

## Strategies to Build Your Business & Personal Net Worth

### Depreciation lightens up

New rules affecting depreciation methods and useful lives give you greater ability to recover otherwise lost depreciation deductions from errant depreciation methods and lives.

You can catch up for prior year mistakes on your current return instead of amending old returns.

You can deduct 100% of the

additional depreciation this year if too little depreciation was taken in previous years; however, if too much depreciation was taken, the catch-up can be spread over a four-year period.

Under the new rules, you can file an application to change the useful life of assets and recover the cumulative amount of missed depreciation on your 2003 return.

When you sell an asset and later discover too little expense

was claimed, the IRS will now permit you to claim this lost depreciation in the year of sale. This reduces the gain on sale, allowing for its true economic gain or loss.

**The new rules also clarify that depreciation changes resulting from cost segregation studies qualify as accounting method changes.**

Depreciation adjustments resulting from cost segregation studies may be claimed in the year the accounting method change is requested.

All of these accounting method changes are made by filing Form 3115 with the current return.

### 404 help from BKD

Compliance deadlines for Sarbanes-Oxley (SOX) Section 404 were recently delayed, and you may have questions. BKD provides SOX consulting services to public companies and also to nonpublic companies interested in following the spirit of the regulations. Contact your BKD advisor for guidance.

### What's a cost segregation study?

If you purchase, build or renovate a property for your business, a real estate cost segregation study can help accelerate income tax depreciation deductions and generate significant cash-flow savings.

Instead of waiting years to see a return on real estate investments, a cost segregation study could help your company recover major capital improvement costs more rapidly.

Based on applicable tax authorities, cost segregation is a procedure that identifies and reclassifies your property into shorter-lived assets that qualify for five-, seven- or 15-year write-off periods. A complete audit trail traces derived unit costs from contract documents and other source data.

Last year alone, our cost

segregation consultants helped thousands of businesses generate \$51 million in tax benefits from:

- ✓ New buildings presently under construction
- ✓ Existing buildings undergoing renovation, remodeling, restoration or expansion
- ✓ Purchases of existing properties
- ✓ Office/facility leasehold improvements and "fit outs"
- ✓ Post-1986 real estate construction, building acquisitions or improvements where no cost segregation study was performed (even though the statute of limitations previously closed on the property construction/acquisition year) □

### Electronic tax payments

The IRS recently launched a new program to increase the use of electronic tax payments by business taxpayers. Now, when the IRS issues new businesses an employer identification number, it also automatically enrolls them in the Electronic Federal Tax Payment System (EFTPS).

Businesses will separately receive an EFTPS personal identification number and instructions for activating their enrollment (the enrollment is not automatically active).

Using EFTPS, taxpayers can pay federal tax deposits and other taxes online, by phone or with the help of special software.

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## Compensatory stock options can be beneficial

One way to attract, motivate, reward and retain key employees is to provide fringe benefits based on the company's stock, including:

- ✓ Give stock outright to the employee
- ✓ Give restricted stock, which vests in installments over a specified period; thus, delaying the employee's ownership
- ✓ Issue "phantom stock"; no stock changes hands, but units corresponding to shares of stock are assigned with the same effect as if stock or options were exercised
- ✓ Offer nonqualified stock options, which, when exercised, are taxed as compensation income

Most taxpayers whose aggregate annual deposits of federal taxes are more than \$200,000 are required to make payments using EFTPS. For the moment, smaller taxpayers may continue to make manual payments using federal tax deposit coupons.

For more information, go to the EFTPS web site at <http://www.eftps.gov/>.

## HSAs can save you money

Effective January 1, 2004, you may use a health savings account (HSA) if you switch to a health insurance plan with a higher deductible and lower premium.

