BEYOND THE HORIZON

1st Quarter, 2008 Issue

A word of thanks to our valued clients — We appreciate your continued business and your referrals. They both have contributed to our success!

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IN THE NEWS

Our first quarter issue reports the tax rules and limits for the new year. The following are those FOR THIS COMING YEAR (2008):

- **New break on capital gains for 2008:** Filers who are in the 10% or 15% tax bracket will pay 0% on capital gains in 2008, down from the previous 5% rate. Once income is high enough to push them into the 25% bracket, the balance on the gains is taxed at 15%.

- **Federal income tax rates** will not change but the brackets widen a bit, adjusted for inflation.

- The **standard deduction** for 2008 will now be $10,900 for married individuals filing jointly (plus $1,050 for each spouse age 65 or older); $8,000 for heads of household (plus $1,350 if age 65); and $5,450 for single filers (plus $1,350 if age 65).

- **Personal exemption** increases to $3,500 per person.

- Maximum **contribution limit for Traditional and Roth IRAs INCREASES to** $5,000 for 2008. The additional "catch-up" contribution for those age 50 or older holds at $1,000 for a total maximum contribution limit of $6,000.

- **Taking the deduction for Traditional IRA contributions may be limited** for those who participate in an employer retirement plan. The income phaseout is $85,000- $105,000 for couples and $53,000-$63,000 for singles. Where only one spouse is active in a plan, the phaseout is $159,000-$169,000.

- There are income limits for making **Roth IRA contributions.** The income phaseout for couples is $159,000-$169,000 and $101,000-$116,000 for singles.

- There is **no change** to the contribution limits for company-sponsored retirement plans. The **401(k) contribution limit holds** at $15,500 (plus a $5,000 "catch-up" for those age 50 or older). The limit for **contributions to a Simple IRA** also holds at $10,500 (plus a $2,500 "catch-up").

- The phaseout for the **Hope and Lifetime education tax credits for 2008** begins at $96,000 for marrieds and $48,000 for singles. The maximum **Hope credit rises** to $1,800.
- Annual limit for **contributions to a Coverdell Education Savings Account** holds at $2,000 per child. Remember, the contribution deadline is April 15th of the following year.
- The **annual gift tax exclusion holds at** $12,000 per recipient.
- The **estate tax exemption also holds at** $2.0 million.
- The **Social Security wage base** for this payroll tax rises to $102,000 in 2008.
- Those **collecting Social Security who are between the ages of 62 and 66 can earn wages** up to $13,650 without losing benefits in 2008. Those over 66 can earn an unlimited amount without losing benefits. Individuals who turn 66 in 2008 won't lose benefits if their earnings are $36,120 or less before reaching age 66.
- Starting in 2008, the kiddie tax age will be extended to include children under age 19 and full-time students under age 24, depending on their income.
- Annual cost-of-living increase for Social Security recipients for 2008 will be 2.30%, slightly less than the 3.30% increase last year.
- The **standard mileage** rate for 2008 increases to 50-1/2 cents per mile for business miles driven and 19 cents for medical or moving purposes. The allowance for charitable miles driven remains steady at 14 cents.

Sources: Internal Revenue Service website; The Kiplinger Tax Letter Vol. 82, No. 26.

2008 OUTLOOK

In looking back to 2007, the market indices once again showed positive gains. The Nasdaq ended the year with a gain of 9.8%, followed by the Dow at 6.4% and the S&P 500 at 3.5%. With the exception of the S&P in 2005, this is the 5th consecutive year of gains for stocks. Will 2008 bring yet another year of gains or will the tides turn? There are quite a few opposing forces at work. For that reason, we are not as confident about the 2008 forecast as we have been in recent years.

On one hand, historical data tells us we are past due for a year of negative returns for stocks. Additionally, concerns over the housing slump, subprime loans and credit in general are expected to continue into 2008. Lastly, rising oil and food prices continue to impact the consumer, making it harder for them to continue spending and supporting the economy.

On the other hand, stocks have historically performed well during Presidential election years, regardless of the party affiliation of the elected candidate. Another favorable factor is that many stocks continue to be fairly valued or undervalued. And despite our slowing economy, other forces at work that favor stocks are low inflation, falling interest rates, healthy exports, and a surplus of liquidity in the markets.

So what is causing the market to start off this year already giving back much, if not all, of the 2007 gains? Most recently, it has been the news of rising unemployment, which adds to the risk of a recession. As investors, should a recession concern us? According to research obtained from Hays Advisory, there have been 12 recessions over the last 70 years. During half of those recessions, the S&P 500 produced declines averaging 18.4%. During the other half, the market advanced by roughly 10%. What should be of more concern to investors would be a bear market, which we do not anticipate in the near future. Could a recession cause a bear market? Not likely, since bear markets usually precede recessions.

