MOSAIC
FINANCIAL PARTNERS, INC.
a Wealth Advisory firm

May 2006

Effective Financial Strategies

The AMT in 2006 and Beyond

You've just done your taxes and figure you should get a nice refund. Then you remember you have to calculate the Alternative Minimum Tax (AMT) and find that instead, you now owe money to the government. It's no fun. AMT is applying to more and more U.S. taxpayers, often in high income tax states. For most, it is a "hidden tax" that catches us unaware.

The AMT was established in 1969 to ensure that a few hundred of the wealthiest Americans didn't take excessive deductions and pay less than their fair share of taxes. Contrary to intent, the AMT now ensnares nearly 4 million middleclass taxpayers, while at the same time proving avoidable by those with the highest incomes. And, without changes to the laws, eventually more than 17 million families will become subject to AMT!

Congress is in a bind. AMT is projected to collect almost $1 ***trillion*** over the next ten years. The size of the current budget deficit is such that they need these tax revenues, so unless they can cut spending, find other ways to tax the citizenry or change the whole approach to taxes, it is unlikely that the AMT will be entirely eliminated.

It therefore is important for each of us to

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Reminders and Notices from Mosaic

Proxy Voting

Mosaic Financial Partners, Inc has no authority to vote proxies on behalf of its clients. We will offer you assistance on proxy matters upon your request, but our clients always retain the proxy voting responsibility. Proxy voting is an important right of shareholders and reasonable care and diligence should be undertaken to ensure that your rights are properly and timely exercised.

If you have questions about how you should follow up on issues of proxy voting, please do not hesitate to contact your client advisor.

When I have a meeting in the SF office where do I park?

Two good choices: 1) Union Square Parking Garage is located 1 block away from our offices on Geary, between Stockton and Powell. The garage entrance is on the right hand (north) side of Geary Street across from Macy's.

2) The Sutter/Stockton Garage is approximately 2½ blocks away on Sutter at Stockton (there is also a Bush Street entrance) The rates at the Sutter/Stock garage are best for daily visits, during office hours.

Change of location—East Bay

As of the first week of May, our East Bay office has relocated to the lovely town of Lafayette at the following address: 3620 Happy Valley Road, Suite 100, Lafayette CA, 94549

Phone and fax numbers remain the same. The new location is easy to get to—it's just behind the Lafayette BART station. Bring your friends by to introduce them!

Stop the Paper … E-Delivery

Would you like to eliminate all those paper statements you get in the mail? Most of our custodians now offer the ability go paperless! You can receive your monthly statements, confirmations and most tax forms online. Schwab, Fidelity and TD Ameritrade each offer this option. However, enrollment works a bit differently with each. For Schwab or TD Ameritrade (formerly

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Waterhouse) — please call or email **Janette Rodriquez** our Client Services Specialist who can help you.

Janette@MosaicFP.com (415)788-1952 X 222

Fidelity Enrollment

You can enroll by going to Fidelity.com and signing in as a new user. At the Fidelity home page, select "Customer Login" (located in the first column of the page). Select "New User Registration" on the next page that opens and enter your social security number where requested. Simply follow the instructions provided from that point forward. Once you have logged in as a user, you can request that your account documents be delivered via e-mail. At the Fidelity website, just go to the "Customer Service" tab at the top right of the page. Select "Common Requests" and make your election.

When Mosaic Calls…

For your next appointment… Janette Rodriguez, our Client Services Specialist, may be contacting you in the upcoming months to schedule your next appointment with your advisor. Please note that Janette is contacting you on behalf of your advisor and your response is greatly appreciated!

2005 Tax Planning - It's Not Too Late …

Did you know that if you are self-employed and have filed for an tax extension, you still have an opportunity to take steps to reduce your 2005 tax liability? Most company-sponsored retirement plans had to be established in the same year for which the tax return applies. However, if you did not set up a plan, or haven't fully funded the one you have, all is not lost. You can still establish a 2005 SEP-IRA account up to the date you file your taxes (but no later than October 16, 2006). Contributions to such a plan will still be considered tax-deductible for 2005.

If you have employees and are making contributions on their behalf to a SIMPLE IRA, SEP IRA, 401(k), or profit sharing plan, you have until your business tax return filing date, plus extensions, to make these contributions. If your cash flow supports making contributions you can reduce your 2005 taxable income and benefit your employees at the same time.