HSAs are tax-advantaged savings accounts that can be used to pay for medical expenses, such as deductibles and copays. Contributions to these accounts are tax deductible (up to



- ✓ Provide qualified stock options, which generally are not taxed at issuance

All of these stock options have different advantages and disadvantages,

but they all provide employees ownership. As a result, you, the employer may see increased employee motivation and satisfaction. □

## Section 83(b) elections lessen taxes

Employees often receive restricted stock as compensation. Under the general rule, employees are taxed on the value of the restricted stock on the date it vests.

Alternatively, employees can elect to use the date the restricted stock is received from the employer, instead of the date of vesting.

This can lessen taxes on the eventual sale of the stock if the value on the date it is received from the employer is less than its value on the date of vesting.

If the election is made and the stock is later forfeited or declines in value, no capital loss will be allowed.

Accordingly, consult your BKD advisor before proceeding with the election.

The election must be made within 30 days of the date the restricted stock is received from the employer. Employers can make the election on behalf of employees. Once made, the election is irrevocable. □

the amount of the policy's deductible), and distributions used to pay medical expenses are not taxable.

The 2004 deduction limits are \$5,150 for HSAs with family coverage and \$2,600 for HSAs with individual coverage. Individuals born before 1950 can contribute and deduct an additional \$500 in 2004, and unused contributions can be carried over for use in a future year.

In other words, a contribution to an HSA can reduce the tax on other types of income, such as dividends, interest and capital gains.

To qualify, you must be enrolled in a high-deductible health insurance plan, one that has an annual deductible of at least \$2,000 and limits the annual out-of-pocket expenses to \$10,000 for family coverage. The amounts are halved for self-only coverage.

Many financial institutions and insurance companies offer

HSAs, which are administered similar to an individual retirement account (IRA). Unlike an IRA, you are not required to have earned income to be eligible to establish or make contributions to an HSA. *Note:* Taxpayers eligible for Medicare are not eligible for HSAs.

Although an HSA belongs to the individual, it can be set up as part of an employer's cafeteria plan, and employers can make tax-deductible contributions as part of an employee-compensation package. This may result in lower insurance premiums for the employer.

Each employee owns his/her HSA, which is portable when changing employers.

## Do you have an exit strategy?

A recent survey of the heads of family-owned businesses found 55% started their business from

scratch, 30% inherited the business from the previous generation and 15% were hired to run an existing business and eventually bought out the former owners.

When asked about the future, almost 75% of the business heads surveyed had no specific plans for the future of their companies. Responses to the question, "What will you do with your company when you retire?" included:

- ✓ Am in the process of planning an exit strategy – 49%
- ✓ Not in a position to determine the future of the firm – 24%
- ✓ Plan to pass it on to my children – 21%
- ✓ Intend to pass it on to a non-relative – 6%

Failure to have an exit strategy can be devastating to the individual owners and to those who are left to pick up the pieces.

Both **BKD, LLP** and **BKD Financial, LLC** have helped many business with succession



planning and exit strategies such as sales, employee stock ownership plans, recapitalization, management buyouts and other strategies.

## IRS does not require some expense receipts

The IRS has clarified that a receipt may not be required to substantiate business expenses in certain instances.

You must still maintain adequate records to substantiate expenditures, *e.g.*, contemporaneously maintain an account book, diary, log or similar record to substantiate the amount, time, place and business purpose of an expense.

The IRS recently updated simplified per-diem rates businesses can use to reimburse employees

for lodging, meals and incidental expenses incurred during business travel without the need to produce receipts.



The new rates apply to travel on or after November 1, 2003, and are slightly higher than those for the previous year. Simplified per diems have risen from \$204 in high-cost locales and \$125 in low-cost locales to \$207 and \$126, respectively.

The incidental expense per diem also increased from \$2 to \$3, and there have been changes in locations deemed high-cost areas.

To reimburse and/or subsidize employee travel expenses,

employers who use an accountable plan arrangement and do not want to maintain records of actual expenses may use either the simplified per-diem rates or the more detailed Government Service Administration (GSA) rates.

