



Does The European Union Matter To U.S. Investors?

You may not have noticed that the European Union is marking its 50th anniversary this year, and it probably doesn't seem like a big deal in any case. But for investors, the EU's metamorphosis from its original six-member country club to a confederation of 25 nations has growing significance. EU member countries, now with a population of close to half a billion people, are committed to creating a barrier-free trade zone and greater economic efficiencies, with the ultimate goal of operating under one official currency, the euro. Already, the EU is one of the world's three major trading blocks, rivaling those of the United States and China/Japan, says Campbell Harvey, an international business professor at Duke University's Fuqua School of Business. "Does this matter to U.S. investors? Yes, absolutely," Harvey says.

Geographic expansion of the EU, which recently added several central and eastern European members, is translating into financial opportunity and market clout. Last year, the gross domestic product for the eurozone, made up of the countries that have adopted the euro, rose 2.7%, while shares in European companies had a fourth consecutive year of gains, as increasing numbers of U.S. portfolio managers and individual investors take notice. "U.S. investors have tended to dismiss Old Europe as a place where nothing exciting is happening compared with the hype about China or India," says Dan Lefkovitz, a senior mutual fund analyst at Chicago-based Morningstar. "But that means overlooking many of the world's best companies. Western European companies have benefited from deregulation, increasing consumer demand, and other economic

reforms, and the European stock markets have been some of the world's best performers in recent years."

The Dow Jones Stoxx 600 Index, which tracks Europe's 600 largest publicly traded companies, was up 17.8% in 2006, Britain's FTSE 100, which tracks 100 companies with the largest capitalization on the London Exchange, gained 10.7%, Germany's DAX 30 index of blue-chip stocks rose 22%, and the French CAC 40 index of the largest stocks on the Paris Bourse climbed 17.5%.* U.S. investors nearly doubled their allocation to European stock mutual funds, to about \$6 billion last year, according to Boston fund consultant Financial Research Corp. And U.S. mutual funds devoted to international investing now have about two-thirds of their assets in European countries, says Lefkovitz, with many portfolio managers attracted by the relatively modest valuations of companies there. Whereas U.S. shares trade at an average of 16 to 17 times 2006 earnings, price-to-earnings ratios for Big European companies are in the 13 to 14 range, according to Standard & Poor's in New York.

Economic expansion, as well as a wave of merger and acquisition activity, has bolstered European companies' profits, says Lefkovitz, as has a U.S. dollar that has lost value against the euro. Yet the euro's rise, likely to continue, could ultimately have negative ramifications for European companies that have earnings in dollars, says David Wyss, chief economist at Standard & Poor's.

That's one reason Wyss and others expect eurozone growth to slow to about 2% this year. Climbing interest rates pose another challenge. "The biggest problems

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Diversification: Going Beyond The S&P 500

As I write this article, the S&P 500 has finally surpassed the previous record set on March 24, 2000. A portfolio fully invested in this large-cap stock index over the last seven years would just now be getting back to even. This is a prime example of how diversification and asset allocation benefit investors.

A diversified portfolio using the Modern Portfolio Theory of asset allocation may include asset classes such as bonds, small-cap stocks, international stocks, real estate, large-cap stocks, and sometimes alternative investments like hedge funds. The benefit is evident when comparing their performance versus large-cap stocks over the last seven years.

As of December 31, the Russell 2000 small-cap index returned 13.56% on average over the last three years and 11.39% on average over the last five years, versus comparable returns of 10.44% and 6.19% for the S&P 500 and 19.93% and 14.98% for international stocks, as measured by the MSCI EAFE index.

As of March 31, the Dow Jones Wilshire REIT index return returned 24.09% on average over the last three years and 22.76% on average over the last five years.

With proper asset allocation and periodic rebalancing, investors can take advantage of multiple asset classes to increase returns and minimize risk.

Charitable Giving Through Insurance

The need for life insurance, once obvious as a way to protect your family, may decrease as your wealth expands. But rather than simply letting an old policy lapse, you could redirect the benefits from your heirs to a charity. Or you might want to buy new life insurance to compensate other beneficiaries for a philanthropic gift that reduces their inheritance. Here are several potential strategies.

Changing beneficiaries.

This is the simplest way to go, and it lets you call the whole thing off if you change your mind. But merely making a charity the beneficiary of an existing policy has several limitations. You don't get any tax benefit while you're alive, and the nonprofit you're supporting also doesn't gain until your death. Moreover, because you continue to own the policy, the proceeds will be potentially taxable as part of your estate, though your heirs should be able to deduct the value of the charitable gift.

