

**PERFORMANCE RESULTS**

Page 11

**Articles**

**Summary of Q3 2006  
Manager Research  
Activity - (pg 3)**

**A New Brand Image -  
(pg 3)**

**Disaster Recovery  
Plan: We Have  
One...Should You? -  
(pg 4)**

**Socially Responsible  
Investing (SRI):  
History and Trends -  
(pg 4)**

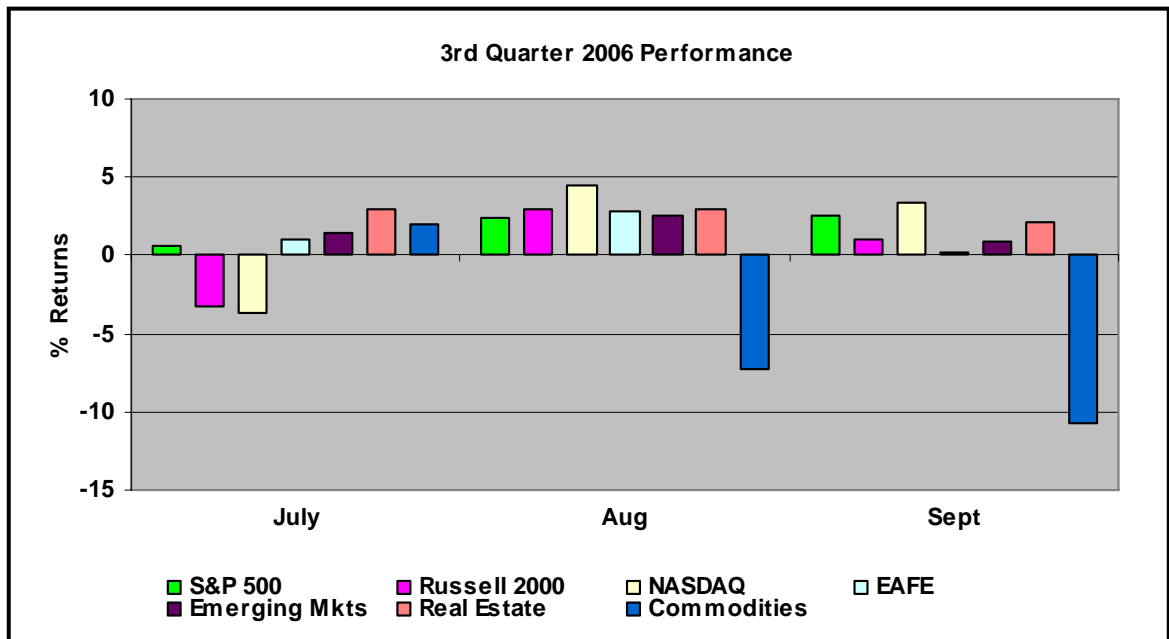
**Five Non-  
Controversial, Non-  
Political Suggestions for  
Environmentally  
Responsible Living - (pg  
7)**

**Another Way to Get  
From Point A to Point  
B: Looking at Private  
Jet Travel - (pg 7)**

**More Tax Law Reform  
- (pg 8)**

## Third Quarter Rebound

The third quarter of 2006 produced very good results for our clients as investment markets, generally, recovered from the mild correction of the second quarter. After a dip in mid-July, results were positive in August and again in September, especially in publicly traded real estate and emerging markets and in overseas and domestic large cap stocks.



We attribute this good performance to several big investment developments over these past three months.

Probably most significant was the decision by the Federal Reserve to pause in its long sequence of short-term interest rate increases. This was followed by a second meeting with, again, no increase in rates, signaling that the monetary watchdogs are reasonably confident that they've, for now at least, achieved the right balance between minimizing inflation risks while continuing to foster sustainable economic growth. Meanwhile, mid-to longer-term interest rates have declined, producing again this year an inverted yield curve. In earlier times, this might have spelled trouble ahead for the domestic economy; now, with continued great demand for US debt obligations from overseas investors, the news is probably good: continued credibility of the US economy combined with an expectation of a lowering of short term rates ahead. This would bode well for the equity side of the investment equation, where almost all of our clients devote most of their exposure.

Further, despite the handwringing tone of some commentators, a relatively "soft landing" in housing values seems to be underway. Rather than a sharp housing downturn with its negative effect on consumer spending, sales volumes and prices are experiencing, so far at least, only modest relaxation from what were extraordinarily robust levels. Interest rates are helping here too, with long term mortgage rates, contrary to many fears, coming down from recent, modest increases. Much broader than just the domestic real estate picture, however, is the domain we will pursue for our clients' portfolios' real estate exposures. Despite lingering risks of a bursting of a "bubble" in specific domestic residential real estate markets, we are very confident that a globally diversified portfolio, reflecting a variety of real estate categories, will handsomely reward our clients over the coming years.

The other major influence favoring good investment performance this quarter was the dramatic easing of energy prices. Oil grabbed a lot of media attention as it approached \$80 a barrel, but not nearly so much as it has declined by over 20% in just weeks to less than \$60 in response to the happy combination of new oil discoveries, no disastrous hurricanes, a cease-fire in Lebanon, a toning-down of the reciprocal saber-rattling over Iran's nuclear ambitions, the end of the summer driving season, and some reduction in worldwide energy demand.

We don't suggest that prices can't spin upward again (and many would actually prefer a more sustained elevation of prices to provide impetus for greater energy conservation and development of greener energy sources); they can and no doubt, someday, will. Rather, our point is that prices reflect the *expectations* of supply and demand. History shows that supply is amazingly responsive to demand.

Reflecting this energy price softening, one of the few weak elements of clients' portfolios this quarter occurred in the small commodities exposures many clients have. We've taken appropriate opportunities to capture the tax losses that have occurred as a result. While we would have preferred positive results in these holdings (and that could have occurred even with price declines in the underlying commodities, see our [1<sup>st</sup> Quarter 2006 Wealth Management Commentary](#) for more on commodities), they gave us what we had bargained for most fundamentally – a portfolio component that behaved differently from the predominant equity exposures of our clients' portfolios. As we have discussed here before, finding an optimal exposure to this asset class that is tax efficient has been a challenge. We believe we've found an excellent solution. See the box on "iPath."