When per-diem rates are used, the employee recognizes no income or employment tax withholding when reimbursed, and the employer gets a travel-expense deduction under the per-diem rates, subject to an adjustment for the 50% cap on business meal deductions.

Employees who do not have an accountable plan, or individuals who are self-employed, are allowed business travel expense deductions

pursuant to GSA rates; however, they may not use simplified rates.

## Payments in lieu of dividends

The 2003 Tax Act lowered federal income tax rates on qualified dividends. Some taxpayers will be surprised when they receive their annual brokerage statements because what they thought were dividend payments actually were not.

Most brokerage agreements allow the broker to lend clients' stock held in margin accounts or street name without further notification. Brokers often lend clients' stock to other investors, who use the borrowed stock to

cover short sales.

If the broker does this, the client is no longer the owner of the stock and the payment received in lieu of the dividend does not get the lower 15% tax rate. Instead, the in-lieu payments can be taxed at federal rates as high as 35%.

Many brokers as well as taxpayers did not track all the information needed to determine if dividends are eligible for the lower rate since it was not necessary before 2003.

The IRS announced it will not penalize taxpayers for reporting in-lieu payments as dividends on their 2003 returns if the broker reported them as dividends and the taxpayer does not know otherwise.

## Capital expenditures: new regulations provide opportunities

by Mike Dambach, St. Louis, [cmdambach@bkd.com](mailto:cmdambach@bkd.com)

**T**he IRS has issued final rules that change its previous position that all expenditures with a future value must be capitalized.

The new rules require capitalization for expenditures incurred in acquiring or creating intangibles. Certain types of enhancements to intangibles also must be capitalized.

The final regulations carry the following safe harbors and "simplifying assumptions" that permit the current deduction of certain costs and reduce taxpayers' recordkeeping burden:

- ✓ 12-month rule for costs of certain intangible assets with relatively short useful lives
- ✓ De minimis rule for certain costs of \$5,000 or less
- ✓ 15-year safe-harbor amortization period for certain created intangible assets lacking a readily ascertainable useful life
- ✓ Exceptions for employee compensation and overhead

For accrual-method taxpayers to take advantage of the 12-month rule, the econom-

ic performance and all-events tests must be met; these additional requirements do not apply to cash-method taxpayers.

The all-events test is met on the date the payment is unconditionally due, and the liability amount can be determined with reasonable accuracy. For the expenses listed in the accompanying box, the economic performance test is met upon payment.

For example, assume Corporation N, an accrual-method taxpayer with a calendar year end, pays a \$10,000 insurance premium due December 15, 2003, for a one-year policy beginning December 15, 2003, and ending December 14, 2004.

Under the new regulations, the payment is fully deductible on the 2003 return.

In contrast, if the coverage period runs from January 1, 2004, to December 31, 2004—and the premium is not unconditionally due until January 1, 2004—the payment is not deductible until 2004 even if it's paid in 2003.

The new regulations also clarify which costs must be capitalized in trade or business acquisitions and allow a current deduction for certain package design costs.

To take advantage of the new rules, taxpayers must file Form 3115 for an automatic accounting method change.

In addition to qualifying prepaid expenses, certain other intangibles created in taxable years ending on or after January 24, 2002, may be written off in 2003. □

## Expense deductions offered

**T**he 12-month rule presents an opportunity for taxpayers to deduct qualifying prepaid expenses in the year paid, including:

- Prepaid insurance premiums
- Prepaid warranty contracts
- Prepaid service contracts
- Prepaid taxes
- Prepaid licenses, including vehicles

To qualify for the current deduction, the right or benefit must not extend *beyond* the earlier of:

- 12 months after the first date the taxpayer realizes the right or benefit, or
- End of the taxable year following the taxable year the payment is made □

Investors should discuss what should be done for 2004 with their brokers. They may want to move their stock from a margin account to a cash account because brokers do not lend stock held in cash accounts.