Giving away existing insurance.

This can work whether you have a term or whole-life policy, though the pros and cons vary by type of insurance. In either case, the basic strategy is the same. You transfer

ownership of a policy to a charitable organization, which can then name itself as beneficiary. With term insurance, this gift has little or no current value, greatly limiting your charitable deduction. But if you choose to keep paying the

premiums, you can deduct the amount you give each year, and assuming the policy remains in force, the charity gets the death benefit. The gift of a whole life policy, in contrast, will earn you an immediate deduction for the insurance's current cash surrender value, which

could be substantial. In addition, you could take responsibility for future premium payments, thus earning ongoing annual deductions.

Meanwhile, your chosen philanthropy benefits from greater flexibility than it would have if it had received a term policy. It owns an asset it could choose to cash in at any point, or it might be able to borrow against the policy.

Buying new insurance to offset a gift. Suppose you'd like to make a big charitable gift during your lifetime—say, to endow a chair at your alma mater. The president of the college will be your new best friend, and you'll get a major charitable deduction, subject to IRS limits, for the value of the cash or securities you gave away. But to make sure your other heirs are none the poorer for your philanthropic splash, you could purchase a new life policy equal in value to the assets you gave away. And if you place the new insurance in an irrevocable life insurance trust, the proceeds won't be subject to estate tax.

There could be several creative variations on these basic themes—for example, creating a charitable remainder trust that pays you a lifetime annuity you use to fund an insurance policy for your heirs. We can work with you and your attorney to craft a philanthropic plan that fits your needs. ●



When Your Financial Advisor Accepts The Role Of Fiduciary,

In the world of financial advisors there are myriad labels, certifications, registrations, and other terms that tend to be meaningful only to industry insiders. But one distinction could be crucial: An advisor bound by contract or law to serve as a “fiduciary” is obligated to act solely in your best interest. That’s different from others who may seem to work for you but in fact owe primary allegiance to the companies that pay them.

With other professionals, such as lawyers and CPAs, there’s typically a fiduciary responsibility that requires them to act in clients’ best interests.

But for financial advisors, fiduciary status is not yet standardized or guaranteed. So while you may think your stockbroker offers unbiased advice, he or she is probably receiving a commission for selling you products. To complicate matters, even a fee-based advisor who charges for advice may not be acting solely in your interest.

Not surprisingly, there’s widespread confusion among consumers on this point. According to a recent survey by a major financial services firm:

- More than half of the investors interviewed believed both stockbrokers and Registered Investment Advisors

(RIAs) have an obligation to act in the client’s best interests.

- Three out of four investors didn’t realize that only independent RIAs have a fiduciary duty to their clients.

RIAs must inform clients of potential conflicts of interest, and they’re legally obligated to act as a fiduciary. They have a fiduciary duty to act in their clients’ interest at all times. Stockbrokers don’t have the same obligation. Brokers must make recommendations that are suitable but are not required to adhere to the higher standard of care—to always do what’s in your best interest—as a fiduciary.

Five Financial Ideas For Grandparents

Spoiling your grandchildren with extravagant gifts may be fun, but you're not really doing them—or yourself—any favors. Instead, it may be wise to look for ways that help grandchildren but that also make financial sense for all of you.

Your long experience handling money matters is one invaluable gift you can pass along. Sharing your savvy not only helps grandkids develop healthy financial habits but also to understand family and cultural values. So tell them about your first job, how you started a business, and financial goofs you've made, such as spending too much or getting suckered into bad investments. "There's a big legacy gap," says Nathan Dungan, author of *Prodigal Sons and Material Girls: How Not to Be Your Child's ATM*. "Grandparents aren't having these conversations with the grandkids."

But don't leave your own children out of the loop. Make sure your advice and giving strategies don't conflict with their plans or guidance for your grandchildren. Here are several ways you might help:

Leverage your gifts. A grandparent can now give as much as \$12,000 a year tax-free to each child and grandchild. If you have a large family and make such gifts for several years, you could substantially reduce your taxable estate.

But rather than simply putting cash in the grandchildren's pockets, consider creative alternatives. For example, you might open a custodial savings account for a grandson and match what he saves. Or you could establish a brokerage account and use your contributions to help your granddaughter learn about investing. But stick to broad mutual funds rather than individual stocks. Choosing the wrong stock could lead to deep losses and discourage your would-be Warren Buffett.

