Alban Investment Management, LLC Newsletter for July 2003

The newsletter normally has three sections. **Investment and Economic Indicators** gives a brief snapshot of some current and predicted conditions. **Investment Product of the Month** provides information on a selected investment product or opportunity. **Investment Topic of the Month** provides information on an investment concept. Past issues of the newsletter can be found at **www.alban-invest.com**.

In this month's newsletter, the Product and Topic sections are replaced by a discussion of some investment implications of the recently enacted federal income tax law changes.

If this newsletter was forwarded to you and you wish to receive future issues, please e-mail me at **rcalban@alban-invest.com** so that I can add your e-mail address to the distribution list. Or, if you want to be dropped from the list, please e-mail me at the same address.

My firm provides two services: (1) the development of comprehensive, long-term investment plans to achieve client objectives, and (2) the on-going management of investment assets. My goal is to help clients achieve their investment objectives through a combination of sound investment principles and practical knowledge. To learn more, visit **www.alban-invest.com**, or e-mail me at **rcalban@alban-invest.com**.

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Investment and Economic Indicators

Category	Total Return YTD 6/30/2003	Comments
1. High Yield Bonds	**+17.2%**	cyclical peak has probably been reached
2. US Equities Overall	**+12.9%**	strong recovery in April/May/June
Technology	+19.3%	best performing sector
Telecommunications	+2.1%	worst performing sector
3. Developed World Equities	**+7.7%**	very strong in May/June
New Zealand	+26.1%	best performing country
Netherlands	+1.2%	worst performing country
4. Investment Grade Bonds	**+4.3%**	
5. Municipal Bonds	**+3.7%**	unusually high rate relative to Treasuries
6. Money Markets	**+0.6%**	below inflation rate

Country	Projected 2004 GDP growth rate	Comments
7. United States	3.4%	strong recovery expected in 2004
8. Japan	0.8%	weak recovery
9. Germany	1.2%	weak recovery
10. Great Britain	2.5%	
11. France	1.9%	weak recovery

	Interest Rates on 10 Year Gov. Bonds	
12. United States	3.53%	likely to rise

13. Euro Area	3.82%	direction unclear
14. Japan	0.88%	likely to remain very low

15. % change in exchange rates since 1/1/03

Euro to $	+9.7%	euro weakened a bit in June
Lb. Sterling to $	+2.9%	
Yen to $	-0.8%	Japanese gov. continues to intervene

Note: The strong euro is favorable to US exports going into Europe.

Federal Tax Law Changes & Implications for Investments

Changes to the federal tax laws were signed into law on May 28, 2003. Many of these changes have sunset provisions that cause them to expire at various times in the future. For the purposes of this discussion, I assume these changes will become permanent. **NOTHING HEREUNDER IS TAX ADVICE! Consult a tax professional for tax advice.**

Some of the key changes for individuals:

1. Reduction of tax rates, starting in 2003. **New rates: 10%, 15%, 25%, 28%, 33%, 35%**
Old rates: 10%, 15%, 27%, 30%, 35%, 38.6%

2. The break between the 10% and 15% brackets was increased to **$7000** of taxable income (from $6000) for single taxpayers, and to **$14,000** (from $12,000) for married taxpayers filing jointly.

3. For married taxpayers filing jointly, the break between the 15% and 25% brackets was increased to **$56,800** (from $47,450).

4. The standard deduction for married taxpayers filing jointly was increased to **$9500** (from $7350).

5. The maximum child tax credit was increased to **$1000** (from $600).

6. The tax rate on net long-term capital gains realized after May 5, 2003 was reduced to **5%** (from 10%) for taxpayers in the 10% and 15% brackets, and to **15%** (from 20%) for taxpayers above 15%. The new rates to not apply to collectibles gain, section 1202 gain, and unrecaptured 1250 gain.

7. **Most dividends**, from either US or foreign corporations, **are now taxed at the long-term capital gains rate**, rather than at ordinary rates.

8. The alternative minimum tax exemption amount was increased.

Some of the key changes for businesses:

1. The special 1'st year depreciation rate for qualified property acquired after May 5, 2003 was increased to **50%** (from 30%).

2. The limit on section 179 expense deduction was increased to **$100,000** (from $25,000).

What are the implications of these tax law changes for investors?

1. The tax cuts are expected to **stimulate economic growth.** Economic growth usually leads to improved corporate

profits, which in turn lead to **increased equity** values. The growth rate of the US economy is expected to be about double the rest of the developed world, due in part to the stimulation of these tax cuts.

2. The tax cuts on capital gains and dividends will mainly **benefit equities**, rather than fixed income securities. This is likely to create additional demand (and upward price movement) for equities, at the expense of fixed income securities.

3. The lower tax rate on dividends will probably lead to **increased dividend payouts** from corporations (especially corporations with excess cash). This has several long-term benefits to the economy and to the corporate sector. First, excess cash paid as dividends reenters the economy and can be invested by individuals into other more promising investment opportunities. Second, corporations will become less dependent on using retained earnings as their source of new capital. Instead, corporations will become more dependent on raising capital from the capital markets. Raising money from the capital markets usually adds greater discipline and objectivity to capital budgeting--and tends to result in a better selection of projects. This will tend to improve the performance and value of corporate equity over the long-term.

4. Investors seeking **current income**, particularly those in high tax brackets, will be attracted to stocks that pay **high dividends**. The highest tax rate on dividends is 15% versus a rate as high as 35% on interest income. As a side note, foreign corporations often pay higher dividends than US corporations--and so foreign stocks may get some extra demand from the lower tax on dividends.

5. **Some dividends do not qualify for the lower rate.** For instance, dividends paid by Real Estate Investment Trusts (REITs) will continue to be taxed at ordinary rates. Thus, REITs should be held in tax-deferred accounts, if possible. Any portion of dividends paid by mutual funds which are attributable to interest income do not qualify for the lower rate. In general, securities that have taxable interest should be held in tax-deferred accounts, if possible.

6. The lower long-term capital gains rate will encourage investors to **hold investments for at least a year**. Short term capital gains are taxed at the higher ordinary rates--and the difference between ordinary rates and capital gain rates is now greater.

7. The portion of an investor's portfolio with high dividend paying stocks should be mainly located in a **taxable** account. The benefits of the lower tax rate on dividends is wasted in a tax-deferred account.

8. The lower tax rates on long-term capital gains and dividends **reduce the tax benefits** from variable annuities and tax-deferred accounts. This will probably lead to more assets being held in taxable accounts.

9. Creative ways will be sought to take advantage of the **very low tax rate of 5%** on capital gains and dividends for taxpayers in the 10% and 15% brackets. For a single person, if taxable income is below $28,400 for 2003, capital gains/dividends qualify for the 5% rate. Single people include children. Children (14 or older) pay taxes based on their income and bracket, not based on their parents' bracket. So, if parents in a high tax bracket gift assets to children, the children will likely pay a much lower tax rate on capital gains/dividends than the parent. There are other implications of placing assets with the child, including an impact on college financial aid eligibility. This technique should not be undertaken without a thorough analysis of the pros and cons.

In sum, the recent **tax law changes will tend to increase the attractiveness of equities** compared to fixed income securities. This does not mean that investors should radically change the target asset mix of their portfolios. But, it may be appropriate to slightly increase the equity portion of your portfolio in response to the tax law changes and to adjust the mix of holdings between taxable and tax-deferred accounts.

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