## MFTR helps military families

November 11, 2003, President Bush signed into law the *Military Family Tax Relief Act of 2003*. Its provisions include tax breaks related to military personnel:



**Exclusion of gain from the sale of a principal residence by military and foreign-service personnel** – permits military and foreign-service personnel to make an election to suspend, for a maximum of 10 years, the running of the five-year period while they are away on active-duty assignment.

Military and foreign-service personnel who have sold a residence since May 7, 1997, also may retroactively qualify. Those individuals have until November 11, 2004, to claim an otherwise time-barred refund or credit resulting from the change.

**Exclusion of military death gratuity payments** – the exclusion amount increases to \$12,000 for all death gratuity payments for deaths occurring after September 10, 2001; thus, taxpayers who received death gratuities exceeding \$3,000 on account of an eligible death occurring after September 10, 2001, and who have already filed tax returns for either 2001 or 2002, will want to file an amended return for those years to claim the additional tax benefit provided by this change.

**Exclusion of amounts received under military housing assistance program** – such payments made after Novem-

ber 11, 2003, are not included in income.

**Expansion of combat-zone filing rules to include contingency operation** – extends income tax filing period for military personnel assigned to contingency operations designated by the Secretary of Defense.

**Clarification of treatment of child-care subsidies** – child-care benefits for military personnel are excludible from income for tax years beginning after 2002.

**Treatment of service academy appointments as scholarships for purposes of Code Sec. 529 and Code Sec. 530 education programs** – permitted are penalty-free withdrawals from Coverdell education savings accounts and qualified tuition programs made on account of the attendance of the account holder or beneficiary at one of the U.S. service academies for tax years beginning after 2002.

**Above-the-line deduction for overnight travel expenses of National Guard and Reserve members** – an above-the-line deduction is provided for overnight transportation, meals and lodging expenses of National Guard and Reserve members who must travel away from home more than 100 miles (and stay overnight) to attend National Guard and Reserve meetings for tax years beginning after December 31, 2002.

## FSA update

Flexible spending accounts (FSAs) are a simple and convenient solution for paying out-of-pocket health and dependent-care expenses with pretax dollars. They can be funded by the employer, employee or both.

Following are details about FSA debit cards and deductions for over-the-counter medications.



**Debit cards** – the IRS says employers who

offer FSAs may provide debit cards to participants to pay for medical expenses not covered by their health insurance. The cards, which employers must provide, will reduce much of the paperwork associated with FSAs and will increase quick access to funds in the account.

Health care providers can expect to see more patients using debit cards. Physicians, pharmacists and other medical care providers should be sure their existing systems can process payments via the debit cards.

**Over-the-counter medications** – in general, medications are deductible as personal, itemized medical costs only when prescribed by a doctor; however, over-the-counter medical items can now be bought on a pretax basis and reimbursed under FSAs. This is because the IRS definition of medical care is broader for tax-free reimbursements than for itemized deductions.



Consequently, health FSAs now can cover antacids, allergy medications, pain relievers and other such items used to alleviate or treat personal injuries or sickness; however, over-the-counter medications for general good health, such as vitamins or dietary supplements, are not reimbursable.

If you currently participate in an employer's health FSA, you should factor it in when determining how much of your 2004 pretax salary to contribute to the plan.

Employers may want to consider amending FSA plan documents to provide coverage for over-the-counter medications and other qualifying health care items. □

# Employee

by Dave Leising, Indianapolis, [dleising@bkd.com](mailto:dleising@bkd.com)

Here's a recap of key issues covered at the American Institute of Certified Public Accountants' Annual Benefit Plans and Department of Labor (DOL) Update in December.

## Benefit plan audit requirements

In general, an employee benefit plan—401(k), cafeteria, profit-sharing plan, etc.—requires an audit if more than 100 participants are eligible at the beginning of the year.

An audit also is required if there are fewer than 100 eligible participants, but the plan fails either the financial or disclosure tests.