### Options "Backdating"

One of this past quarter's cause célèbres and of considerable concern to many of our corporate executive clients is the most recent chapter in real or suspected wrong-doing in stock options. Because of the general climate of suspicion, virtually every public company is conducting its own investigation of option timing practices, if not already under scrutiny from the SEC, federal and state prosecutors, or shareholder activists. We plan a more thorough and, we hope, balanced comment on this matter in a future issue.

For now, we present as our major article in this *Commentary* remarks by Karen Blodgett and Jason Thomas on the subject of socially responsible investing. By many definitions, that often involves concerns about wise corporate governance and appropriate executive compensation.

### Amazing China

China's cumulative trade surplus is approaching one trillion dollars. Whether due to Treasury Secretary Paulson's effective schmoozing of high Chinese officials or because of its own need to deal with its red-hot economy, China seems poised to continue to permit the yuan to appreciate, probably

at a slow pace but just enough to forestall attempts in Congress to impose tariffs on Chinese imports. As a consequence of my serving as Chair of the Financial Planning Standards Board, I've been able to witness, first hand, some of the very rapid development in countries such as Malaysia, India, and China. And most recently, as Chair of the International Advisory Panel for the Financial Planning Standards Council of China, I've been privileged to meet several senior government officials, financial services executives, educators, and fledgling professional counterparts in China. Wealth management, while still in its infancy in China, is robust and rapidly developing. We hope to find ways to bring this exceptional access to developments in China and other key, rapidly growing economies to the benefit of our clients.

A counterpoint to the thrill of overseas travel is the major inconvenience of heightened airport security, especially if one's routing involves Heathrow airport in London. Avoiding the time and discomfort could make the cost of almost any alternative worthwhile. Sarah Bailey presents some of our research on options that could appeal to our clients who travel by air very frequently.

### Advance Planning for the Predictable...and Unpredictable

2006, thus far, has been spared the major disasters of recent years. No tsunamis, earthquakes, or hurricanes. Maybe now is an especially good time to think ahead. Linda Fitz describes our plans to provide uninterrupted client service and presents some very important information for your personal emergency preparedness in an article below. Young Kim outlines a long list of year-end planning opportunities that we are eager to help you with and we summarize several key features of recent tax legislation to help you take maximum advantage of some new or expanded opportunities.

### Expectations for the 4<sup>th</sup> Quarter

Since we've already achieved or exceeded our initial expectations for client portfolio performance for the full year of 2006, we hesitate to expect much more from these last three months. Nevertheless, we do see the likelihood of some further good news before year-end. Interest rates should stay low and inflation seems unlikely to spike. Always a wild card, however, geopolitical turbulence could erupt and regime changes in Japan, the UK, and possibly in the US Congress (the world's three largest equities markets) could spawn market fears. Closer to home, there are no guarantees that the Fed has "got it right" and either or both inflation and slow economic growth could be in store. On balance, however, we don't think so. So, we believe that clients should not depart from existing, well-considered investment strategies and that prospective clients need not fear adopting and promptly implementing reasonably aggressively investment plans.

Tim Kochis, Editor

## Summary of Q3 2006 Manager Research Activity

Below is a tally of the existing managers we have met with and investment opportunities we have considered over the past quarter. While we receive unsolicited calls or emails daily, we only list those investment opportunities which pass an initial screen and which we then review in depth.

Traditional	13
Hedge Fund	6
Private Equity	4
Real Estate	4
Other	3
Total	<u>30</u>

### Selected Manager Research Activity

In the 3<sup>rd</sup> quarter, activity included initial investment decisions for the following specific opportunities. Where appropriate, we decline to identify specific opportunities by name to avoid inadvertent publicity for the specific investment situation.

Opportunity	iPath Commodity Exchange Traded Note (ETN)
Decision	Has been approved for client investment and presented to client service teams.
Notes	See box on this page.

Opportunity	Global REIT fund
Decision	Due diligence is completed and the strategy has been submitted to the IC for approval.
Notes	<ul style="list-style-type: none"> <li>▪ REITs and real estate operating companies (REOCs) on a global basis;</li> <li>▪ Regional asset allocation with bottom-up stock selection;</li> <li>▪ One of the world's leading managers of public and private real estate, with over \$63 billion in assets under management.</li> </ul>

## iPath

We have adopted the iPath Exchange Traded Note (ETN), benchmarked to the Goldman Sachs Commodities Total Return Index (GSCI), as our preferred commodities asset class vehicle. This iPath ETN, which began trading under the ticker "GSP" in June 2006, is a senior, unsecured, unsubordinated debt security issued by Barclays Bank PLC. Unlike a mutual fund, GSP trades throughout the day like a stock, but is structured such that its return is exactly equal to the performance of the GSCI, less a very small management fee. Because the future return of GSP is not determined in advanced (like a "zero coupon note") and there are no interest payments, iPath expects that there will be no tax consequences until a position is sold or until maturity in 2036.

We are excited about the ability of GSP to provide liquid, cost-effective, and tax efficient exposure to commodities, a sector which has been plagued by high fees and extreme tax inefficiency. GSP will be used to establish new positions in commodities and the Investment Committee is working with client service teams to establish a tax-sensitive approach to reallocating existing positions.

## A New Brand Image

Over most of the past year, we have been carefully exploring our brand. This was not an effort to create a new brand. Rather, through a thorough review of the competitive landscape and with the gracious help of many clients and other friends of our firm, we have rediscovered what our brand has always been: we are the leading independent wealth management firm. Our goal is to assist our clients to achieve...even beyond their own expectations. Our key distinguishing characteristics are our commitment to intelligent planning through client education, our penchant for unconventional wisdom, our global perspective, and our pro-active mindfulness of opportunities for client service.

Because of our long and unparalleled history of innovation in the content of the financial planning art and our contribution to the development of the wealth management profession, extending even well beyond the founding of Kochis Fitz in 1991, we are claiming unqualified leadership among independent wealth management firms. In doing that, we gladly take on the implicit commitment to be at the forefront of this profession...forever.