Whether or not we head into a recession, we should anticipate continued volatility in stocks and expect declines. It is important to remind ourselves, however, that market declines from time to time are normal. As noted in American Funds' January 2008 investor newsletter, a decline in stocks of 10% or more normally occurs about once a year. Declines of 15% or more occur about once every two years. Despite market declines, stocks have historically been the best performing asset over time. Understanding these points should help investors to maintain patience and avoid making one of the most common mistakes —getting in and out of the market as a reaction to market volatility.

Though we anticipate that 2008 will be a challenging year for investing, there are always opportunities to make money. At the same time, we will be focusing on protecting principal. As we have often said, "it's not just about how much you're making but how much you're protecting along the way"..

Sources: Sector Notes from Hays Advisory, 1/2/08; Morning Market Comments by Hays Advisory on 12/6/07; American Funds "the flyer", January 2008 issue.

CONVERTING TAX-DEFERRED INVESTMENTS FOR WEALTH TRANSFER

Our journey through life also takes us through various stages or cycles of our financial life. While we are working, we are in the Accumulation Phase when we are saving dollars to be used during retirement. Most commonly, the dollars being saved are in tax-deferred investments, such as 401(k)s, IRAs and annuities. Then during retirement, we may need to tap into those investments to supplement our income sources (i.e. Social Security benefits and/or pensions). This occurs during the Distribution Phase.

But what about the investments we don't need to use to supplement income? They continue to grow on a tax-deferred basis, thereby creating more of a tax liability for the future. For those who have adequate resources (i.e. income and assets) to fund lifetime needs, consider converting tax-deferred investments into an income stream versus passing them on to heirs as a lump sum. This strategy can be a helpful tool for wealth transfer and/or wealth protection. For example, the income stream could be used to:

- fund IRAs for children and/or grandchildren
- fund 529 or Coverdell college savings plans for grandchildren
- pay premiums on a life insurance policy to create a tax-free investment for the family
- pay premiums for a long-term care policy for yourself
- gift your mandatory IRA withdrawal to a charity, which is considered a tax-free distribution for yourself

One potential benefit of converting tax-deferred investments into an income stream is the tax saving component. Depending on your current income tax bracket, you may be able to withdraw the income while minimizing current income taxes. In addition, using that income in the above examples may reduce future inheritance taxes for your heirs. For others, the benefit may be the ability to help family members now rather than in the future. Then again for others, the benefit could be to gain wealth protection by using the income stream to purchase life insurance or long-term care coverage.

If you or a family member want to explore whether or not these techniques are appropriate or beneficial for you, please call our office for a consultation.

INVESTMENT CORNER

The Taxpayer Relief Act of 1997 established a powerful saving incentive - the Roth IRA. More than 10 years later, many investors continue to overlook the tremendous tax saving opportunity that the Roth IRA offers.

Contributions to a Roth are not deductible from current income. Instead, all earnings grow and are then withdrawn on a tax-free basis if withdrawn as qualified distributions. In order to be qualified, distributions must be made after age 59-1/2 and no sooner than five years from the first contribution. There are other benefits than the tax-free earnings. Penalty-free withdrawals can be made prior to age 59-1/2 as they can be with the Traditional IRA. Additionally, there is no mandatory age when withdrawals must begin. Tax-free earnings can continue as long as you desire. But in order to qualify, you must have earned income that does not exceed the limits mentioned on page 1.

So which is better - saving taxes now by contributing to pre-tax plans such as a 401(k)s or Traditional IRAs OR saving taxes later with the Roth? That depends on several factors, one being whether or not you will be in a lower tax bracket during retirement. For many, that might not be the case. For example, your income may be lower during retirement but tax rates may be higher at that time. For those whose tax bracket might be relatively the same, the Roth may produce greater after-tax distributions.

Have you taken the time to consider whether or not a Roth IRA would be a suitable for you? We are not implying that you consider substituting Roth contributions for 401(k) contributions. However, it might be advantageous for a portion of your retirement savings. Remember, you have until April 15th to make a 2007 contribution. For more information or to discuss if making Roth contributions would benefit you, call our office.

Highlighting this topic in no way implies that it is suitable for everyone. FOR MORE INFORMATION ON THIS OR OTHER TAX TIP OR ACCOUNT TYPE, PLEASE CALL OUR OFFICE.

HORIZON FINANCIAL ADVISORS
Jonnet Building, Suite 303 4099 William Penn Highway
Monroeville, PA 15146-2513
Phone (412) 856-7300 / (800) 852-7182 - Fax (412) 856-3677
E-Mail: info@horizonfinancialadvisors.com

Securities Offered Through
TRUSTMONT FINANCIAL GROUP/TRUSTMONT ADVISORY GROUP
200 Brush Run Road, Greensburg, PA 15601 /(724) 468-5665
Member FINRA/SIPC