The financial test requires 95% or more of the plan's assets be held as "Qualifying Plan Assets," which include:

- ✓ Participant loans
- ✓ Qualifying employer securities or assets held by a bank; credit union; insurance company; registered broker-dealer; permitted trustee of an individual retirement account (IRA)

The disclosure test requires the plan comply with the following:

- ✓ Identify in the Summary Annual Report (SAR) the institutions holding plan assets and the amounts held
- ✓ Inform participants and beneficiaries in the SAR of their right to examine the statements in the SAR
- ✓ Make year-end statements from financial institutions available to participants and beneficiaries

## benefit plan update

**Note:** These rules do not apply to health and welfare plans.

### SAS 99's impact

In 2003, Statement on Auditing Standards (SAS) 99, *Consideration of Fraud in a Financial Statement Audit*, went into effect for financial statement audits for periods beginning on or after December 15, 2002.

For auditors who perform financial statement audits, SAS 99 provides operational guidance on considering fraud risk when planning and performing audits.

SAS 99 increases an auditor's responsibility for designing procedures to detect material misstatements. As a result, more substantive auditing procedures and documentation are required, including:

**Engagement team discussions** to determine how and where the plan's financial statements might be susceptible to fraud and how management or others could perpetrate and conceal fraudulent financial reporting or misappropriation of assets

**Inquiries of management and others about fraud** to obtain their views on internal controls and ethical behavior and how

these views are communicated to employees; discussion also will cover management's knowledge of fraud or suspected fraud; knowledge of any specific fraud risks; how entity's internal controls prevent, deter or detect fraud, etc.

**Evaluation of analytical procedures** to help detect any unusual or unexpected relationships in financial reporting that may indicate fraud risk factors

**Increased documentation of controls** or additional internal control questionnaires and related procedures

**Increased responsibility** to communicate possible fraud to management, audit committees and others

Auditors should modify their audit programs to address the above requirements and to help address specific fraud risk factors, including:

- ✓ Lack of management oversight
- ✓ Lack of review of plan investment transactions
- ✓ Lack of segregated duties
- ✓ Use of service providers that do not provide a SAS 70 report
- ✓ Failure of plan administrator

to maintain independent records to periodically check information provided by the custodian

Because of additional auditing procedures required by SAS 99, employee benefit plan sponsors should expect additional time required on the part of their auditors and management for future plan audits.

### Sarbanes-Oxley's impact

Several sections of the *Sarbanes-Oxley Act of 2002* affect plan audits for public companies. The most pertinent sections to benefit plans are Title II and Title III.

Title II provides guidance on auditor independence. This section includes details about:

- ✓ Services that may no longer be performed by the plan auditor
- ✓ Audit committee pre-approval of services provided by the auditor
- ✓ Audit partner rotation requirements
- ✓ Required communications from auditors to audit committees

Title III covers corporate responsibility for financial reports and restrictions on insider trading during pension-fund blackout periods.

### Form 5500 changes

The 2003 Form 5500 format has changed and so has the DOL's usual procedure of mailing booklets with forms and instructions. This year, a postcard will be sent to filers of record reminding them to file.

To avoid common 5500 filing errors, visit the DOL web site at

<http://www.efast.dol.gov/>. The site offers helpful tips, instructions and the 2003 form.

The Delinquent Filer Voluntary Compliance Program, established in April 1995 and modified in March 2002, is essentially a permanent amnesty program for voluntary compliance for Form 5500 filing.

Penalties can be greatly reduced if a plan sponsor voluntarily enters the program, rather than waiting until the government identifies the plan sponsor as being delinquent. □

## Employee benefit plan solutions from BKD

**B**KD's experienced benefit plan consultants can help your company with a wide range of employee benefit plans. Our solutions include:

- Plan design and implementation, as well as nontraditional plan design
- Analysis of tax benefits or consequences
- Employee communications
- Administration
- Daily valuation services
- Audits for plans with 100 or more eligible participants
- Form 5500 preparation
- Recordkeeping outsourcing
- ESOP feasibility analysis □

## DOL policy updates

- Effective February 3, 2003, the Department of Labor (DOL) changed the name of the Pension and Welfare Benefits Administration to the Employee Benefits Security Administration.
- On January 24, 2003, DOL published final rules establishing a new federal law requiring 401(k) plans to give participants and beneficiaries a 30-day notice of "blackout periods" (times when workers are restricted from trading stock).
- DOL continues to increase the number of retirement plans they audit. In particular, examiners are scrutinizing the timeliness of participant contribution remittance, the use of plan assets to pay operational costs and the responsibilities of plan fiduciaries to search for missing participants.