As we celebrate our fifteen years as Kochis Fitz on October 18 at the Asian Art Museum in San Francisco, we will introduce a new expression of this enduring brand—new colors, new shapes, a more up-to-date, forward looking logo, and website design—to demonstrate our great enthusiasm for the work ahead.

With our sincere thanks to our clients for the privilege of service,

Tim Kochis  
CEO

## Disaster Recover Plan: We Have One...Should You?

Power outage, either routine or from a calamity, is one of the catalysts that can initiate the Kochis Fitz Disaster Recovery Plan. Bay Area residents certainly recall the inconvenience when the 1989 earthquake knocked out electrical and phone systems. Happily, most systems were running in most places in a day or two. Should downtown San Francisco have such an outages again, Kochis Fitz has a plan to keep the business running even if we can't get to the office and even if the office has no power.

Our disaster recovery plan provides for immediate, accurate, and measured response to emergency situations, maximizes the safety and well being of firm personnel, and provides our clients with as seamless a service experience as possible.

### Data Back-up.

Client data that resides on our server is backed up every night, and access to the data on the tape is electronically restricted. The daily back up tapes are taken off site nightly, a different monthly back up is taken off site to a second location, and every six months the back up tape is sent to a third location that is not only secure but temperature controlled to insure the integrity of the tape. Back-up data is kept off-site for six years.

While extremely costly in the past, vendors of online back-up services are vying for business with ever more sophisticated and cost effective storage methods. These vendors all copy files, securely, through the Internet to a data storage facility outside of our geographic area. We are considering adopting the use of online back-ups, analyzing issues such as accessibility, encryption, security, capacity, cost, and reliability. Our arrangements are meant to ensure that all necessary records will be available to meet operational and regulatory requirements, including email and client contact information.

Current investment data (prices, positions, transactions), and most historical data, are, of course, available though the portfolio custodians, and all custodians we work with also back up their files.

### Communicating with Employees

In the event of a disaster that occurs during work hours, we would of course be able to tell our employees where to go if we needed to vacate the office, and whether or not to return to work the next day. However, if the disaster should occur outside of normal work hours, a not-unlikely scenario, it would be difficult to communicate with each of our employees in a timely fashion. Consequently, we have set up a toll free number that employees can call for instructions and updates about the office and our service to clients, as well as leave messages as to their status and whereabouts.

### Offsite Workplaces

If downtown San Francisco is not available, Kochis Fitz employees can work from remote locations once we can access the data across the Internet---as our staff are currently equipped to do, using passwords to access the secured data.

## Home Preparedness

Our annual review of our disaster recovery plan at Kochis Fitz reminded us that, as individuals, we may need to update our own home emergency preparedness. This led to our investigation of the resources available to make this easier.

We found a valuable tool for San Francisco Bay Area residents at [www.quake.usgs.gov](http://www.quake.usgs.gov). This website compiles information from the Red Cross, the US Geological Survey, the SF Office of Emergency Services, and Homeland Security, among others.

Besides fascinating geologic maps and highly motivating earthquake damage photos, this excellent website features useful lists such as:

- Personal Disaster Kit (energy bars, cash in small bills...),
- Household Disaster Kit (drinking water, lighting, pet food...),
- Reducing Home Hazards (heavy art above your bed, gas pipes...),
- Disaster Recovery Kit (essential documents to keep in safe deposit box).

Additional websites, some with much broader scope, include:

- [www.ready.gov](http://www.ready.gov),
- [www.72hours.org](http://www.72hours.org), and
- [www.redcross.org/services/disaster/be\\_prepared](http://www.redcross.org/services/disaster/be_prepared).

### Making it Easier

To get the job done, you might want to buy a ready-made survival kit. Hardware stores and do-it-yourself stores have pre-made kits with their own reminder system to tell you when to replace your supplies. Online sources are listed by Google right next to the above-referenced website listings.

Linda Fitz

## “Socially Responsible” Investing (SRI): History and Trends

The desire to combine personal ethics with investing has been around for centuries. Religious organizations were the first known adopters, avoiding association with economic activities that were not consistent with their beliefs. This could be considered an early form of what is described today as “negative screening”: the complete avoidance of investing in an activity that does not meet the ethical criteria, however defined, of a particular investor.

During the second half of the twentieth century, there were two eras in particular that drove the development of SRI as a broadly acknowledged, if seldom followed, investment approach. The first was the Vietnam War and social unrest of the 1960's, which led to a rise of interest in promoting civil rights, women's rights, and the peace movement. The second was the human rights and environmental crises of the 1980's, driven in particular by South African apartheid, and the Exxon Valdez, Bhopal and Chernobyl disasters. Notions of

corporations having social responsibility mandates and of duties to “stakeholders” beyond shareholders came out of these events, and have influenced much of the modern day thinking encompassed by SRI.

The first socially responsible mutual funds were founded during this era. In addition to negative screening, these funds attempted to identify companies for investment through “positive screening” methods as a way to promote desired social and environmental behavior. The table nearby lists the most common screens used by investors today.

**Top 10 Mutual Fund Social Screens (Positive and Negative) in 2005**

- |                        |                      |
|------------------------|----------------------|
| 1. Tobacco             | 6. Environment       |
| 2. Alcohol             | 7. Labor relations   |
| 3. Gambling            | 8. Products/Services |
| 4. Defense/weapons     | 9. Employment        |
| 5. Community relations | 10. Faith based      |

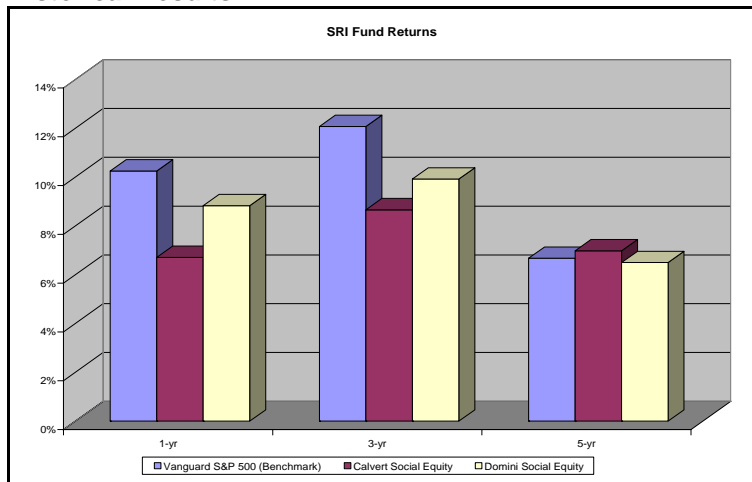
To quantify the potential impact of screening, the market capitalization of tobacco companies in the S&P 500 as of 8/2/06 was 1.61% of the total.

