

Retirement Weekly

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On the heels of personal tragedy Surviving spouses need to act fast on finances

After the death of a husband or wife, surviving spouses have a lot to handle. Chief among them and often overlooked initially is the "afterlife" of their spouse's retirement assets.

One major decision is what to do with inherited IRA and 401(k) assets. Fortunately, the options are limited.

A surviving spouse can remain a beneficiary of the IRA or 401(k) account, or roll the assets into their own qualified plan. They could cash out of the plan and pay whatever taxes might be due if any, or transfer the money to a trust or contingent (i.e. secondary) beneficiaries using a "disclaimer."



Which option is best? First you have to figure out which options are available to you.

Denise Appleby, a Maplewood, N.J. retirement-plan expert, says it's critical to determine whether the retirement-account owner died before the so-called Required Beginning Date (RBD) — the date by which the deceased retirement account or IRA owner must begin receiving required minimum distributions from their retirement account. Also important is the age of the beneficiary in relation to the deceased's age at time of death.

Death before the RBD: The options available to beneficiaries here depend on who they are and whether they're one of multiple beneficiaries, Appleby says. A spouse who is the sole, primary

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to Robert Powell at rpowell@marketwatch.com.



Women and 401(k)s

The shift from traditional pension plans to 401(k) plans is at once good news and bad news for women, says a new Boston College Center for Retirement Research study (http://www.bc.edu/centers/crr/facts/jtf_13.pdf). The study says 401(k) plans tend to benefit short-tenured workers, and women tend to have shorter job tenures than men.

The bad news: Women must stretch their retirement benefits over longer life expectancies and bear significant longevity risk. And, if they want to convert their 401(k) plans into an annuity, they will pay a higher price than men. Worse yet, women don't have the same joint-and-survivor distribution rights to their spouse's 401(k) plan as they do with a traditional pension. **RW**

What to do with inherited retirement assets

(Continued from page 1)

beneficiary of the retirement account may withdraw the assets gradually over her or his life expectancy, or fully by Dec. 31st of the fifth year following the year the participant dies, Appleby says. Spouses who decide to withdraw the assets over their life expectancy must begin receiving post-death distributions the year following the death of the account owner or the year the deceased spouse would have reached age 70½ — whichever year is later.

Appleby says the surviving spouse would use the Single Life Expectancy Table in Appendix C of IRS Publication 590 to calculate post-death Required Minimum Distributions. This table, she says, must be referred to for each year the spouse needs to calculate the post-death RMD. For instance, if the spouse were required to begin distributions in 2005, he or she would consult the table to determine the life expectancy period for 2005. In 2006, he or she must use the table to determine the life expectancy for 2006.

Remaining a beneficiary works best, experts say, if the surviving spouse is much older than the deceased spouse or when the spousal beneficiary is younger than 59½.

If the account is an IRA and the spouse is the sole primary beneficiary, Appleby says the surviving spouse has the option of transferring the assets to his or her own IRA. Those who opt to transfer the assets, by the way, should use a direct transfer or what is often called a trustee-to-trustee transfer. That way the funds from the deceased spouse's account go straight into the surviving spouse's IRA. The direct transfer works best if you haven't turned 70½ but your deceased spouse had.

Death after the Required Beginning Date: If the participant dies after the RBD and the spouse is the sole primary beneficiary, Appleby says the surviving spouse is required to distribute the assets over the life expectancy of the spouse or the remaining life expectancy of the deceased, whichever is longer. If the funds are distributed over the life expectancy of the spouse, his or her life expectancy is re-determined each year. If the funds are distributed over the remaining life expectancy of the deceased, the life-expectancy number is fixed in the year of death and then reduced by 1 in each subsequent year.

Yet another alternative: George Chamberlin of Financeware.com, a Richmond, Va.-based advisory firm, says surviving spouses under age 59½ and who need to the money in the retirement plan for living expenses might consider other options as well. If the survivor is over age 59½, distributions may be taken without the 10 percent penalty applied to early distributions from qualified retirement plans. Younger survivors can take advantage of a series of substantially equal periodic payments, sometimes referred to as 72(t), to avoid the penalty. (Naturally, says Chamberlin, those distributions are subject to income tax.)