For more information, visit DOL's web site at <http://www.dol.gov/ebsa>. □

# Protection & planning helps build wealth

by Howard Sharfman, Schwartz Benefit Services, LLC

Over the years, through good times and bad, a statistical constant has warned us only 4% to 5% of Americans will achieve financial independence by retirement age, leaving the remaining 95% a destiny of financial dependence.

Protection is a cornerstone of wealth-accumulation planning. To build wealth, you must first protect the assets you already have.

Of course, insurance can help you do that: liability insurance can

protect your home, car and other personal property; disability insurance can protect your income;

life insurance can help protect your loved ones' standard of living should the family's primary wage earner(s) die.

From a financial perspective, the most basic reasons to purchase life insurance include:



Howard Sharfman

## Introducing BKD Insurance, LLC...another WealthPlan resource

Effective December 2003, BKD has a new wholly owned subsidiary: BKD Insurance, LLC, a NASD-registered broker-dealer.

Insurance solutions are a component of WealthPlan, our family of professional services whose goal is to grow, preserve and protect our clients' assets.

Now, with BKD Insurance and its relationship with Schwartz Benefit Services, an independent insurance consulting company, we have more resources to help with the protect aspect.

"Insurance is one of the cornerstones of our financial lives and an important component of

WealthPlan," says Jack Thurman, WealthPlan leader. "Along with our tax, investment, personal wealth planning and estate planning advisors, we now can introduce clients to Schwartz Benefit Services and the insurance solutions it provides."

Schwartz does not replace our referral relationships with local insurance agents but provides another option.

How can BKD Insurance, through Schwartz Benefit Services, assist with your insurance needs? Our solutions include:

- ✓ Analyze your asset/liability risk
  - ✓ Evaluate your life insurance
- (continued on page 8)*



### ✓ Family income protection

Life insurance protection is generally purchased to provide ample income to replace the income lost when a family's wage earner dies.

### ✓ Economic concerns

Developing forced savings for the future can be beneficial. Because of the costs of the death benefits provided, life insurance may not be the best way to invest, but it has historically been the best method for many people to save money.

Currently, cash values accrue tax deferred and can often be accessed on a tax-free basis.

### ✓ Estate settlement costs

People with sizable estates often have a high percentage of their total wealth tied up in nonliquid assets.

When such an individual dies, the executor of the estate must pay federal estate taxes within nine months of the death and may be forced to sell a portion of the nonliquid assets within the estate at depressed values.

In such cases, the income tax-free proceeds from life insurance can protect heirs from unnecessary shrinkage, the result of the distressed sale of assets to pay estate settlement costs.

Life insurance also can be arranged in an irrevocable trust so that the entire death benefit escapes estate taxes. For this reason, life insurance can be an essential element in an estate.

### ✓ Business reasons

Many partnerships and closely held corporations have agreements that provide for the purchase of a deceased partner or shareholder's ownership in the firm from the decedent's heirs.

It can be advantageous to

fund such buy-sell agreements with life insurance to guarantee the availability of funds to fulfill the agreement's terms.

By so doing, the corporation or surviving partner(s) avoids the financial strain of fulfilling the buy-out agreements.

In addition, many business owners sign personally on business loans. If the owner dies, this can result in a liquidity crisis for the estate because the loans he/she signed will be called. Life insurance is the most appropriate vehicle to prevent this.

