Kensington Times

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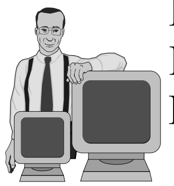

From The President's Desk

Ralph H. Phillips

Did you know...

The circulation of this quarterly newsletter has now exceeded 750 copies, and it is still growing! Many thanks to all of our friends and Clients for the referrals!

In this edition, please pay special attention to the articles concerning Roth and Education IRAs. Many changes we all need to be aware of have taken place in the past year.

Special congratulations to Renee LeVeque for graduating from the Leadership Alle-Kiski Valley Program. We are very proud!

Special, special congratulations to our friends, Tom & Kim on the birth of their daughter, Sarah Grace, to Andy & Michele on the birth of their daughter Domenica Nicole and to Mark & Cheryl on the arrival of "Barney"!

Please call your Kensington Financial representative if you ever have any questions concerning you accounts or if you have any investment or insurance questions.

Make Finance Work

With summer upon us, many people will flock to their local car dealership to buy a new car. Are you one of these individuals? This also means that many of those same people will be taking out loans to finance their purchase.

Did you ever wonder how you could calculate your loan payment? Well, it is actually quite simple, using the following formula: **Payment = Present Value divided by the Present Value Interest Factor of an Annuity**. "Present Value" is the value of your asset today. Thus,

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Questions and Answers...Roth IRAs

Q: *Are withdrawals from a Roth IRA included in my modified adjusted gross income, which is used to determine the taxability of my Social Security Benefits?*

A: While we are not accountants, it is our understanding that the answer is "No." One advantage of converting a regular IRA to a Roth IRA is avoiding the adverse impact that distributions from a regular IRA can have on the taxability of Social Security benefits. However, the conversion itself counts as "modified adjusted gross income," the figure used to determine taxability of Social Security benefits. If you convert to a Roth in 1998, the resulting income is spread over four years and could affect your Social Security taxation for four years unless you elect to recognize all the income in the current year. If you convert to a Roth in '99 or later, the conversion will only affect the taxation of your benefits that one year. We would strongly suggest that anyone who is contemplating a Roth IRA rollover/ conversion contact a tax qualified CPA for advice and guidance concerning your particular situation.

Q: *I am one of the early converts to the Roth IRA. However, it has become a nightmare of financial documentation from sponsoring IRA firms. In June of '97, I opened a regular IRA with a contribution of $2,000. In February of this year I converted it to a Roth IRA. Three weeks later, I wanted to send a contribution of $2,000 to that Roth IRA for 1998 but was told, by the mutual fund company, that I must open a NEW* ***Contributory*** *Roth IRA for '98. My original IRA has now been labeled a Roth* ***Conversion*** *IRA. The fund company has said, for various reasons, that they cannot consolidate my accounts and it is driving me crazy! What is the story, here?*

A: The IRS strongly "encourages" the maintenance of separate Roth IRA accounts for regular contributions and for each year you make a regular IRA to Roth IRA conversion. This is because for purposes of qualifying for tax-free distributions, there was originally a separate five-year holding period for the amounts attributable to each year you make a

Merger Mania

Does the recent sweep of mergers and buyouts have you totally confused? Over the past several months we have witnessed the announced mergers of BankAmerica and NationsBank, Chrysler and Daimler Benz, Citicorp and Traveler's Group, Compaq and Digital, AT&T and TCI, and the attempted hostile takeover of Mellon Bank by the Bank of New York, just to name a few. So, exactly what is a Merger and Acquisition (M & A)?

A merger and acquisition is simply the combination of two or more businesses into a single operational entity. The question that this brings up is why would any company want to lose it's autonomy by merging with another? Well, M & As bring about many benefits to a company that it could not have possibly achieved on it's own. Often it can even lead to higher quality products and services as a result of two different companies sharing their strengths. There are also numerous other benefits to M & As. These include: increased market share, sharing of new technology and methods, tax benefits, reduction in risk of bankruptcy, economies of scale, unused debt potential, and the ability to take on more profitable projects.

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conversion, as well as different rules regarding earlier withdrawals from conversion Roths and other Roths. Your fund company was following the IRS recommendation. By doing so, they were watching out for your interests to help you avoid accounting and tax problems when take distributions.