For business owners (the rules are different for sole proprietors) this means you can contribute up to the lesser of — 25% of earnings or $42,000, for yourself and eligible employees. This will reduce your 2005 tax bill.

If you filed on extension and would like to set-up a SEP-IRA for tax year 2005, please give our office a call.

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understand how AMT works and how to avoid being subject to it. When you do your tax return, you have to do the calculations in the regular way first. Then you have to calculate AMT. You pay the higher amount.

Fundamentally, the AMT calculation uses the normal approach, and then takes away some of the tax benefits Congress has granted citizens over the years. These are referred to as "tax preference" items and include things like the standard deduction, parts of your medical deduction, any deductions for state and local income taxes or property taxes, and miscellaneous deductions.

Planning for AMT can be tricky and is often contrary to the approach for regular taxes. In the latter, you generally want to defer income and accelerate deductions. With AMT, it will often pay to do precisely the opposite. If you are not sure if you will be in AMT or not, you often have to wait until the end of the year, do a "practice" tax calculation, and then act accordingly.

To accelerate income, you might take prepayments of salary or bonus, redeem EE U.S. Savings Bonds or Certificates of Deposit, recognize short-term capital gains, convert tax-free bonds to taxable bonds or withdraw money from an IRA or other retirement account.

To defer deductions, it is often possible to depreciate rather than expense business furniture and equipment. You might also be able to hold off on paying non-AMT deductible items. Sometimes property taxes or state income taxes can be deferred into the following year.

If you own tax-free bonds, some are truly tax-free, but those referred to as "private activity bonds" may be taxable under AMT.

Incentive stock options (ISOs) are particularly pernicious. The difference between the strike price of an ISO and the fair market value on the date of exercise is considered income by the AMT, regardless of whether you've actually sold the stock and received the cash. Be sure to consult with your tax advisor prior to exercising ISOs to develop a tax efficient strategy.

The AMT is unfair and costly to plan for, but plan you should! Minimizing the tax cost of AMT is best done in close cooperation with your tax advisor.

Why Don't You Sell that "Dog"? Fund Performance vs. Asset Allocation

We occasionally receive calls from clients asking why we continue to hold a given mutual fund that has gone down in value over the last few quarters. The question is often: "Wouldn't it make more sense to dump that ABC Bond Fund that has lost money and buy more of the XYZ Emerging Market Stock fund that has been doing great?"

Well, in a word, "no". In fact, we are probably more inclined to do the opposite! Remember that our investment focus is primarily on your asset allocation — what percentage of your portfolio is allocated to the various asset classes we employ (such as US Small Stocks or Short Tem Bonds). Studies have shown that asset allocation has a far greater impact on the variability of investment returns than individual security selection or market timing (jumping in and out of the market trying to guess when a given sector is going to go up or down).

My broker was E.F. Hutton, and E.F Hutton said ...

All our clients have a written Investment Policy Statement (IPS) which includes an asset allocation that is designed to meet your long term goals. We believe you'll have the highest probability of achieving your goals by adhering to a sound investment plan and avoiding ad hoc changes to your asset allocation based on recent events.

If that "hot" emerging market fund has generated above average returns for a while, it may have pushed your Emerging Market holdings above the desired percentage of your total portfolio. This means you are now exposed to more risk in this volatile sector than is intended in your investment plan. To manage this risk, we will sell some of your emerging market holdings to bring this allocation back into its target range. What are we going to do with the sale proceeds? You guessed it! We will purchase more of another asset class that is BELOW its target allocation (bringing it back up to its target range). This often means we are adding to asset classes that have had recent poor relative performance.

Recently, bond funds have lost value due to rising interest rates. But this does not mean we should abandon the asset class. To achieve your desired long term expected return with the appropriate level of risk, we need to maintain the correct allocation to ALL of the asset classes that make up your diversified portfolio. Most of our clients hold nine or more distinct asset classes. Almost by definition, at any given time, some of these nine will be up in value while others will be down. It is how these asset classes work together over time that is important. We suggest you monitor your overall portfolio performance and not get too distracted by the performance of any individual component in a given time period.