A recent private letter ruling (PLR), however, offers yet another alternative to 72(t) and life-expectancy distribution options. In the PLR case, Chamberlin says, the deceased spouse had owned an interest in a profit-sharing plan that had to be distributed to the



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Inherited retirement assets?

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surviving spouse no later than five years after the account owner's death. The IRS allowed the surviving spouse to roll over the deceased's plan interests into an IRA established in the deceased's name and of which the survivor was the named beneficiary.

That rollover was not included in gross income in the year of the rollover. And, even better, the surviving spouse was permitted to take distributions from the rollover IRA without penalty despite the fact the survivor had not attained age 59½ and did not qualify for a substantially equal payments under section 72(t). The IRS noted that the statutes provide that distributions from a participant's plan to a beneficiary on or after the death of the participant are not subject to the penalty.

This exception, Chamberlin says, allows the survivor to currently benefit from the plan assets after the death of the participant. When the survivor takes this approach, Chamberlin says the distributions may be larger than when the survivor opts to roll over the plan assets into the survivor's own qualified plan. Also, the stretch-out feature using the survivor's qualified plan may be lost when the survivor is, instead, the beneficiary of the deceased participant's plan, as in this case.

That PLR may not be an option for everyone. "I would be hard pressed to find an IRA custodian that would allow an IRA to be established for a deceased person," Appleby says. That's because an IRA custodian usually requires the IRA owner (not the surviving spouse or any other party) to sign the necessary documents used to establish an IRA.

Says Appleby: "If the spouse beneficiary transfers the assets to an inherited IRA — that is, they move the assets via a non-reportable transfer to an IRA in the name of the deceased and the name of the spouse and under the spouse's Social Security number — distributions and withdrawals from this inherited IRA will be penalty-free (i.e., free from the 10 percent excise tax and early distribution penalty that usually applies to individuals under age 59½)."

If the spouse moves the assets to her or his own IRA, the 10-percent penalty may apply to withdrawals that occur before the spouse reaches age 59½ — unless they meet an exception to this penalty. The payout options available to the spouse, she says, depend on whether the IRA owner died before the required beginning date.

Appleby says it's true that spouses who keep the assets in an inherited IRA will be required to withdraw larger amounts each year than if they moved into their 'own' IRA. However, some spouses need to keep the assets in an inherited IRA to avoid the 10-percent early distribution penalty.

The good news is the spouse beneficiary may change her or his mind at any time and transfer the assets from the inherited IRA to her or his own IRA, which gives the spouse the ability to benefit from both options, albeit consecutively. **RW**

What the experts say about Social Security reform

Retirement Weekly will begin publishing this week the opinions of various economists and academicians on the subject of Social Security reform.

- Jason Taylor, faculty economist and assistant professor at Central Michigan University

The current Social Security system is not a good deal for most Americans, since they filter 12.4 percent of their pay into the system to get a 2 percent rate of return on their investment. Those who live shorter life spans, including lower-income Americans (most notably African-Americans), receive negative returns. Americans could do better if they were able to invest 12.4 percent of their paychecks into a diversified portfolio of bonds, real estate, precious metals and mutual funds. This would help end the current bias against socioeconomic groups that live shorter life spans.

- Sylvester Schieber, director of research and information at Watson Wyatt Worldwide and co-author of "The Real Deal: The History and Future of Social Security"

Now is the time to seriously consider reforming the system. Further delay in taking up this issue puts us at risk of having the sort of experience that Japan and Germany are going through, namely having to cut benefits not only for future retirees, but for current retirees. The system is underfunded. Part of the solution has to be in finding added financing. **RW**

The state of affairs

Seniors spend more on food consumed at home

The average U.S. family spends 7.6 percent of their money on food at home, but those ages 65-74 spend 8.9 percent, and those over 75 spend more than 9.2 percent, says Packaged Facts. Overall, Americans in the 55+ age group spend \$101 billion on food at home each year. Visit <http://www.packagedfacts.com/pub/1006028.html> to learn more about the report.

Workers falling behind on retirement savings

Almost half of U.S. employees are concerned about outliving their retirement savings, according to a MetLife Study of Employee Benefit Trends. That may be because a third admitted they haven't started saving or set a retirement savings goal.