An important consideration when deciding your life insurance needs is to explore the difference between temporary and permanent life insurance.

For short-term needs of one to 15 years, temporary or term insurance is best. On the other hand, term insurance is inappropriate if the need exceeds 15 years; consider permanent life insurance for long-term needs.

Life insurance, an integral part of any wealth-accumulation plan, can help you protect your current assets and provide a safety net for your heirs.

Similar to your other investments, your insurance portfolio should be regularly reviewed and updated to meet your changing needs and expectations.

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Contact your BKD advisor to discuss a review of your current policies and financial situation. We can help you identify your insurance needs and help you determine the amount and type to purchase. □

**BKD Insurance, LLC is another resource to enhance our WealthPlan solutions for you.**

# Individual vs. institutional risk: Do you know the difference?

by Jack Thurman, BKD Wealth Advisors, LLC, [jthurman@bkd.com](mailto:jthurman@bkd.com)

In addition to the old, reliable sources of advice about investing (like your cousin's wife or the guys you play poker with), there are many new and easily accessible sources—books, magazines, the Internet, financial advice shows on radio and television.

But real knowledge and understanding of the investment information you obtain is only as strong as your ability to position those many different pieces of information into a complete picture.

## Decoding the message

Some of the difficulty in learning something new comes from learning a new vocabulary or applying new meanings to familiar words you've used for years.

Here's an analogy: Every four years the Olympic torch burns, and, if you watch the games, you may learn new words like "luge"—words that have one meaning and are specific to one topic.

As your Olympic's vocabulary grows, you also learn different, specialized meanings for words you've known all your life—words like "axle," "tuck" and "pike."

Learning about investing and building an investment vocabulary works much the same, and one of the most frequently misunderstood words is "risk." It can have two meanings when used by an investment professional.

Many individual investors don't understand the two meanings for risk, and they also may not know the advice they get may be

based on a definition of risk that doesn't apply to them at all.

## So, what is risk?

For many people, risk is the possibility something won't turn out the way they want, like the possibility it will rain on their daughter's outdoor wedding reception or the chance their bungee cord is too long.

When your investment information source talks about risk in your portfolio, it's important to understand how your source is using the word.

Before the 1980s, the investment universe was dominated by institutions—pension plans, endowment funds and the like.

An institution's administrator was usually responsible for these asset pools, and his/her approach to investing was framed by the following:

- ✓ Infinite time horizon; the institution never plans to go out of existence
- ✓ No concern about taxes; this kind of institutional investor doesn't pay taxes on investment gains
- ✓ Meeting the benchmark every quarter, typically the focus of the board of directors to whom the administrator reports

For the past two decades, individual investors have become a significant presence in the world of investing. They differ from institutional investors because they:

- ✓ Set a specific time when they want to accumulate enough money to fund their objective
- ✓ Want to know how much of their investment return is being lost to taxes every year

- ✓ Understand any given quarterly investment return is only a data point in a long-term plan

To an institution, risk means underperforming the benchmark this quarter, an incidental event for long-term individual investors whose strategy is properly defined and implemented.

To individual investors, risk means something critically different. For them, risk is the chance they will reach retirement age, or their children's college years, and not have enough money accumulated to meet their needs.

Today, millions of individual investors are learning how to invest intelligently, and you may be one of them. Add the word risk to your investment vocabulary and remember its double meaning. The investment advice you receive should be based on risks appropriate for you.

\* \* \*

BKD Wealth Advisors, LLC, can help you make intelligent investment decisions. Our advisors will discuss the kind of risks that challenge you and help you develop the right strategy. □

## 1st quarter market commentary & outlook

### Commentary: double-digit gains & record productivity

- ✓ The U.S. economy posted strong real-growth gains during the year. High productivity growth rates were behind the success of the corporate sector as companies effectively leveraged cost cutting and leading-edge technology to bolster output.
- ✓ U.S. stock prices moved higher during 2003, posting their first positive annual result since 1999. Stock market gains were a result of several factors: dramatic but real economic growth, record corporate profit gains, record-low interest rates, low inflation and budding investor optimism.
- ✓ The best-performing economic sectors for 2003 were capital goods, technology, consumer durables and raw materials. The sectors that lagged for the year were utilities, health care, consumer nondurables and transportation.