So when DO we sell a fund? From a performance perspective, a fund is sold if it is no longer a solid performer within its asset class. We evaluate a fund's performance relative to its peer group over multiple time periods (such as the last one, three and five years). We usually ignore short term periods of underperformance since these are not uncommon even among the best funds. If one of our favorite funds is not keeping up with its peers, we will try to understand why and if there isn't a satisfactory explanation, our Investment Committee may decide to sell the fund from our client accounts.

Market returns are often derived from "buying low and selling high." This approach requires you to periodically sell winners while buying what may appear to be losers. This is one of the hardest disciplines for investors to follow.

Aside from performance, we may sell a fund for other reasons, such as management changes, increased expenses, or if the fund changes its investment style and no longer represents the desired asset class.

Keep in mind that the rebalancing process described in your IPS provides the discipline to "Sell High, Buy Low" and that usually works out pretty well!

Around the Office ...

Education A Continuing Affair ... In early April, the Mosaic advisory team attended the two-day FPA Northern California Regional Conference. **Norm, Kevin, Susan, Mary, Holly, David, Linda, Sabrina** and **Dave** all attended. In early May, **Norm, Linda, Holly** and **Sabrina** all attended the four day FPA "Retreat" in Scottsdale Arizona. This highly interactive conference focused on advanced planning issues and strategies. **Kevin** continues his work on the FPA national conference to be held in October. Kevin is overseeing the educational sessions on "investments." **Susan Morse's** many hats include being the Chief Compliance Officer for our firm. She recently attended a multi-day conference on Compliance and the latest topics in that rapidly changing arena. In April, **Juliet Wisdom** completed the Dale Carnegie Leadership Training for Managers course. **Annette Brinton** just completed a graduate level Estate Planning course and is now preparing to sit for the CFP exam in July 2006.

Coming soon ...

A Client Appreciation Event

An evening with

Martin Muller at the Modernism Gallery

Thursday June 29 6-8 PM

RSVP 415.788.1952

At the Podium... In March, **Kevin Gahagan** presented "Hedge Funds – The State of the Industry" to the Sacramento American Association of Individual Investors. **Kevin** also recently conducted workshops for our clients on the new Medicare D prescription drug plan. In April **Sabrina Lowell** presented a case study to students in UC Berkeley's final course in the Personal Financial Planning course; she also discussed industry best practices as implemented at Mosaic Financial Partners. **Dave Cowles** was the star of the show for a video crew from Charles Schwab for their seminar on "Best Practices in the Investment Management Industry." Dave discussed our technology and quality control procedures to process our client Quarterly Performance Reports. In May **Holly Gillian Kindel** and **Sabrina** participated in a "Scenario Learning" presentation at the FPA Retreat, dealing with helping clients plan for changing circumstances in their lives. Holly, a former screen writer, wrote the 15-person script which portrayed two possible future scenarios. In February **Norm Boone** and **Linda Lubitz** spoke to the Tucson FPA chapter about using an IPS in their practice.

Giving Back to the Community … **Holly** has helped develop a pioneering 16 week course at Golden Gate University that teams up veteran financial planners and planning students to provide comprehensive financial plans for economically disadvantaged families. In April **Sabrina** helped organize the annual Patron's Reception for the Spinsters of San Francisco, all proceeds of which go toward the positive development of youth, ages 6-14 in San Francisco's Visitacion Valley.

Professional Developments … **Norm** and **Linda** have spent the last three years working with programmers to create a software program to help advisors and others easily create a flexible, high quality investment policy statement. In April, they were pleased and relieved to release their new product. You can learn about it by watching the Video Tour at www.IPSAdvisorPro.com. Initial sales have already made it a successful launch.

Employee Spotlight

We've had two new additions to our team.

Sombo Nkhwazi is our new intern from Malawi, Africa. Sombo graduated from Principia College, Elsah, IL in March 2006 with a degree in Business Administration and Economics. He has been working on number of special research projects and has been assisting Dave Cowles in our investment department. He will go on to business school starting this September at the University of Portland. His ultimate goal is to run an investment company in Africa, investing in African companies. In his free time, he likes to read, travel and discuss politics and economics.

Our wonderful and friendly receptionist and office assistant **Chenda Sar** is our most recent full-time addition. She is from Oakland and is a passionate A's fan, attending as many home games as she possibly can with any one of her five sisters (no brothers). She graduated from Oakland High School and attended Laney College. Prior to joining Mosaic, Chenda worked for four years as the receptionist for Seneca Center, a non-profit school for children with learning disabilities between the ages of 5 to 18. Besides rooting for the Oakland A's Chenda's other passion in life is Poker. Apparently, she is quite the card shark.