The study showed four in 10 workers understand their employer's benefits program and 27 percent try to fill in the gaps by talking to friends and relatives. In a ranking of benefit options by importance, medical plans topped the list at 81 percent, followed by vacation time (64 percent) and retirement programs (57 percent). To view the entire study, go to <http://www.metlife.com>.

For 2005, more Americans strive to shed pounds, not debt

More Americans, for the first time in three years, are focused on losing weight rather than eliminating debt as their New Year's resolution, says Bankrate's annual consumer study. Those surveyed had \$11,288 in debt on average, slightly less than the \$11,895 recorded a year ago. Other findings: Men want to lose on average of 21.3 pounds while women want to lose 23.9 pounds. Visit <http://www.bankrate.com/brm/about/pr/20041230.pdf> to view the study. **RW**

News in brief

AARP opposes private accounts

The nation's largest lobbying organization this week launched a \$5 million advertising campaign to fight President Bush's proposal for private Social Security accounts. AARP wants to block the creation of private accounts financed with payroll-tax revenues. Full-page advertisements that appeared in more than 50 newspapers around the country said the accounts would cause "Social Insecurity."

The association also said it supports strengthening the existing Social Security system in a number of ways, including investing part of its surplus so that it earns higher returns than offered by U.S. Treasury bonds; raising the cap on the amount of wages taxed to support Social Security from today's \$88,000 to about \$140,000; and including all newly hired state and local government workers in Social Security.

Visit the TV & Radio section of CBS MarketWatch at <http://www.marketwatch.com/tvradio> to learn more about AARP's view of Social Security reform.

White House denies Social Security benefits rejiggering

The Bush administration disputed reports that it will propose that Social Security base future benefit hikes on changes in the Consumer Price Index, rather than on changes in wages. Because wages tend to go up faster than inflation, experts say the change could lead to big cuts in the purchasing power of future retirees' Social Security benefits.

Press reports also suggested the government might let each worker shift as much as \$1,300 in annual Social Security payroll taxes into a private account.

Scott McClellan, the president's press secretary, said this week that Bush continues to want to move forward on Social Security reform in a bipartisan way. "The president hasn't made any decisions about a specific proposal at this point," McClellan said, according to a written version of his remarks, which can be found at <http://www.whitehouse.gov/news/briefings/>.

IRS issues automatic rollover guidance

The IRS this week released new guidance for retirement-plan administrators who want to close out small accounts owned by departing plan members.

Under a new law, employers must automatically rolling small, \$1,000 to \$5,000 401(k) plan accounts and other small retirement plan accounts over into individual retirement plans. The guidance can be found at <http://www.irs.gov/pub/irs-drop/n-05-05.pdf>.

Treasury rejects plea for use-it-or-lose-it relief

The Bush administration has declined to try to use regulatory authority to ease current restrictions on use of flexible spending account assets (FSA), reports *National Underwriter*. Today, employers must take unused FSA assets back at the end of the tax year, even though employees have funded the accounts with contributions from their own earnings. The employee benefits industry says the Treasury Department has the authority to modify the current "use it or lose it" rules without going to Congress to seek changes in the laws that govern FSAs, but Treasury does not believe it has the authority to let FSA holders keep unused assets in the accounts after the end of the year. **RW**

Best & Worst Retirement Planning Ideas

Retirement Weekly is publishing a series of columns containing retirement-planning ideas from expert Natalie Choate.

BEST: Take after-tax money first from your Qualified Retirement Plan (QRP).

A few QRPs contain after-tax contributions made by the employees. Usually, the employer keeps track separately, so each employee has two accounts, the "Employer Contribution Account" (containing the employer's contributions and earnings thereon; all pretax money) and the "Employee Contribution Account" (containing the employee's contributions and earnings thereon; partly pretax money and partly after-tax). The two accounts are treated as one account for Minimum Required Distribution (MRD) purposes, but treated as separate accounts for purposes of determining how much of each distribution is taxable.

Thus, the employee determines the combined MRD (for both accounts), but can then take the entire MRD from the Employee Contribution Account, so that a high proportion of the distribution is tax-free. Tax-free distributions can be used to satisfy the MRD requirement just the same as taxable distributions.