Take care of college. Setting up a state-sponsored 529 college savings plan for your grandchild brings benefits for both of you. Start early and kick in the annual gift-tax-free maximum, and your grandson or granddaughter should be in fine shape when tuition comes due. Money in 529 plans grow tax free and withdrawals for qualified college expenses aren't taxed, either. And, if you want to accelerate giving, you can make five years' gifts—a maximum of \$60,000—all at once. Moreover, because you control the plan, you don't have to worry about a spendthrift scion squandering the money. And, if you didn't get around to starting a 529? Consider sending a tuition check directly to your grandchild's college. It won't count against your \$12,000 annual gift-tax exemption.

Put a roof over their heads. First-time homebuyers often earn enough to qualify for a mortgage but lack cash for a

down payment and closing costs. Your gift could make up the shortfall. But there are other options, too. You could make a low-interest or interest-free loan, though that may raise complicated tax issues. Or, if qualifying for a home loan is a problem for your grandchildren, you could co-sign a mortgage. Some financial companies offer programs allowing grandparents to pledge securities as collateral for a grandchild's mortgage, so you can lend a helping hand without the expense and taxes of liquidating personal holdings.

Guide with your gifts. One alternative to direct giving is to fund one or more type of trusts, which can be customized to fit many financial and personal situations. An incentive trust, for example, could be instructed to distribute funds to your grandchildren in installments, at specified points in their lives, and may tie payouts to your grandchild's accomplishments—reaching a certain income level, for example, or getting a college or graduate degree. But tread carefully, warns Dungan. "You need to help a grandchild develop healthy financial habits before trust distributions start," he says. And be careful about the kinds of hurdles you set up. "You want your grandchildren to be connected to their life passions, not yours, so don't strive for too much control," he suggests.

Encourage philanthropy. There are several options for helping your grandchildren learn the value of charitable giving, and many of these vehicles also offer estate tax advantages. For example, you could transfer assets from your estate into your own family foundation, though to be effective, a family foundation needs an initial commitment of as much as \$1 million. Your grandkids could get involved by helping screen grant applications or serving on the foundation's board. A less expensive alternative is a donor-advised fund, which also lets grandparents and grandchildren confer about what charities to support. "This is like having your own foundation to support causes you believe in, but without the hassles and paperwork that go along with operating one," Dungan says. ●

You Have A Foundation For Trust

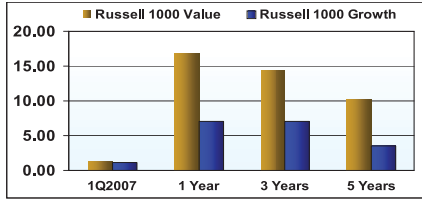
The distinction between an advisor who is a fiduciary and one who is not could be critical when weighing an advisor's recommendations. There may be a hidden agenda—for example, if an advisor is receiving better commissions for selling you one mutual fund instead of another.

Rules recently clarified by the Securities & Exchange Commission permit brokers to give you investment advice on a fee basis and not act as a fiduciary. In these instances, a broker can only give you advice about one or two issues—such as your retirement plan or investing. If a broker wishes to give you comprehensive financial

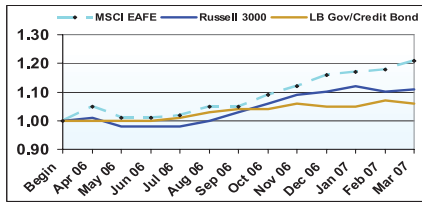
advice that spans insurance, taxation, college planning and estate planning as well as investing and retirement planning, the broker must accept his or her role as a fiduciary to you. He must disclose that he will begin giving you advice as a fiduciary and then tell you when he has stopped acting as a fiduciary and reverted back to his role as your stockbroker.

Working with someone who is a fiduciary, or will sign an agreement to act as a fiduciary, doesn't guarantee you'll profit from the advisor's recommendations. But it does give you a greater assurance that you're both sitting on the same side of the table. ●

Market Data Bank: 1st Quarter 2007



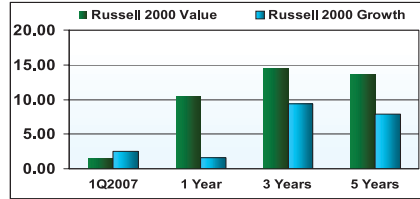
LARGE VALUE VS. LARGE GROWTH
Both growth and value investment styles delivered relatively modest returns in 1Q07 as volatility returned to the market. Among large-cap companies, value outperformed growth 1.24% versus 1.19%.