Proponents of SRI argue that companies which are better corporate citizens will earn higher profits through their social responsibility (because they can attract and retain better employees, for example). This form of SRI, also known as “best in class” investing, commonly involves a scoring system, such as the one used to construct the Domini 400 Social Index.

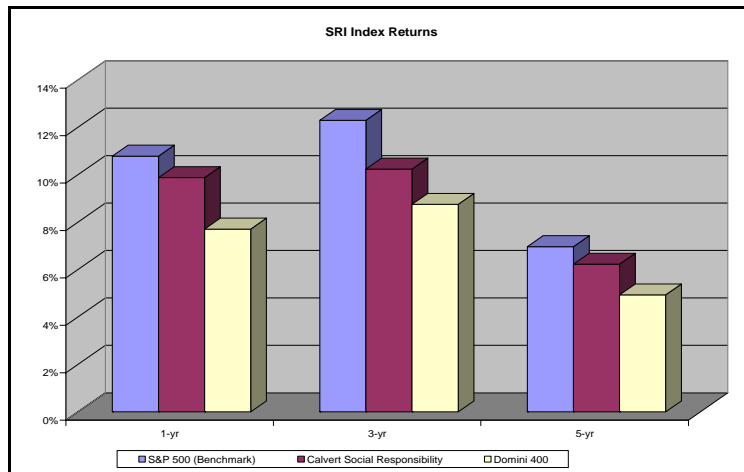
Today, in addition to the wide use of social screening, institutional investors in particular are turning to activism and advocacy as a way of more directly influencing corporate actions. Activities range from organized proxy fights to direct dialogue with company management.

For the individual investor, such activities are not practical on a grand scale, although they can participate, to a limited extent, indirectly through SRI mutual funds. Individuals often have more success when their efforts are focused on their local communities, either through direct investment or direct philanthropy.

**Historical Results**



Many studies have been conducted to determine whether socially responsible investing strategies result in superior performance. So far, there is no compelling evidence that suggests the performance on average is significantly better... or worse... than the performance of the market as a whole.



However, as is the case with any specialized investment strategy, the costs of managing a socially responsible fund is higher than a traditional index fund and, all things being equal, will reduce the returns to investors. As an example, consider the expense ratio and estimated associated tax costs (as calculated by Morningstar) for two institutional class funds: The Domini Social Equity Fund and an index fund for its related benchmark, The Vanguard S&P 500 Index Fund.

	<u>DIEQX</u>	<u>VFIAX</u>	<u>Difference</u>
Expense ratio	0.40%	0.09%	0.31%
Tax cost	<u>0.65%</u>	<u>0.40%</u>	<u>0.25%</u>
Total costs	1.05%	0.49%	<b>0.56%</b>

**Our Experience**

In our years of experience, we have identified four general types of clients with a desire for their investments to reflect their views on social responsibility: the hardliners, the idealists, the pragmatists and the activists. (These terms are a bit tongue-in-cheek and do not capture the wonderful variety of our clients' perspectives and desires, and we are not making any value judgments in their use.) Following is a discussion of each of these four types of investors and what the most appropriate solution is for them in terms of portfolio implementation .

**The Hardliners**

The Hardliners have a very clear idea about which industries or companies they want to avoid and have zero tolerance for owning these companies. Hardliners use a series of screens to remove companies from standard benchmarks/asset classes in a binary way (either “in” or “out”). The resulting screens are often based on a personal definition of social responsibility, rather than any industry standard.

Because these screens are non-standard, the only solution is the establishment of a separately managed account for the asset class(es) involved. Since “hardline” mandates often screen out companies with market capitalizations that are smaller than the weighted average of the market, the profile of

the (market-cap weighted) portfolio is not substantially altered and the performance of the separate account is usually measured against a standard market benchmark. While there is some additional cost associated with having a separate account (we often use tax-management to aggressively harvest tax losses as a benefit to offset – if not outweigh – those costs), there is no direct additional cost for the screens themselves. Like other separate accounts, these tend to make sense only for allocations of \$750,000 or more.

**The Idealists**

The Idealists are willing to accept an available (and actually investable) definition of social responsibility, and wish to screen out those companies excluded by that particular definition. While Idealists recognize that withholding their investment from these firms will not, by itself, impact the financial markets, they hope that the impact of the decisions of all like-minded investors, in aggregate, will motivate more responsible corporate business activity.

There are a growing number of mutual fund and separate account options which screen out companies in a range of industries. Because the number of companies screened out can be large, the investment profile of the resulting portfolio can be quite different from the market as a whole. Therefore, the performance of these portfolios is often measured only against socially responsible indexes, such as the Domini 400.

**The Pragmatists**

The Pragmatists have a general desire to support companies exhibiting social responsibility and good governance, but do not necessarily want to completely screen out any particular company or entire industries. A “best-in-class” investing approach, as described above, often appeals to them, where their portfolios overweight those companies ranking highest on social responsibility metrics within a given industry.

The best-in-class approach offers significant flexibility in implementation. Options include separate accounts which overweight companies according to socially responsible criteria, actively managed mutual funds which attempt to add value by owning companies which, they believe, will perform well because they do good, and a new ETF from iShares which optimizes exposure to socially responsible factors. Some products are measured against standard benchmarks, others against socially responsible benchmarks like the Domini 400.