Q: *I converted an existing IRA in January of '98 to a Roth IRA. In March, my company was merged with another. The merger terms stated that all employees would be able to exercise their stock purchase options regardless of the option dates and that all shares would be redeemed immediately in cash. I now have a short-term capital gain that will push my adjusted gross income for the year significantly over the $100,000 AGI maximum. Is it possible to undo my Roth conversion and if so, what are the penalties?*
A: Assuming that the Senate passes, and the President signs the Tax Technical Corrections Act, you will be able to undo your rollover to a Roth and return the money to an ordinary IRA, together with the earnings that accrued while it was in the Roth. The rollover must be undone by the due date, including extensions, for your 1998 tax return. There will be no penalties for undoing a Roth conversion done in error. We would strongly suggest that anyone who is contemplating a Roth IRA rollover/conversion contact a tax qualified Certified Public Accountant for advice and guidance concerning your particular situation.

Q: *I have a rollover IRA, am 61, and desire to convert to a Roth IRA. My income is below the maximum for a single person and I qualify for conversion. After I roll my IRA over to a Roth and spread the taxes due over 4 years, how long is the time limit before I*

Taxpayer Act of 1997 Creates Education IRA

The Taxpayer act of 1997 has created an exciting way to save for College, called the Education IRA. This investment opportunity allows for tax-free growth of invested funds, AS LONG AS the money is used for the higher education of any child. You may make contributions to your Education IRA until the child is eighteen years old. To qualify you must have an Individual Adjusted Gross Income of less than $110,000 or less than $160,000 jointly, per year. Contributions made are limited to $500 per year, per child and are not tax deductible.

Like the Roth IRA, the advantage of the Education IRA is that any growth it realizes is tax-free. Any amount not used can be rolled over to another child in the same family. However, all funds in an Education IRA must be used by the time the beneficiary has reached the age of thirty. Contributions to an Education IRA do not count towards Roth IRA or Traditional IRA contribution limitations. **If you would like more information, or if you would like to set up an Education IRA, please contact a Kensington Financial Representative at 724,334,1950.**

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if you buy a $20,000.00 car and put down $2,000.00, your present value is $18,000.00. The "Present Value Interest Factor" of an Annuity can be obtained from the table, shown below.

Just look at the number of years listed vertically in the left hand column and the corresponding interest rate listed horizontally along the top of the table. This is a factor that takes into consideration the time value of money and simplifies the formula. This table, will provide the annual payment. Since, we pay the same amount each period this payment is called an annuity. Therefore, if you take out an $18,000.00 loan over 5 years at 8% interest, your monthly payment would be calculated as follows:

Payment = $18,000.00/3.993, which gives you a total of $4,507.89 per year. Simply dividing $4,507.89 by 12 months, will give you the monthly payment of $375.65. This formula can be used to roughly calculate any loan payment.

Int. Rate	**1%**	**2%**	**3%**	**4%**	**5%**	**6%**	**7%**	**8%**	**9%**	**10%**
1 year	.990	.980	.971	.962	.952	.943	.935	.926	.917	.909
2 years	1.970	1.942	1.913	1.886	1.859	1.833	1.808	1.3783	1.759	1.736
3 years	2.941	2.884	2.829	2.775	2.723	2.673	2.624	2.577	2.531	2.487
4 years	3.902	3.808	3.717	3.630	3.546	3.465	3.387	3.312	3.240	3.170
5 years	4.853	4.713	4.580	4.452	4.329	4.212	4.100	3.993	3.890	3.791
6 years	5.795	5.601	5.417	5.242	5.076	4.917	4.767	5.623	4.486	4.355
7 years	6.728	6.472	6.230	6.002	5.786	5.582	5.389	5.206	5.033	4.868
8 years	7.652	7.326	7.020	6.733	6.463	6.210	5.971	5.747	5.535	5.335
9 years	8.566	8.162	7.786	7.435	7.108	6.802	6.515	6.247	5.995	5.759
10 years	9.471	8.983	8.530	8.111	7.722	7.360	7.024	6.710	6.418	6.145

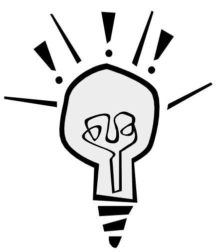
(Continued from "Merger Mania" on page 1)

The Chrysler/Daimler Benz merger provides a good example of the possible benefits of increased market share and the sharing of technology and methods. The merger, if approved, would create the world's fifth largest auto maker. Chrysler would benefit from the merger by receiving access to Mercedes Benz's (a subsidiary of Daimler Benz) tremendous engineering resources, as well as it's outstanding reputation for luxury. Mercedes Benz would benefit by obtaining access to Chrysler's highly successful minivans, SUVs, and light trucks. Mercedes would also gain access to Chrysler's manufacturing methods and trend setting styles.