- ✓ While most stock groups posted double-digit gains during the year, the NASDAQ composite of tech-related companies provided the largest single contribution to return in the broad market. Value stocks outpaced growth stocks and small-cap stocks continued their performance leadership over their larger-cap counterparts. The largest gains were in stocks bid higher by speculators.
- ✓ Rising inflationary expectations and slightly higher interest rates were the main culprits behind minimal returns in the Treasury bond market during 2003. Conversely, corporate bonds, specifically lower-rated bonds, posted sizable gains during 2003 as yield spreads for these issues narrowed sharply relative to Treasury yields. In the junk-bond sector, yield spreads narrowed over 6%, a reflection of the improving U.S. economy and corporate profit picture.
- ✓ Non-U.S. equity markets also *(continued on page 8)*

## 1st quarter market commentary. . .

(continued from page 7)  
posted substantial gains during 2003 (outpacing U.S. stocks) because of improving fundamentals, pre-2003 depressed stock prices and much stronger local currencies relative to the U.S. dollar. The biggest gains to U.S. dollar

investors during the year were in Greece, Germany, New Zealand and Sweden. The markets that lagged during the year on a U.S.-dollar basis were Finland, the Netherlands, the United Kingdom and Switzerland.

### Outlook: positive but cautious on U.S. stocks

- ✓ Reasonable real returns in stocks are probable over the coming year. The weak dollar will facilitate higher real growth but also will place upward pressure on interest rates. A sustainable recovery in real economic growth will require continued job-market improvements.
- ✓ Economists expect interest rates to move higher during the later half of 2004, with the Federal Reserve expected to raise short rates to a level of 2% by year end. We believe the odds favor a trend toward higher interest rates over the next several years, and we expect a major impact on capital investment. Higher rates will make it difficult for investors to make money in bonds. Higher inflationary expectations and increased government borrowing also will feed the rate hikes. Despite higher commodity prices, there may be little threat of retail inflation.
- ✓ The falling dollar may have short-term benefits for U.S.

economic growth, but a sustained fall could cause major economic damage outside U.S. borders and have a negative impact on both stocks and bonds at home. A continued slide in the dollar also places pressure on higher bond yields, causing a potential negative reaction in both stock and bond prices. □

### Tale of the Tape

#### Selected Returns through March 3, 2004

Benchmarks	1 Year	Year to Date
DOW	36.24%	1.33%
S&P 500	38.70%	3.52%
NASDAQ Composite	54.70%	1.50%
Russell 2000	65.85%	6.18%

#### Selected Asset Classes - Mutual Funds

Large Cap Growth	2.74%
Large Cap Value	4.32%
Mid Cap Growth	4.86%
Mid Cap Value	6.75%
Small Cap Growth	5.13%
Small Cap Value	6.24%
Science & Technology	3.49%
International	4.29%

**Source** - The Wall Street Journal, March 4, 2004. As with a portfolio of all stocks and bonds, a diversified portfolio gives no guarantee of safety of principal, which is subject to fluctuation.

## BKD Insurance...

(continued from page 6)  
coverage and strategies

- ✓ Assess your disability insurance coverage
- ✓ Provide second opinions of current or proposed insurance coverage and products

If you are looking for a knowledgeable insurance consultant to discuss your personal and business life insurance coverage, either current or proposed, or wish to get a second opinion on coverage from other providers, ask your BKD advisor for an introduction to **Howard Sharfman**, president of Schwartz Benefit Services. □

## Investment strategies from BKD Wealth Advisors, LLC



For a complete list of our offices and subsidiaries and their contact information, go to [bkd.com](http://bkd.com) or call Director of Communications at 417 831-7283.

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