When to take Social Security?

One of the more confusing issues surrounding Social Security is deciding when to begin taking retirement benefits. Congress has raised the "full retirement age," but not the early retirement age. Early retirement age is still 62. Anyone can begin receiving their Social Security benefits at that age. But, if you want full benefits, you must wait until your full retirement age (FRA). Your FRA depends on your year of birth. If you were born in 1938, the FRA is 65 and two months. Born in 1939, it's 65 and 4 months. 1940: 65 and 6 months ... And so on!

For every month you start receiving benefits early, your benefit will be reduced by 0.525% as compared to what you would otherwise receive if you wait until reaching your full retirement age. For example, persons who retire this year at age 62 (or 46 months before reaching their full retirement age) will get a check almost 24% lower. Over time, the size of that early retirement discount will grow; by the year 2022, it will reach 30%.

Will you come out ahead by starting early with smaller benefits or by holding out for larger payments that you won't collect for as long? The answer is highly personal and depends on a number of factors including: your current cash needs, family longevity, whether you plan to work while in retirement, and whether you plan to spend or invest the money. In simple terms, this is a bet on your longevity. Those who die young are better off taking their checks early. Centenarians, on the other hand, come out well ahead if they wait for a larger benefit.

Here's how it works: let's say that in January you turn 62 and that you will qualify for $13,500 a year immediately. You'd get $18,000 annually if you waited until your Full Retirement Age of 66 (adjusted for inflation).

The math analysis is fairly simple. If you receive benefits of $13,500 per year starting at age 62, you will have received a total of $216,000 when you turn 78. If you wait for four years and start benefits at age 66 (getting $18,000 a year) you will also receive a total of $216,000 before turning 78. But, every year thereafter, your ongoing benefit will be greater.

If you think it's likely that you will live past age 77 and you don't need the cash income right away, you would be wise to wait until reaching your full retirement age.

Moreover, if you assume that your Social Security payments increase by a 3% inflation factor per year, you will have gotten more money in total from Social Security beginning in your 75th year and each year thereafter.

If you take the time value of money into account and assume that these "early" payments will be invested at 6% (or that other money you have invested won't need to be spent) then your "break even" period reverts back to age 77. Simply stated, if you think it is likely that you will live past age 77, and you don't need the cash income right away, you would be wise to wait until full retirement age before starting your benefits.

According to Social Security life expectancy tables, a 65 year old man has on average 16.1 more years to live. In other words, there's a 50% chance the average man will see age 81. A 65 year old female is expected to live to 84. In both cases, the average 65 year old would live beyond the Social Security "break even" age.

But for many people the odds are even better. The better educated you are and the more you earn, the healthier you're likely to be and the longer you're likely to live. Using longevity stats that reflect this fact, the odds of a 62-year-old living to 81 are closer to 63 percent for a man and 75 percent for a woman. And the odds are improving because of advances in medical technology.

One other factor to consider is that if you take Social Security ahead of your Full Retirement Age and you continue to work, either as a consultant or as an employee, your Social Security benefits can be reduced by $1 for each $2 you earn above a set limit ($12,480 in 2006). Thus, if you plan to work while drawing down your Social Security, the value of your benefits will be significantly reduced, until you are past your Full Retirement Age. At that point, you may earn any amount and not see any reduction in your Social Security payments.

Would it ever pay to postpone benefits even longer? It might—the Social Security Administration gives "delay credits," which increase your payments by 5.5% - 8% (depending on your birth year) for each year you wait after full retirement age, up to age 70. For this to be a benefit, you would have to live well into your 80's.

Call us if you'd like help with this issue.

Financial Planning & Investment Management

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In This Issue:

Thoughts to Live By ...

"If you doubt you can accomplish something; then you can't accomplish it. You have to have confidence in your ability, and then be tough enough to follow through. -- **Rosalynn Carter**

"When you find peace within yourself, you become the kind of person who can live at peace with others." -- **Peace Pilgrim**

"What you make of your life is up to you. You have all the tools and resources you need. Your answers lie inside of you." -- **Denis Waitley**

"Always bear in mind that your own resolution to succeed is more important than any other one thing." -- **Abraham Lincoln**