

KEYSTONE FINANCIAL PLANNING
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International diversification continues to increase returns and reduce risk

Happy New Year! The year 2006 was a great one for equity investors around the world as stock prices rose in 46 of the 50 countries whose equity market returns are reported by MSCI. Among these, only Israel, Jordan, Thailand, and Turkey saw their local stock market indexes slump for the year. The 2006 return for US stocks was 15.32% according to MSCI, placing it next-to-last among 23 developed markets (in dollar terms) and 42nd out of 50 countries in all. There were 36 markets with a total return greater than 20% (in dollar terms), and 19 had a total return greater than 40%. Nine of the top ten were emerging markets. So, the “moral of the story” is that international diversification can pay big rewards while reducing portfolio risk! In fact, international asset classes significantly outperformed their U.S. counterparts over the last five years.

The following chart shows the 1-year, 5-year, and 10-year performance of many DFA funds (representing different asset classes) compared to the S&P 500 Index:

DFA Fund / Index	1 Year Return (Period Ending 12/31/06)	5 Year Return* (Period Ending 12/31/06)	10 Year Return* (Period Ending 12/31/06)
<i>S&P 500 Index</i>	<i>15.80</i>	<i>6.19</i>	<i>8.42</i>
DFA U.S. Large Value	20.18	12.37	11.92
DFA U.S. Micro Cap	16.16	15.16	13.48
DFA U.S. Small Cap Value	21.55	18.90	15.84
DFA Real Estate (REITs)	35.26	23.35	15.17
DFA Int'l Large	24.86	14.46	7.93
DFA Int'l Large Value	34.15	22.26	11.58
DFA International Small	24.88	26.40	10.63
DFA Int'l Small Value	28.39	30.30	12.90
DFA Emerging Markets	29.17	25.88	10.16
DFA 2-Year Global Bonds	4.46	2.85	4.36
DFA 5-Year Global Bonds	3.89	4.33	5.45

Note: Returns for periods greater than 1 year are annualized. Top 3 returns are in **bold.*

IRAs are now charitable giving tools

IRA owners who don't think they will use all of their accounts in retirement have been given a brief opportunity to make charitable gifts directly from their accounts. A temporary tax rule approved this year allows IRA owners who are 70.5 or older to contribute up to \$100,000 to a charity without recognizing the contribution as taxable income. Direct contributions from IRAs were authorized recently in the Pension Protection Act of 2006.

Taxpayers have always been allowed to take any sum of money they want from their IRAs and give it to charity if they preferred. However, they had to recognize the withdrawal as ordinary income and pay tax on it. If they were able to itemize their deductions, they could take an offsetting deduction and avoid tax. But not all taxpayers can itemize their deductions, and other rules either limited the amounts they could give to charity or negatively affected their tax bills.

The new rule will allow retired taxpayers who do not have high incomes to make large, one-time gifts. The basic charitable giving rule limits a taxpayer to deducting gifts valued at up to 50% of their income. So a couple with a \$50,000 retirement income normally is allowed to deduct only \$25,000 in charitable gifts. But with the new rule they could make \$25,000 in deductible gifts and withdraw as much as \$100,000 tax-free from their IRA and donate that as well.

High income taxpayers who want to make a large gift from their IRAs also will benefit because they will be able to skirt other rules that limit their ability to deduct donations. Without the rule, large withdrawals from an IRA could push their income high enough that their itemized deductions would be reduced or phased out. Now they can do an extra \$100,000 in tax-free donations without hitting those limits.

Finally, middle-income retirees whose income is low enough that they escape tax on Social Security income will also benefit. Without the rule they would have had to recognize an IRA withdrawal as income, which would push their total taxable incomes past thresholds that then require them to pay tax on up to 85% of their Social Security incomes.

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