**The Activists**

The Activists want to actively support a particular cause. While public companies may be in a position to help or hinder the cause, activists generally believe that their decision to invest or to withhold an investment in one of these companies is unlikely to cause any direct effect. They therefore focus instead on donating their wealth and time directly to organizations supporting the cause. Activists also recognize the poetic justice of using their share of profits from a company to agitate for change in its activities.

Activists do not generally change their investment approach as the result of their interest in supporting a cause. They have an appetite for profit to support their interests, and invest so as to maximize the return consistent with their risk tolerance.

		Technique		
		Negative Screens	Negative & Positive Screens	Market Portfolio
SRI Definition	Client-Specific	Hardliners		Activists
	One of the Multiple “Ready-Made” Definitions	Idealists	Pragmatists	

**Our Recommendation**

Thus far, at least, the evidence is inconclusive about the investment merits of socially responsible investing and prevailing portfolio theory doesn’t offer much support. In theory, deviation from market capitalization weighting is *expected* to produce a lower return over time because the resulting portfolio has a more narrow opportunity set and is therefore less “efficient” (in the terminology of Modern Portfolio Theory). This conclusion is particularly true where the implementation cost is higher.

Because of the volatility in financial market returns, definitive empirical evidence (in the form of a statistically significant deviation in performance) is not likely to become available. The one aspect of future investment performance we can forecast confidently – the impact of high management fees – tilts the scale against the vast majority of currently available vehicles to implement socially responsible investment strategies. We would therefore counsel clients using SRI vehicles to expect somewhat lower after-tax returns in the long run.

A key element in the Kochis Fitz investment philosophy is the avoidance of cost for *unproductive* active management. In our search for the highest after-tax returns for a given level of risk, we are generally not eager to expose our clients to the higher operating *and* tax cost of SRI alternatives, but, of course, do our best to carefully implement the available approaches when our clients wish to pursue them. The reality is, despite all of the effort required, SRI screens do not have a major impact on the composition of the aggregate portfolio. For example, companies characterized as tobacco-related represent only 0.31% of a common Kochis Fitz client portfolio... a mere three dollars for every \$1,000 invested.

Our clients’ experiences suggest that the most effective, and satisfying, approach to SRI is to use the profits from investing activity to support issues and charities directly – the “activist” approach – rather than by substituting SRI alternatives for our recommended core investments.

Karen Blodgett and Jason Thomas

The authors are pleased to acknowledge the following valuable sources for research for this article:

The Social Responsibility of the Investment Profession, by Judy Hudson, CFA. The Research Foundation of CFA Institute, 2006.

Socially Responsible Indexes: Composition, Performance and Tracking Errors, by Meir Statman, Santa Clara University. Published May 2005.

## Five Non-Controversial, Non-Political Suggestions for Environmentally Responsible Living

*From our client, Rich Morrison, retired Senior Vice President of Environmental Policies and Programs at Bank of America, current member of the Investment Advisory Committee of the Sierra Club, and with numerous affiliations with other environmental organizations..*

1. Climate change -- Reduce energy consumption to help mitigate the effects burning fossil fuels has on the buildup of greenhouse gases.
  - Drive vehicles that get higher miles per gallon, ideally hybrids
  - Reduce electricity consumption at home and in the office by using compact florescent bulbs
  - Insulate homes and offices and install double-pane windows to reduce energy used to heat and cool
  - Use Energy Star appliances
2. Water conservation -- Reduce water consumption to lessen the need for environmentally destructive dams. This is especially important in California.
  - Install low flow water fixtures
  - Use drip irrigation for outdoor plants
  - Landscape with native plants, which require less watering
3. Organic food and fabrics -- Buy organic to reduce the use of pesticides and chemical fertilizers, which escape into the environment.
4. Materials -- When building, remodeling or purchasing, buy used items or items made from natural or recycled materials. Such materials require less energy to produce and involve less extraction from environmentally sensitive lands.
5. Political action -- Make your opinions known to your elected representatives at the local, state and federal levels, and urge them to pass laws that you believe support living responsibly.

## Another Way to Get From Point A to Point B: Looking at Private Jet Travel

The increasing costs of commercial travel, combined with frequent delays, hectic airports, and security screening that many frequent travellers consider excessively burdensome, have led some of our clients to consider private jet travel. Private jets offer many advantages. They can operate out of smaller airports according to the traveler's schedule. Private jets have access to more than 5,000 airports in the U.S. and Europe alone. And many providers can schedule private jet travel on just a few hours notice. But it is not cheap. The cost of private jet travel is dictated by the size plane a traveler requires to reach their destinations and the size of the traveling party.

## Kochis Fitz Strives to be a Socially Responsible Company

1. Since 2004, our office has taken a "less-paper" approach to maintaining client files and generating correspondence. (The term "less paper" acknowledges the difficulty of attaining a truly "paper-less" work environment.) Client files are now electronic, and we encourage electronic forms of communication wherever possible with our clients and other service professionals with whom we work (CPAs, attorneys, etc).
2. We are now encouraging our clients to receive their Kochis Fitz quarterly performance reports electronically, and we have recently updated our website to include an electronic archive. If you'd like to sign up for this, please contact us.
3. Schwab, our primary asset custodian, has greatly expanded its electronic document capabilities in recent years, and now offers electronic account statements, trade confirmations, and third party communications such as proxy ballots, fund prospectus, etc. If you have not yet enrolled in your custodian's e-delivery services and would like to, please contact us for assistance.
4. In those instances where paper communication is still required, we recognize that the choice of paper can make a difference. Our new stationery, featuring the recently refreshed Kochis Fitz brand, is being printed on 100% post consumer fiber paper stock.
5. We provide "Commuter Checks" to our employees, vouchers redeemable for transit passes that encourage the use of public transportation.
6. Our employee benefit programs include domestic partner benefits, adoption assistance, and company matching of charitable gifts up to \$1,000 per year per employee (including a charitable contribution of \$10 for every hour spent volunteering).
7. We strongly promote diversity in our workplace. Our staff represent Chinese, Filipino, Cambodian, Black, Hawaiian, Hispanic, Korean, Native American, Caucasian, Japanese, men, women, married, single, gay, and straight.