Merging companies can realize tax benefits if one firm has generated tax credits for suffering losses (which can be carried back three years or forward fifteen years). If the firm with losses does not have the earnings necessary to use its tax credits, a merger can provide these necessary earnings. Another benefit of M&As can also be the ability to take on profitable projects. Often due to capital rationing, an individual company may be forced to pass on an expensive project that could offer a high return. The combined resources of a merger can make pursuing these high profile projects possible. A company may also realize the benefits of M&A if it acquires a firm that has unused debt capacity. This allows companies to increase their debt, while taking advantage of the tax benefits associated with using the debt as a means of financing, because interest expense is tax deductible.

Even after taking these advantages into consideration, it is important for companies (and their shareholders) to keep things in perspective. It is vitally important that all participants in a M&A have the ability to adapt to each others corporate cultures. This has been mentioned as one, of many, concerns in the Chrysler/Daimler-Benz merger, because of the radically different organizational climates attributed to each company. Thus, despite their many advantages, mergers and acquisitions should always

The Educated Investor



Here are some very common terms used in the investment industry that may help you to understand how risk is measured in a portfolio:

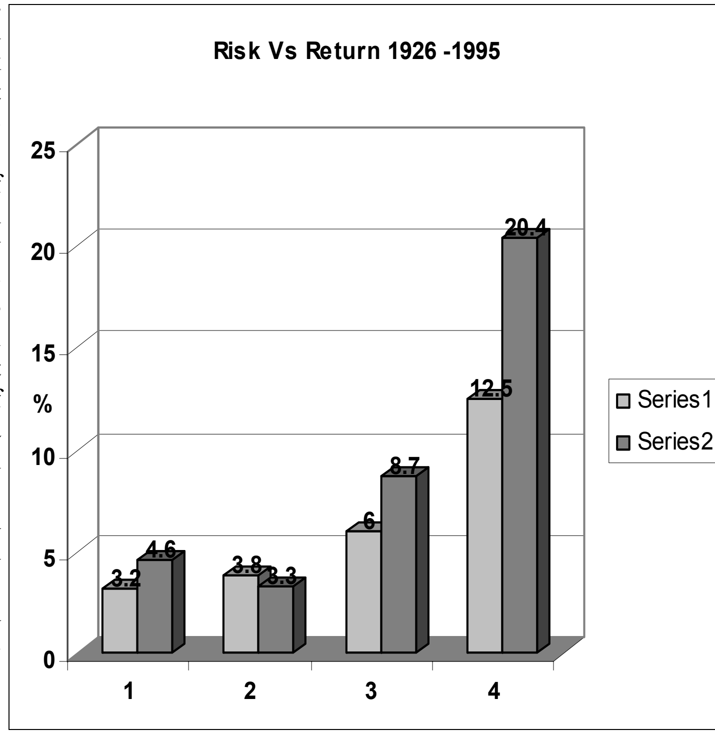
1. **Standard Deviation** - Illustrates how far the return on your investment deviates from the mean or average return for that type of investment.
2. **Beta** - Measures the average relationship between an investment's potential return and that of the S&P 500 Index. For example, if a company has a beta of 1.06 it means that when the market goes down $1 the company goes down $1.06, if the market goes up $1, the company goes up $1.06. Due to this factor, the company would most likely be considered riskier than the market average.
3. **Diversification -** Reduction of risk by investing in different types of securities rather than investing in only one security.
4. **Systematic Risk -** Market risk that cannot be reduced through diversification. Factors that effect the economy as a whole, such as changing interest rates.
5. **Unsystematic Risk -** Risk that can be reduced by diversifying a portfolio. This is a type of risk which is unique to a particular company and does not effect the entire market.
6. **Asset Allocation -** Diversifying across different types of investments using set percentages. For example, investing in Treasury Bills at 10%, Corporate Bonds at 20%, Common Stock at 50%, and Preferred Stock at 20%, instead of placing 100% of investable assets in one type of security.

