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December 14, 2007

Is Your Portfolio Ready for 2008?

Year's end is rapidly approaching. Yet, in the short time left in 2007, you can still save yourself some money and set yourself up for a profitable 2008 by making a few key moves in your portfolio. In so doing, consider the tax implications of any changes to your holdings, and keep track of distributions and capital gains to come. Finally, make sure you've contributed the maximum amounts allowable to your 401(k), IRA or other tax-deferred investment accounts. We've laid out seven steps below that all investors should consider before they head out for some New Year's cheer.

Step One: Re-balancing Your Portfolio. Throughout the course of the year, the performance of the various funds in your portfolio will not be uniform. For example, let's assume you owned 10% positions in both emerging markets and REITs funds at the beginning of the year. Through the end of November, assuming the rest of your portfolio simply matched the stock market, that emerging markets holding is now probably worth closer to 13% while the REITs position is worth just 8%. Re-balancing is simply the act of taking that extra 3% out of emerging markets, putting 2% of it into REITs, and the remainder into your "market performers" to adjust back to the original ratio, keeping with your long-term strategy.

While rebalancing is simple, psychologically and emotionally it is one of the most difficult tasks investors face since they are forced to sell their "winners" and add to the "losers" in their portfolio. This is where investors can benefit from the discipline and guidance of an independent investment manager—one who can make these adjustments without the emotional attachment to the particular winners and losers in your account. At Adviser Investments we have actively trimmed, and added to our holdings in funds like Vanguard Health Care and Hartford Global Health over the past few years, for example.

If you do plan on making allocation changes, take your losses in 2007, but wait to take gains until January 2, 2008. This allows you to use the losses on your 2007 tax return and will keep you from owing taxes on your gains until 2009.

Step Two: Check to see if any of the funds you own in a taxable account (or are considering purchasing) will be distributing capital gains before year-end. Both Fidelity and Vanguard list funds that are expected to make capital gains on their websites along with

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distribution calendars. (You can also see full distribution calendars for both Fidelity and Vanguard in our November 28 Adviser Update).

Step Three: If you have a loss in a fund, it is occasionally appropriate to sell out of it to avoid a distribution, rather than have the distribution add to your tax bill. However, you'll need to consider the size of the distribution, the size of your loss and what fees may be incurred in the sale before doing so. This is not always the best move. (Note: This does not apply to tax-deferred accounts.)

Step Four: You definitely want to avoid buying into a fund just before it makes a distribution. You'll end up paying taxes on the distribution as though you'd held the fund all year. So check carefully before you purchase a fund in a taxable account this month (no need to worry if the purchase is for a tax-deferred account). If it is poised to make a distribution, hold off on buying until after it does so (after the "record date"). You can buy a fund on its ex-dividend or reinvest date, when the share price drops to reflect the distribution.

Step Five: It's been our long-standing recommendation that you have your income and capital gains distributions sent to your money market fund and not reinvested in the fund that generated them. By doing this you have the option of reinvesting in the fund after it's made its distribution or using your cash to add assets to other funds in your portfolio that may have underperformed that year—this can be a part of any re-balancing you deem necessary.

Step Six: Take advantage of tax-deferred accounts. It's a well-known fact that 401(k)s, IRAs and other tax-deferred investment accounts are a great way to keep your assets growing tax-free, compounding their value year after year. For this reason it's important to contribute the maximum amounts allowed to each account every year you can. Also, if you're over 50, you are allowed to make 'catch-up' contributions to your 401(k) and IRA, above and beyond the normal limits. For 2007, you can put an extra \$5,000 in your 401(k) and an extra \$1,000 in an IRA. You have until April 15, 2008 to make your 2007 contributions, but why not do it now?

Another aspect of retirement accounts to be aware of if you're over 70½ years old is your RMD (required minimum distribution). The RMD exists to make sure that savings in a retirement account are actually used for retirement and not just saved to pass on to heirs. The RMD is calculated (in most cases) by dividing the adjusted market value of your tax-deferred retirement account as of December 31 of the prior year by an applicable life expectancy factor taken from the IRS. If you fail to take your RMD from your retirement account, you will be assessed a penalty equal to 50% of the amount you should have withdrawn in addition to normal income taxes. So if this applies to you, make sure you've taken your RMD before the end of 2007!

Step Seven: Wrap-Up. While taxes are one of the last things anyone wants to think about during the cheer of the holiday season, an early effort can prevent bigger headaches and bills come April. That said, restructuring a portfolio and moving assets in an attempt to avoid distributions can be tricky, which is why we recommend you consult with a professional before doing so. At Adviser Investments, we have the experience and expertise to help make the end of the year's tax blizzard a breeze, freeing up our clients to focus on what's most important to them.

Vanguard Extended Duration Treasury Index Opens

It took a little while longer than expected, but Vanguard finally opened the doors on its new Extended Duration Treasury Index on Monday, December 10.

As we mentioned in our July 13 Adviser Update, Extended Duration Treasury is available in three share classes: Institutional, requiring a \$5 million minimum initial investment and charging 0.11% in expenses; Institutional Plus, \$100 million minimum and 0.08% in expenses; and ETF shares (ticker: EDV), no minimum and 0.14% in expenses.

While the ETF shares offer an affordable point of entry into Extended Duration Treasury, the fund carries a high degree of interest rate risk, featuring a duration of between 20 and 30 years, and it is not a fund that we see ourselves normally incorporating into our clients' portfolios. This fund would be most suitable for educated investors with a very high tolerance for risk, who also have a clear strategy for making interest rate bets. Anyone else who ventures here may find themselves in for extended woes during periods when interest rates march higher.

About Adviser Investments

Adviser Investments is an independent, professional money management firm specializing in Fidelity and Vanguard mutual funds. With 1,400 clients and \$1.2 billion dollars under management, Adviser is one of the nation's largest mutual fund research and money management firms. Our staff of 35 investment professionals focuses on helping individual investors, trusts, foundations, and institutions meet their investment goals. Our minimum account size is \$350,000.

For more information, please visit www.adviserinvestments.com or call 800-492-6868.

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