There are several different options for private jet travel. Two of the most popular are private jet *membership* and fractional private jet *ownership*.

### Membership

Private Jet membership may be appropriate for travelers who fly fewer than 50 hours per year and with limited geographic scope. The typical contract length is one year, so this could be the more attractive choice for someone who does not want to be committed for the long term. Membership programs can generally accommodate travel within the U.S., Caribbean, and Europe, depending on the provider. Typically, participants

purchase contracts for 25 hours of flying time. The pricing of the contracts are based on the type of aircraft; depending on the program, participants may be allowed to “trade” a certain number of their flying hours for a bigger or smaller type of aircraft. The total cost of the contract includes all management fees and expenses associated with the specified number of travel hours and ranges from \$100,000 for a small size plane to \$300,000 or more for the largest aircraft.

### Ownership

Fractional ownership is geared for the traveler who plans to fly more frequently because the smallest increment of ownership is a 1/16<sup>th</sup> share, which corresponds to 50 hours of annual flying time. You can purchase up to a ½ share, which corresponds to 400 hours. At the inception of the management contract, the fractional owner purchases an equity interest in a specific aircraft. Fractional owners may also use different aircraft at an exchange rate. Many fractional ownership companies have partnerships that enable them to coordinate private jet travel around the globe. The average contract length is five years; at the end of the initial five-year period the fractional owner may be able to renew their current management agreement at the prevailing monthly and hourly rates if they want to retain their ownership for same aircraft. Other programs require the fractional owner to sell back their interest at the end of the contract, and re-purchase a new interest.

On top of the initial equity outlay to purchase an interest (\$1 million for the smallest size plane that seats six to \$3 million for a larger size plane that seats twelve for the 1/8<sup>th</sup> equity or 100 hours of flying time), the fractional owner pays a monthly management fee to cover all of the fixed costs associated with the fractional jet ownership program, such as pilot salaries and training, and insurance. Fractional owners also pay an “occupied hourly rate” that covers the direct operating costs, such as fuel and aircraft maintenance, for the hours a traveler is actually on board the plane. These fixed and operating costs could easily top \$300,000 for someone flying, say, 100 hours a year, on a small aircraft.

The offerings of private jet membership programs and fractional ownership companies differ greatly. There are many factors to investigate before selecting an option that may be right for you. If you're interested, we have compiled information about several of the most popular providers.

Sarah Bailey

### More Tax Law Reform

On August 17<sup>th</sup>, President Bush signed the Pension Protection Act of 2006. This massive new law aims to strengthen our traditional pension system as well as improving over 20 retirement tax-savings benefits. Like many pieces of legislation, it also contains other diverse topics such as recordkeeping rules for charitable contributions. We have highlighted those provisions that have the greatest impact on our clients.

### §529 Plans: Sunset Provisions No Longer a Concern

The popular §529 college savings vehicle has had one of its most attractive features protected by the Pension Protection Act.

§529 plans enable families to invest tax free for qualified higher education expenses for their children. Kochis Fitz has recommended these plans for many clients to assist their children and/or grandchildren. The tax benefits are attractive not only because plan assets are withdrawn tax free for qualified higher education expenses, but account owners can aggregate five years of gifts (\$12,000 in 2006 for an individual or \$24,000 for a couple) into one gift-tax free lump sum contribution. Thus, an individual could contribute up to \$60,000 (\$120,000 for a couple), in 2006 to a §529 plan, without incurring a gift tax.

However, under its initial legislation, the benefit of tax free withdrawal from §529 plans was scheduled to sunset, or expire, after 2010. At that point, investment gains within the distributions from these plans would have become taxable at the tax rate of the plan beneficiaries. The Pension Protection Act now makes eligible withdrawals tax free permanently.

Some states (notably New York and Connecticut) offer a small state-tax deduction when assets are invested in a §529 plan. Unfortunately, California does not yet offer any state-tax benefit (no deduction and all distributed investment gains are taxable). Kochis Fitz regularly monitors the plans offered by California and by other states to seek out those plans that offer both competitive pricing, in the form of low fee structure, and superior investment alternatives. One needn't be a resident of a particular state to use that state's plan.

### Charitable IRA Distributions

For the remainder of 2006 and all of 2007, clients over the age of 70 ½ will be eligible to make charitable gifts directly from their IRA without realizing income on the distribution. Gifts must be transferred directly from an IRA (neither a SEP nor a SIMPLE IRA qualify) to a public charity (not a donor advised fund, private foundation or supporting organization) and are limited to \$100,000 in each of 2006 and 2007. There is no tax deduction, but there is no tax on the amount of the IRA distribution that is given to charity.

These charitable IRA distributions count toward the minimum required distribution (MRD) so this is an attractive way for clients to meet charitable goals and avoid realizing otherwise mandatory taxable income. If the IRA has basis (from prior after-tax IRA contributions), the basis stays with the IRA.

Optimal charitable gift planning will usually limit the amount of this gift to an individual's MRD, even if that is less than \$100,000. Preserving the tax deferral benefits of the IRA (by limiting any withdrawal to the minimum required) and making any intended further charitable gifts by transfers of highly appreciated assets will usually combine to achieve the best overall results. We of course stand ready to advise you based on the specifics of your IRA and portfolio circumstances and your specific charitable objectives.

### Qualified Retirement Plan to Roth Rollover

Beginning January 1, 2008 clients can transfer their qualified retirement plan directly to a Roth IRA, but must pay tax on that transfer (see our [2<sup>nd</sup> Quarter 2006 Wealth Management Commentary](#) for more on Roth conversion). Until then, clients must first transfer their qualified retirement plans to a "Rollover IRA" and subsequently to a Roth IRA, if eligible. As we discussed in our last Wealth Management Commentary, until 2010, Roth conversions are limited to individuals or couples with adjusted gross income less than \$100,000; married couples filing separately are prohibited from converting. Beginning in 2010, these income limitations go away. An added benefit is that half of the income realized from a 2010 Roth conversion can be counted on the 2010 tax return and the other half deferred to the 2011 tax return.

