximum cap of 20 percent on securities held for more than 12 months. This means that for every $10,000 of gain you have in a long-term capital investment, up to $2,000 can be lost to the federal government if you sell.

Protecting your gain. The challenge then is to find a way to benefit from the full fair-market value of your holdings without incurring a tax on the capital gain. Many of our friends have found a solution to this dilemma through good charitable planning.

When you give a gift of long-term, appreciated securities to the University of Wisconsin Foundation, you get a deduction for the full fair-market value of the gift. But that's not all. You completely avoid any tax on the paper gain of the securities.

Example: Mr. A makes a pledge to the University of Wisconsin Foundation and decides to fulfill it by transferring stock, now worth $10,000, that he bought several years ago for $2,000.

*In his 30 percent tax bracket, Mr. A saves $3,000 as a result of the $10,000 deduction he is allowed for the current year. What's more, he avoids $1,600 in the capital-gain tax he would have incurred had he sold the stock and realized the $8,000 profit (*20 percent of $8,000*).*

Clearly, the stock was a far better choice for Mr. A to fund his gift with than cash. It might be that you, too, could benefit from this strategy to protect your appreciated stock investments without incurring a tax on the capital gain.

Charitable Plans to Match Your Objectives

Your charitable planning should always reflect and coordinate with your overall financial goals. As you reassess your own situation and redefine your goals for the future, you may find that a more cautious approach is in order during this volatile period.

If so, you'll probably want to pursue charitable-planning strategies consistent with that conservative approach. For example, you may be considering switching some of your appreciated growth investments into more secure, income-producing bonds but are reluctant to act because of the potential capital-gain tax on the sale. A *charitable remainder annuity trust* funded with the appreciated assets may fit right in with your financial objectives. *Benefits of such an arrangement:*

- fixed annual annuity payments to you for life
- a charitable deduction for the present value of our remainder interest
- avoidance of all capital gain on the appreciation

We would be happy to explore with you how this or other charitable plans that generate a guaranteed stream of income for life may benefit you.

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