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I. TD Waterhouse to Merge with Ameritrade:

Earlier this year, it was announced that Toronto Dominion, one of Canada's largest banks, had agreed to sell its US brokerage business TD Waterhouse ("TDW"), to Ameritrade. A s TDW is the custodian of more than $13 million of client and personal assets, this sale/merger is of more than passing interest. As Ameritrade is to be the new parent company, our interest and concern is heightened. In September, TDW and Ameritrade bega n submitting filings to various US regulators. The merger is expected to be completed in early 2006.

TDW has had two principal lines of businesses: first, discount brokerage for individuals. This division is advertised extensively on television, often featuring actors from the "Law and Order" television series. Second, custody and transaction services for independent investment advisors. This is the division with which we are concerned. It has been announced that the current president of TDW will " be responsible for overseeing the independent advisor business of the combined TD Ameritrade." There may be some change to the online systems which allow me to assist you, but that's largely my problem. We will be watching and informing as this merger oc curs.

I don't believe clients have much cause for concern. The names on the monthly statements and trade confirmations will change, there may be some differences in formatting in those documents and in the website where you obtain information on your acc ounts, but these should be relatively minor.

The best news is that, if you have access to the internet, and wish to reduce the amount of paper you receive from TDW, you will be able to do so. Here is the text of an announcement from TDW, dated last week:

"*Statement, Confirmation, Tax Document Electronic Delivery*

> "…clients can now choose to receive account statements, trade confirmations, and tax documents electronically via e-mail notification or continue to receive these documents through traditiona l U.S. mail delivery. By choosing email notification, clients simply log on to AdvisorClient.com and view their documents from the Account Documents page."

Smartt comment:

Many of you have noted the high level of paper you receive from TDW. In the past I have often recommended that, if you are interested, you need only keep on file the December monthly statement and your IRS form 1099 (dividends, interest, capital gains distributions, sales proceeds). The rest you can throw away (since both of us have access to copies of the monthly statements online). Now, if you wish, you can see it via email, print it if you wish, store it (as you store other emails) if you wish, or not.

More than a year ago I ceased receiving copies of client statements in hardcop y each month. Going online to see these statements has never been a problem. I will be requesting that I receive my personal monthly statements, etc., via email online. You can choose to keep receiving the paper or eliminate it. I will be pleased to as sist you to make the change to electronic delivery and, if you then need copies, I'll be glad to assist you by supplying them.

II. What Are OUR and THEIR Asset Allocations?

Each of us has a different ability to live with uncertainty (ris k) and so our investments will be different:

As of September 30, 2005	Clients	The Smartts
Money Market Funds	2.2%	0.0%
Bond Funds	31.5%	4.0%
Stock Funds	66.3%	96.0%
Totals	100.0%	100.0%

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III. Vanguard Rates of Return (through September 30, 2005):

Performance percentages are per ***Morningstar.*** Amounts in parentheses are percentile rankings (1= best and 100= worst) within category.

Periods ended September 30, 2005	Yr. to date		5 Years		10 Years	
500 Index	**2.7%**	(60)	**-1.6%**	(48)	**9.4%**	(21)
Tax-Managed Growth & Income	**2.8%**	(58)	**-1.5%**	(46)	**9.5%**	(19)
Total Stock Market Index	**3.7%**	(45)	**-0.6%**	(34)	**9.3%**	(24)
Tax-Managed Capital Appreciation	**5.0%**	(28)	**-2.6%**	(16)	**9.3%**	(16)
Extended Market Index	**7.5%**	(41)	**2.1%**	(85)	**10.0%**	(75)
Tax-Managed Small Capitalization	**7.4%**	(29)	**10.7%**	(47)		
Small Capitalization Index	**6.1%**	(46)	**7.3%**	(73)	**10.4%**	(75)
REIT Index	**10.0%**	(38)	**18.7%**	(34)		
Tax-Managed International	**9.3%**	(47)	**3.2%**	(23)		
Balanced Index	**3.1%**	(60)	**2.5%**	(40)	**8.5%**	(33)
Total Bond Market Index	**1.7%**	(25)	**6.1%**	(44)	**6.3%**	(24)
High–Yield Corporate Bond	**1.5%**	(54)	**5.6%**	(59)	**6.3%**	(30)

For comparison, here are several stock and bond benchmarks:

Periods ended September 30, 2005	Yr. to date	5 Years	10 Years
S & P 500 (large stocks)	**2.8%**	**-1.5%**	**9.5%**
Russell 2000 (small stocks)	**3.4 %**	**6.5%**	**9.4%**
Lehman Brothers Aggregate Bond Index	**1.8%**	**6.6%**	**6.6%**
CS First Boston High -Yield Index	**1.7%**	**8.6%**	**7.7%**

Notice the last ten years. Stocks have increased about 9 -10% per year over the decade ended September 30, 2005. With inflation at below 3% for the period, stocks have performed very close to their 200 year average after inflation (6.8% is the historical average). Stock returns for the decade look like an "*N*", up for several years, down for three years, then up for a year or two.

Good quality bonds have performed better than their expected return of 3.0% AFTER inflation. High yield ("junk") bonds have not beaten my expected inflation-plus 4.5%.