Reading Stock Quotes

Are you interested in following your stock investments, but you just can't understand all the symbols in the newspaper and what they mean? Well here is a quick rundown on how to read your daily stock page. The headers at the top of each column should read something like this: **"52 Week Hi Lo Stock Sym Div Yld PE Vol Hi Lo Close Net Chg"**. The "52 Week Hi Lo" provides the high and low prices of the stock during the past year. For example, if the 52 week high is 82 7/8 and the low is 56 5/8 the high price of the stock was $82.88 during the past year and the low price was $56.63. The name of the stock is conveniently located under the word "Stock". The stock's corresponding symbol is located directly under "Sym". For example, under "Stock" you may find "GenElec". This means that this particular stock quote is for General Electric. The company's corresponding symbol, "GE", is right next to it's name. "Div" heads a column where you can find the total amount of dividends a company paid during the past year. For instance, "1.82" means that a $1.82 dividend per share was paid in the last year. Under "Yld" you will find the stocks dividend yield, which is simply the amount of the company's dividend divided by the closing price. Under "PE" you will find the company's "price/earnings ratio", which is the current market price (closing price) divided by the firms earnings per share. Under "Vol" you will find the volume (number of shares traded) of your company's stock on that particular day in 100's. The second set of "Hi Lo" provides the high and low price of the stock during the day. "Close" is simply the closing price of that stock on that day. The last column is "Net Change" which is the difference between today's closing price and yesterdays closing price.

Bonds, Stocks, and Treasuries...What are They?

You've heard the terms many times, in fact your portfolio may be comprised of all of them, but do you really know what they are? Well we'll start with the one that technically offers the least amount of risk, Treasury Bills. Treasury Bills are simply short term government debt issues. They are backed completely by the U.S. Government and thus are often considered risk free. In fact they are often used to determine the risk-free rate of return (the rate demanded by investors for putting off current consumption). However, since they do offer less risk, Treasury Bills also offer less return. Bonds on the other hand are a little bit more risky. They are debt issues used by many corporations that pay the holder a fixed amount of interest per year and the return of the principal amount upon maturity. Bonds are a popular financing mechanism for businesses because their interest payments are tax deductible, whereas the dividend payouts on new issues of stock are not. Bonds can often be broken down into different categories such as debentures, Eurobonds, "junk bonds", and zero and low coupon bonds. Debentures are bonds that are unsecured, they are not backed by any hard assets of the issuing company; if the company goes bankrupt, holders of debentures have no claim on assets. Eurobonds are bonds that are issued in a country different from the one in whose currency the bond is denominated. It does not necessarily have to be Europe. Zero and low coupon bonds are bonds that are sold at a substantial discount from their face value. There is no annual interest payment on them. The return is received in the appreciation of the bond over time. Junk bonds are higher risk bonds that offer a relatively high yield. They are usually associated with speculative or startup companies.



Stocks represent ownership in a company and can be divided into two classes; preferred stock and common stock. Preferred stock pays a fixed dividend in perpetuity (no maturity date). Common stock on the other hand has no limit on it's dividend payment. However, it carries the most risk, because dividends are only received from what is left after creditors, bondholders, and preferred shareholders claims have been satisfied. Also, dividends can only be received if they are declared by the company's Board of Directors. The Board of Directors may decide to retain the remaining earnings within the company, which allows common stockholders to earn a return through appreciation in the stock price. The chart above, shows the relationship between risk (measured by the standard deviation of average returns) in the light color and return in the dark color. Along the horizontal axis, 1 is the inflation rate, 2 is treasury bill, 3 is long term corporate bonds, 4 is common stocks. This chart demonstrates

<u>TELL</u> <u>US</u> <u>WHAT</u> <u>YOU</u> <u>THINK</u>!!

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(Continued from Q's & A's... Roth IRAs on page 2)

can withdraw funds from my Roth IRA? Immediately or five years or more?

(Continued on page 4)

A: As with any IRA, you can generally withdraw funds from a rollover Roth IRA immediately. However, for all distributions to be tax free, you must wait until the first day of the tax year after a five-tax-year period that starts with the most recent tax year in which you made a rollover contribution. For a rollover in '98, that would be January 1, 2003. Funds withdrawn before that date are taxable to the extent they represent earnings on the amount rolled over into the Roth, but the rules treat distributions as coming first from rollover contributions. In other words, you can withdraw the amount rolled over tax-free at any time, but withdrawals of subsequent earnings will not be tax-free until 1-1-03. **Note: The answer would be different if you were under age 59 1/2**