You can't do this with an IRA, generally, because of the "cream-in-the-coffee rule" (all IRA distributions are deemed to come proportionately from the pretax and after-tax portions of your IRA, with all your IRAs treated as a single account), unless your IRAs have had all pretax money stripped out.

BEST: Take the year's MRD for all your IRAs from your smallest IRAs, to close them out.

If you have multiple IRAs, take advantage of an IRS regulation to close out smaller accounts. Under this rule, a distribution from any IRA counts toward your MRD requirement for all your IRAs. So determine the total of your MRDs for all your IRAs for the year, then clean out smaller accounts as necessary to fill up the year's total MRD for all your IRAs. Eliminating multiple smaller accounts will make estate planning (as well as future MRD calculations) easier. The same thing works for multiple 403(b) plans. However, you can't use IRA distributions to satisfy 403(b) MRDs or vice versa; and you can't use an inherited IRA or 403(b) to satisfy the MRD requirement for non-inherited IRAs or 403(b)s (or vice versa), or for IRAs or 403(b)s inherited from another person.

WORST: Keep IRA investments liquid to cover anticipated MRDs. A magazine article advised, "Keep a sufficient portion of your IRA liquid to cover anticipated MRDs for the next year or two." This is unnecessary and could cause you to waste commission money and/or investment opportunity, because there is no requirement that MRDs be paid in cash. **RW**



Natalie Choate,
author of "Life and
Death Planning for Re-
tirement Planning Bene-
fits"

About the "best and worst retirement planning ideas" series

These ideas are reprinted with permission from "The 100 Best & Worst Planning Ideas for Your Client's Retirement Benefits," by estate-planning expert Natalie Choate. Her book "Life and Death Planning for Retirement Benefits" is a leading resource for estate-planning and money-management professionals. Both publications are available at <http://www.ataxplan.com>.

Tips of the week

Still time to arrange 2005 tax savings

It's never too early to begin tax planning for the year ahead, says George Jandl, national partner-in-charge of KPMG's Personal Client Advisory Services practice.

The year 2004 may be over, but taxpayers can still positively impact April's tax bill by keeping in mind some basic tax filing tips, says KPMG, a big four tax firm. It's also the perfect time to start planning for 2005 taxes.

"Taxpayers who may have missed the boat in terms of 2004 tax planning should not give up hope," Jandl says. "They may still help lower their 2004 tax bill if they remember some items that are frequently overlooked or under-utilized. Especially this year, with the new sales tax deduction, taxpayers have an incentive to really crunch the numbers and scrutinize their deductions."

Here are his top tips for 2005 planning:

- **Be aware of the Alternative Minimum Tax (AMT).** Taxpayers in high-tax states should be especially sensitive to being subject to the AMT. For 2004, AMT exemption amounts are temporarily increased to \$40,250 for individual filers and \$58,000 for married couples filing jointly, but will revert to pre-2003 limits after Dec. 31, 2005.
- **Reduce taxable income through employee benefit plans.** To help reduce taxable income in 2005, taxpayers should consider maximizing their pre-tax contributions to employee benefit programs such as 401(k) retirement plans, health care and dependent care flexible spending accounts (FSAs), and health savings accounts (HSAs). The 401(k) contribution limit is raised for 2005, increasing to \$14,000 for those under age 50, and \$18,000 for those 50 or older.
- **Contribute to education plans.** Taxpayers may consider contributing to a Section 529 plan or a Coverdell Education Savings Account (ESA). Plan distributions are tax-free if used to pay qualified education expenses. While a Section 529 plan may only be used towards qualified higher education expenses, an ESA can also be used towards elementary and high school expenses. Taxpayers can front-load gifts to Section 529 plans, giving \$55,000 per individual or \$110,000 per married couple, and spread the deductions over five years. ESA contributions are limited to \$2,000 per year, and are not income tax-deductible.
- **Consider making annual gifts.** Financially-able taxpayers should consider establishing a gifting program for children and grandchildren. Generally gifts of up to \$11,000 per recipient are excluded from gift tax, and can be made to any number of recipients. This amount doubles to \$22,000 per recipient in the case of a couple making such gifts.
- **Consider taking out a home equity loan.** Taxpayers with debt other than a mortgage should consider taking out a home equity loan to pay off such debt. Interest incurred on a home equity loan is generally deductible, whereas interest on credit card debt is not. Also, the interest rate on a home equity loan is generally lower than the interest rate on most other personal debt. **RW**



HealthWatch

Medicare to help seniors quit smoking

A new proposal in Medicare coverage will allow certain beneficiaries who smoke to receive counseling to help them quit, according to a recent announcement by the Centers for Medicare & Medicaid Services (CMS).