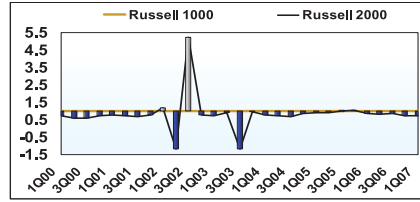
FOREIGN, US STOCKS & US BONDS
While U.S. markets retrenched in 1Q07, the rally went on overseas. In the year ended March 31, U.S. stocks gained 11%, U.S. bonds returned 6%, and foreign shares soared by 21%.

Small-cap stocks represented by Russell 2000 index, large-cap stocks represented by Russell 1000 index. Foreign stocks represented by the Morgan Stanley Capital International's Europe, Australia, Far East Index, and US bonds by the Lehman Bros. Government/Corporate Bond Index. P/E ratios exclude negative earnings. Small-cap stocks tend to be more volatile than large-caps. Bonds offer a fixed rate of return while stocks will fluctuate. Indices are unmanaged and do not represent any specific investment. Foreign investing involves special risks, including political unrest, economic instability and currency fluctuation. Past performance does not indicate future results.

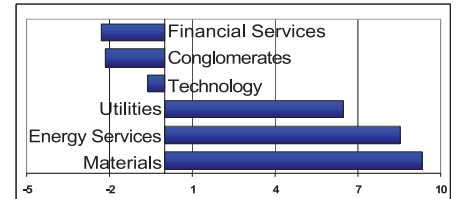
Source: Russell/Mellon



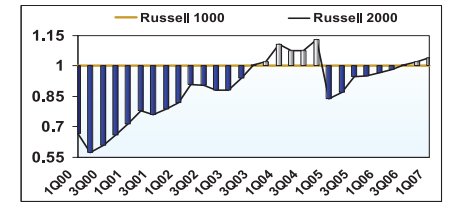
SMALL VALUE VS. SMALL GROWTH
Small-cap company gains were also modest in 1Q07, with growth trumping value 2.48% versus 1.46%. Value stocks over the last five years have consistently beat returns on growth stocks.



LARGE VS. SMALL STOCK EARNINGS
Large and small companies both boosted their profits in 1Q07, but giants found growth easier to come by. Small-caps achieved a profit expansion rate of 74% of that reported by their large-cap peers.



THREE BEST AND WORST SECTORS
High demand pushed materials producers up 9.32% and energy service companies up 8.53%, while caution favored utilities (up 6.47%). Tech and financial shares sank, as did conglomerates.



PRICE-TO-EARNINGS RATIO
Continued small-cap outperformance meant large companies were relatively undervalued. Every \$1 investors thought large-cap earnings were worth translated into \$1.04 for the same small-cap profit.

European Union Matter

(Continued from page 1)

involve the EU's core economies—France, Germany, and Italy,” says Wyss. The big three share common issues, such as high taxes that support generous welfare benefits and laws that make it costly and time-consuming to lay off workers. “The EU hasn't been an effective forum for working out those problems,” says Wyss.

Nor will the addition this year of Romania and Bulgaria, two of the region's poorest countries, do much to spark growth in the EU. Meanwhile, other countries waiting to get in, including Croatia and Cyprus, also won't bring much economic clout. And the latest opinion polls in Turkey, a more significant potential EU entrant, show a majority now opposed to joining Europe's ranks.

The EU faces a wide-ranging political agenda this year. There is a push to deregulate Europe's energy markets and to form a new EU charter after France and Netherlands voted against ratifying a European constitution in 2005. But for investors, there's a bigger issue—whether the euro can become a major global reserve currency that will compete effectively against the U.S. dollar. Though launched in 1999, the euro has faced many hurdles in being widely adopted, Wyss notes. Several EU member nations have had persistently excessive budget deficits, new members have tended to be economically weak, and there have been ongoing questions about the effectiveness of the European Central Bank, which manages the currency and sets monetary policy. Only 12 of 25 EU members use the euro, while the United Kingdom and

several others continue to prefer their sovereign currencies, and recent opinion polls in Germany, which has the euro, show most citizens would like to return to the mark. “That's not going to happen,” says Wyss, though he expects few other EU members to convert to the euro in the near future.

All of this clearly makes a difference for U.S. investors, who must weigh Europe's prospects against those of other leading international markets. We can help you determine how much of your portfolio might profitably be allocated to Europe, and how such investments may help you achieve your long-term financial goals. ●

*An individual cannot invest directly in an index and return may be worse than that of the index. Past performance is no guarantee of future return. Risks of foreign investment include currency fluctuations, economic, political or social instability.

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