While many analysts doubt that the three straight years of stock declines "wrung out" all of the overvaluation of stocks which occurred in the late 1990's, a ten year period with stock returns close to their long term average provides some small bit of comfort. Recall that stock returns vary widely over one year time frames, vary a bit less widely over ten year periods, vary even less over 20 or 30 year periods. Many of us have time frames, for much of our invested capital, of more than 30 years.

So stocks are risky for short periods of time. Bonds are risky for long periods of time because of the possibility of future inflation. Inflation permanently destroys part of the value of bonds. Although inflation has not been a problem during the last decade, most of us remember when it has been a tremendous problem.

In the long run, over multi-decade periods, according to Jeremy Siegel, author of *Stocks for the Long Run*, bonds are more risky than stocks.

IV. **Brokers, the "Merrill Lynch Rule" and Independent Advisors:**

Expensive lobbying efforts continue even after the Securities and Exchange Commission issued new rules for disclosure by brokers. Large brokerage firms, typified by Merrill Lynch, are moving away from merely providing recommendations on individual transactions (e.g. "buy this mutual fund, sell this stock") and into providing investment portfolio advice on a continuing basis. This new and growing line of business for brokers raised the question, "Should the brokers have to register as investment advisors and should they provide the same sort of required disclosure to clients that we, the investment advisor community, do?" Brokerage firms believe that the various licenses held by their employees are sufficient. The investment advisor community asked, "How do you tell a bad or inexperienced broker from a good one if there is no disclosure of the education, and approach to investments, etc. of individual brokers?"

The rule is, as propounded by the SEC: individual disclosure of broker education, etc. will not be required --a win for the brokerage firms. BUT, the SEC has stated that, in turn, there should be more disclosure, to the customers of brokerage firms, **that the interests of the customer and the firm may not be aligned**. Here, from the April 2005 Federal Register, is part of the SEC's suggested "plain-English disclosure."

> "Your account is a brokerage account and not an advisory account. Our interests may not always be the same as yours. …We are paid both by you and, sometimes, by people who compensate us based on what you buy. Therefore, our profits, and our salespersons' compensation, may vary by product and over time."

Smartt comment:

The brokerage firms have decided they don't like this disclosure, have sued the SEC and the whole rule has now been set aside for further study.

What investors ought to understand is that brokers often get more income by recommending a specific product. This product might not be quite as well suited to a customer's needs as another product with a lower rate of commission. For example, Vanguard does not pay brokerage firms (or independent advisors) to recommend/sell its mutual funds, though Vanguard's low cost structure is believed, over time, to provide more return to investors in relation to the risks they bear.

Although not a full member of the Nat'l Assn. of Personal Financial Advisors ("NAPFA—the fee-only association"), I take the annual NAPFA fiduciary pledge, to avoid accepting any commissions or other compensation which is based on which products/funds I recommend. Being fee -only feels comfortable to me and is, I believe, in the best interests of my clients.

An April 2005 article in Financial Advisor magazine, a publication which serves both the commission and the fee-only advisor community, says that wealthy baby boomers, "who are increasingly skeptical or downright cynical about Wall Street [brokers], are increasingly turning to independent advisors. Traditional brokerages have lost 11% of their wealthy clients in the past two years."

V. Roth IRAs and Roth 401(k) Plans; Great Tools for Retirement Saving

Roth IRAs have a several year history. Money added to a Roth IRA does not constitute a tax deduction but, after holding the assets within the account for more than five years AND after becoming age 59 -1/2, there will be no tax on withdrawals of either principal or subsequent earnings. There is no requirement to withdrawal any amount—you can leave it in the account to accumulate. When you and your spouse die, the beneficiary (generally the next generation) must begin withdrawing $$s from the account, but there is still no income tax on either the original principal or the earnings.

Roth IRAs are a great retirement asset, very flexible. If you have wish to create a legacy for the next generation (or for your grandchildren), it's one of the best investment assets to use.

Contributions to Roth IRAs are not allowed for the high income.

Beginning in January, 2006, employers may offer **Roth 401(k)** plans. Contributions will not reduce employee taxable income, but, after retirement, assets within the plan may be rolled over into an individual Roth IRA and the same flexibility applies to the account. With some limits, contributions are allowed for those with high incomes. Contributions, depending upon age, can be as much as $20,000 per year.

If you or your children are employed, inquiry should be made soon as to whether the employer/company will offer the **Roth 401(k).** Only 1/3 of large employers, in a recent survey, plan to offer it. If your employer, or your child's employer offers it, I'd be pleased to assist you with how your family can take advantage.

This is the season for employees to sign up for benefits and deductions for 2006. This is the time to inquire if the employer will offer the **Roth 401(k).** If offered, let me help you take advantage of it. If offered by your children's employer, you might even consider making gifts to them so that they can fund contributions to the new plan.

V. Portfolio Diversification:

An article in *Fortune* magazine in July, noted that financial markets contain more short-term risk than generally imagined. Market values can rise and fall more than 10% per day for a few stocks (though few days contain moves this large for the entire valuation of the market). The same article contained this advice:

"Long-run market returns are dominated by a small number of investments, hence the risk of missing them must be mitigated by investing as broadly as possible. Passive indexing is far more effective than active selection—but you need to go well beyond an S&P 500 fund to do yourself much good."

I recommend broad, diversification within stock markets, small US stocks as well as large capitalization, and international stocks as well as domestic. I'd be pleased to assist you or your friends.

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