#### Higher Eligible Contributions Now Permanent

- Higher dollar limits on defined contribution plans (\$44,000 in 2006); elective deferrals on 401(k) and 457 plans (\$15,000)
- Cost-of-living adjustments for IRA contributions (\$4,000 in 2006 and \$5,000 in 2008)
- Cost-of-living increases in annual benefit limits under a defined benefit plan (\$175,000 in 2006)
- Individuals over age 50 can continue to make additional "catch-up" contributions (\$5,000 for 401(k)s and \$1,000 for IRAs)
- Limitation on deductible contributions to profit-sharing plans increased to 25% of compensation

#### Private Foundations: New Excise Tax Rules

The Act expands the base of net investment income that will be subject to a 1% or 2% excise tax, and specifically includes realized capital gains. Additionally, the penalty tax for failure to distribute required amounts has been increased from 15% to 30% of the undistributed amount.

#### Non-Spouse Beneficiaries

Non-spouse beneficiaries (parents, siblings, children, domestic partners, etc.) can rollover a distribution from a decedent's qualified plan into an IRA after December 31, 2006 and stretch out distributions over their life expectancy. This law eliminates

the previous common situation where company plans required an immediate lump sum distribution with accompanying immediate taxes. Required minimum distributions are governed by the rules that apply to inherited IRAs.

#### Roth 401(k) and Automatic 401(k) Enrollment

In the [4<sup>th</sup> Quarter 2005 Wealth Management Commentary](#) we reported on a new type of 401(k) plan, called the Roth 401(k) which, like Roth IRAs, allows participants to save after-tax dollars and then enjoy tax-free growth. At the time, few employers were adopting this new 401(k) because they were scheduled to "sunset" in 2010. The Pension Protection Act removes the sunset and, consequently, we expect that many more employers will begin to add the Roth feature to their 401(k) plans. Contact your client service team if your employer adds a Roth feature, as it could have important tax-diversification and estate planning benefits.

While probably of little direct impact for our clients, but possibly for their children just beginning their working careers and almost certainly for society as a whole, employers can now automatically enroll employees into company 401(k) plans. While employees can "opt-out", actual participation will probably increase. Many of our clients will indirectly benefit as well since this would increase the likelihood that 401(k) plans will meet "discrimination testing" and allow highly compensated employees to contribute the maximum amount to their 401(k) plans.

#### Charitable Gifts and Required Record Keeping

All cash contributions, regardless of amount, must be kept in the form of a bank record, cancelled check or written communication from the donor showing the name of the donee organization, date of contribution and the amount. Contributions of clothing or household items must be in good condition or better and any single such item valued at over \$5,000 must carry a *qualified* appraisal. The cost of acquiring such an appraisal clearly discourages any large contributions of this kind of property.

Jane Zaloudek, Sarah Bailey, and Brett Gookin

## Planning for Year-End 2006

As we are about to close yet another year, we remind you of certain year-end transactions that we stand ready to help you execute...as conveniently and as timely as possible:

### Retirement Plans

Retirement Plans for the Self-employed – If you have self-employment income (from consulting services or corporate or non-profit boards), our planning staff has discussed with you your eligibility to contribute to your own retirement plan. If you haven't already established a specific retirement plan, we can help you decide which of the several plan choices is appropriate for you. Most of these plans must be established no later than December 31, even if actual funding can occur later.

Roth IRA Conversion – If your adjusted gross income is less than \$100,000 (whether for single individuals or married couples filing jointly), you can convert part or all of your traditional IRA to a Roth IRA by December 31. Taxes must be paid on the conversion but subsequent earnings and distributions are tax-free in a Roth IRA. Your client service team will help you determine whether this opportunity is available to you and, if so, appropriate to pursue.

Catch-up 401(k) and Deductible IRA Contributions – Individuals over age 50 and those who turn 50 during 2006 are eligible to make "catch-up" contributions to retirement plans. The 401(k) catch-up contribution is \$5,000 and the traditional and Roth IRA catch-up contribution is \$1,000. If you meet the eligibility requirements and haven't already made the 401(k) catch-up contribution, please contact your 401(k) plan administrator to make the election as soon possible so the extra contribution is made before the year-end. The catch-up contribution to an IRA can be made as late as April 15, 2007.

Required Retirement Plan Distributions – Clients who turn 70½ this calendar year are required by law to take a first minimum distribution from their retirement accounts. The first required minimum distribution must be taken no later than April 1 of the year following the calendar year in which one turns 70½, so, "first timers" *could* wait till April 1, 2007. Still, it is almost always best to get this done by December 31 of the current year so that you are not required to take *two* distributions in the following year. If you are in this situation, we have been or will be in contact with you soon to coordinate distributions...and the newly available possibility to make a charitable gift of this required distribution. See page 9.

### Income Taxes

Year-end State Tax Payments – We will also be in touch with your tax preparer about any other issues that should be taken into consideration when preparing tax projections and determining your optimal tax payment schedule. In addition, we will forward tax information for the full year 2006 to your tax preparer in February 2007. Please remember to forward any 1099s, K-1s, and other tax records you receive to your tax preparer. If you changed your tax preparer since last year and/or have not already provided us with your 2006 tax preparer's contact information, please do so as quickly as you can.

Charitable Contributions – Appreciated long-term capital gain assets, such as stock or mutual fund shares you've owned for more than a year, are ideal assets to contribute to charities because you can deduct these assets at fair market value without paying tax on the appreciation. If you have charitable intentions but have not yet identified the charity you wish to benefit, you can donate securities to a charitable gift fund, like the ones available at Charles Schwab & Co., Inc or at Fidelity Investments. By doing this before December 31, you can secure your charitable deduction for this year and direct the gift at a later, more convenient time. As discussed above and on page 9, in 2006 and 2007, you can make certain charitable gifts directly from your IRA.