Almost one in 10 Americans 65 and over smoke. Of the 440,000 deaths annually from a smoking-related disease, 300,000 occur in those 65 and older, estimates CMS.

In 2002, the Centers for Disease Control and Prevention (CDC) said 57 percent of smokers 65 and over want to quit the habit. Currently, 10 percent of elder smokers quit each year, with 1 percent relapsing.

CMS proposes to extend smoking cessation coverage to beneficiaries who smoke and have been diagnosed with a smoking related disease, or are taking certain drugs whose metabolism is affected by tobacco use.

Visit <http://www.cms.hhs.gov/coverage/> to review the proposed coverage policy.



Savings from Canadian drug purchases drop for Americans

Americans who purchased brand-name drugs from Canada saved 29 percent in 2004, compared with a 38 percent savings in 2003, according to a report by White Plains, NY-based PharmacyChecker.com. The group attributes the drop to the falling U.S. dollar and to supply restrictions that drove up the wholesale cost of drugs.

The report showed that the average drug price on Canadian online pharmacies rose 23 percent from 2003 to 2004, while prices rose 8 percent at American counterparts.

"Americans can still save hundreds or thousands of dollars a year on their drug bills from Canadian online pharmacies," says Dr. Tod Cooperman, president and founder of PharmacyChecker.com. "But they have to shop around a lot more than in the past," he says. Visit http://www.pharmacychecker.com/news/news_010505.asp for more information on the report.

Options for saving on prescription drugs in the U.S.

The Partnership for Safe Medicines, a coalition of patient, physician, pharmacist, university, industry and professional organizations has released a "Safe Savings" guide for consumers on domestic ways to find safe and affordable drugs.

The guide includes information on private patient assistance programs, comparison shopping and safely buying drugs online. Some highlights:

- Private Assistance Programs — Pharmaceutical companies offer deep discounts and sometimes free brand-name medications to people who cannot afford them. Sites like <http://www.HelpingPatients.org> and <http://www.TogetherRx.com> compile pharmaceutical patient assistance programs that offer deeply discounted, or free, prescription drugs. And RxOutreach at <http://www.rxoutreach.com> is a prescription assistance program providing discounted access to generic medicines.

Visit <http://www.safemedicines.org> for more information and links to other sites. **RW**

Ask Mike

Fine-tuning retirement portfolios

Fourth in a series

Two weeks ago, I discussed some specific asset-allocation strategies for a sample portfolio of someone who was about five years away from retirement and for someone who was about five years into retirement. I also provided some ideas of how to actually build and execute that portfolio using some basic index and exchange-traded funds as well as some basic commodity mutual funds.

This week, I will continue this discussion by elaborating upon the idea of adding commodity products into your asset allocation plan and therefore into your portfolio. Of course, the idea behind adding commodity instruments into your portfolio is to add diversification into your overall portfolio.

There was certainly a time when maintaining a portfolio of stocks and bonds (and maybe some cash) equated to a diversified portfolio, but do these investments actually equate to complete diversification? Do they help account for inflation? Devaluation of the dollar? Scarcity in oil, minerals, or metals?

In a column I wrote in in the Dec. 19, 2003 issue of *Retirement Weekly*, I explained that different asset classes correlate differently. (See table.) As you can see, commodities tend to correlate

differently to stocks and bonds and therefore act as a hedge against unusual events. Moreover, it is very possible that commodities are, in fact, a fine investment simply

based on increased demand and decreasing supply.

The Oppenheimer Real Asset fund (QRAAX) was discussed two weeks ago as a proxy for adding some commodity diversification into your portfolio, and as I mentioned earlier there are not many choices with respect to adding commodities to a portfolio notwithstanding adding the physical assets, utilizing future contracts and the like. Nonetheless, in addition to the Oppenheimer fund, there's the PIMCO Commodity Real Return Strategy fund (PCRAX), a proxy for commodities indexes. **RW**

Correlation Matrix of World Capital Market Security Returns

Security	U.S. Equities	Total U.S. Bonds	Total Real Estate
U.S. equities	1.000	-0.166	0.054
U.S. total: bonds	0.166	1.000	-0.082
Foreign cash equivalents	-0.386	-0.192	0.399
Residential real estate	0.125	0.017	0.916
Gold	-0.088	-0.280	0.684

Source: "World Wealth: Market Values and Returns", Roger Ibbotson

About Mike Finer

Michael S. Finer, a certified public accountant, a certified financial planner®, and a chartered life underwriter, is president of Salem, Mass.-based Major League Investments Inc. Robert Powell is a minority shareholder in the firm. **Email "Ask Mike" questions to michael.finer@majorleagueinvest.com or call 978-740-1011.**

Questions and answers

Converting 401(k) contributions

Q: I have pre- and after-tax money in a 401(k) plan, all of which I want to roll into an IRA, convert only the after-tax money into a Roth and not have to pay tax on the conversion since this money was already taxed.

A: I get that question all the time, says Ed Slott, author of just-published "Parlay Your IRA Into A Family Fortune."

You can't do that. Not even if you have all of the after tax money in a separate IRA and convert only that IRA. All IRAs are considered one IRA even if the funds are in different IRAs. You cannot just convert the after-tax funds and pay no tax on the conversion. Once the funds are in an IRA they can no longer be separated into pre tax and after tax. Every dollar withdrawn from the IRA will contain a percentage of the pre tax money and a percentage of the after tax money. The after tax percentage is based on the amount of after tax funds in the IRA over the total value of the funds in all of your IRAs.

Assume that the value of all your IRAs add to \$100,000 and included in that total is \$10,000 of after tax funds rolled into the IRA from a 401(k). If you now withdraw that \$10,000 from your IRA you will pay tax on \$9,000 and only \$1,000 will be tax free, or 10 percent of the total. The after-tax percentage is 10 percentage because \$10,000 over the \$100,000 total is 10 percent. Every dollar withdrawn from any of these IRAs will be 90 percent taxable and 10 percent tax free. Once you withdrew the entire \$100,000 , then 10 percent , or the \$10,000 after-tax funds would be tax free. **RW**

Best of CBS MarketWatch

- **Five resolutions that will provide financial security**
<http://cbs.marketwatch.com/news/story.asp?guid={F3E2B1B7%2D3541%2D4F62%2D829B%2DDF27CE5662F0}>
- **Ten ideas to help you break bad investing habits**
<http://cbs.marketwatch.com/news/story.asp?guid={2F8E68B1%2D6C73%2D4530%2D8D8C%2D08468F2F5EE0}>
- **More Americans see alternative medicine as cost saver**
<http://cbs.marketwatch.com/news/story.asp?guid={03FB67F0%2D18E9%2D4FBA%2D9DDD%2D81452854615C}>
- **Drawing a line on public, private faith-based investment**
<http://cbs.marketwatch.com/news/story.asp?guid={C7A5A3FC%2D16E5%2D45CB%2DAB19%2DA1B04F5216CF}>

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For reprints of a story within *Retirement Weekly*, or the entire issue, please e-mail **marketwatch@reprintbuyer.com** or call (717) 399-1900 x104. Samantha Soga, newsletters assistant, contributed to this week's issue. Thanks, as always, for spending time with *Retirement Weekly*.



Robert J. Powell III is President of Unison Associates LLC, a Salem, Mass.-based financial education, communication and consulting firm. Powell, who has more than 20 years of experience in the financial services industry, is also co-author of "Decoding Wall Street" and executive producer of PBS' "More Than Money." Previously, Powell served as editor in chief of DALBAR's *Mutual Fund Market News* and columnist for *The Boston Herald*. Powell owns no shares of any investment mentioned in this week's issue. He currently provides consulting services to the Financial Planning Association and Major League Investments, in which he also holds a minority interest.

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