Gifts to Family Members – The current tax law allows each person to make gifts of \$12,000 per recipient, each year, without gift tax. Thus, a married couple can give up to \$24,000 per recipient per year, free of tax. If a recipient is in a very low income tax bracket, it may make sense to give highly appreciated investments rather than cash since the recipient can sell the investment and may only pay 5% capital gain tax. However, a cash gift is still usually the best if you want to maximize the benefits to the recipient. Many clients with young children or grandchildren may be able to give up to \$120,000 (for a married couple) to fund §529 College Savings Plans. These gifts use the same \$12,000 per person, per recipient annual gift tax exclusion but permit a 5-year "bunching" to get to a much greater initial amount.

Your client service team is eager to work with you to *plan* for and then *execute* these transactions as early as possible.

Young Kim  
Director of Investment Operations

## PERFORMANCE RESULTS

		3rd Quarter 2006	12 Months to 9/30/06	3 Years Annualized to 9/30/06
<b>Fixed Income</b>				
<i>Short-Term</i>	Benchmark Index: Citigroup Broad Investment Grade 1-5 yr	2.6%	3.9%	2.7%
<i>(Taxable)</i>	Benchmark Fund: Vanguard Short-term Bond Index	2.5%	3.6%	2.0%
*	DFA Two Year Global Fixed Income	1.4%	<b>4.0%</b>	<b>2.0%</b>
	Vanguard Short-term Investment Grade	2.3%	<b>4.5%</b>	<b>2.8%</b>
<i>Intermediate</i>	Benchmark Index: Lehman Brothers Aggregate Bond	3.8%	3.7%	3.4%
<i>(Taxable)</i>	Benchmark Fund: Vanguard Total Bond Market Index	3.8%	3.5%	3.2%
*	DFA Five Year Global Fixed Income	1.9%	2.9%	2.3%
*	PIMCO Total Return Institutional	<b>3.9%</b>	<b>3.5%</b>	<b>3.9%</b>
<i>Intermediate</i>				
<i>(Tax Free)</i>	Benchmark: Morningstar Muni CA Intermediate Category Avg.	2.8%	3.5%	2.9%
	Vanguard CA Insured Intermediate Tax-Exempt Adm	<b>3.3%</b>	<b>4.0%</b>	<b>3.0%</b>
<b>Real Estate</b>				
	Benchmark Index: Dow Jones Wilshire REIT Index	9.1%	28.1%	27.4%
	Benchmark Fund: Vanguard REIT Index Fund	9.4%	25.9%	25.6%
	Columbia Real Estate Equity	8.3%	25.1%	23.7%
	DWS RREEF Real Estate	<b>9.6%</b>	<b>27.5%</b>	<b>26.4%</b>
<b>Balanced</b>				
	Benchmark Index: 60% Wilshire 5000/40% Lehman Agg Bond	4.2%	7.7%	9.3%
	Benchmark Fund: Vanguard Balanced Index	4.2%	7.6%	9.2%
*	DFA Global 60/40	2.8%	<b>9.6%</b>	N/A
	Dodge & Cox Balanced	<b>4.3%</b>	<b>10.8%</b>	<b>12.9%</b>
	Vanguard Asset Allocation	<b>5.5%</b>	<b>11.0%</b>	<b>11.8%</b>
<b>Absolute Return</b>				
	Benchmark Index: HFRI Fund of Funds Index	N/A	N/A	N/A
	Benchmark Fund: Rydex Sphinx	N/A	N/A	N/A
*	Ironwood Partners	N/A	N/A	N/A
*	Lazard Alt. Strategies	N/A	N/A	N/A
*	Lighthouse Diversified, LP	N/A	N/A	N/A
*	Silver Creek Low Vol 1	N/A	N/A	N/A
*	Trellie Absolute	N/A	N/A	N/A
*	Undiscovered Managers Multi-Strategy Fund	N/A	N/A	N/A
<b>Large Cap: Domestic</b>				
<i>Blend</i>	Benchmark Index: S&P 500	5.7%	10.8%	12.3%
	Benchmark Fund: Vanguard 500 Index	5.6%	10.6%	12.1%
	Schwab S&P 500 Institutional Select	<b>5.7%</b>	<b>10.8%</b>	<b>12.2%</b>
	Schwab 1000 Select	4.9%	10.4%	<b>12.5%</b>
	S&P 500 ETF (SPDR)	5.6%	<b>10.7%</b>	<b>12.2%</b>
*	Tax Managed Index Separate Account (Parametric)	<i>Return based on individual client's portfolio</i>		
<i>Value Style</i>	Benchmark Index: Russell 1000 Value	6.2%	14.6%	17.2%
	Benchmark Fund: Vanguard Value Index Fund	6.6%	15.1%	16.8%
	Berkshire Hathaway B	4.3%	16.2%	8.4%
*	DFA Large Cap Value	2.9%	12.7%	<b>19.1%</b>
*	DFA Tax Managed Marketwide Value	1.8%	12.0%	<b>19.3%</b>

\* Preferential Access Through Kochis Fitz

Returns are stated net of managers' fees, but before Kochis Fitz fees.

Figures in bold reflect performance equal to or better than benchmark fund.

*Continued on Next Page*

## PERFORMANCE RESULTS

		3rd Quarter 2006	12 Months to 9/30/06	3 Years Annualized to 9/30/06
<b>Large Cap: Developed Overseas</b>				
<i>Blend Style</i>	Benchmark Index: MSCI EAFE	4.0%	19.6%	22.8%
	Benchmark Fund: iShares MSCI EAFE	3.9%	19.0%	22.0%
	Vanguard Total International Stock Fund	<b>4.0%</b>	<b>18.8%</b>	<b>23.1%</b>
<i>Value Style</i>	Benchmark Index: MSCI EAFE Value	5.6%	22.3%	25.8%
	Benchmark Fund: Vanguard International Value	4.2%	21.9%	24.4%
*	DFA International Value	<b>6.5%</b>	<b>25.8%</b>	<b>28.1%</b>
*	DFA Tax-Managed International Value	<b>6.2%</b>	<b>24.9%</b>	<b>27.3%</b>
<b>Small Cap: Domestic</b>				
<i>Blend</i>	Benchmark Index: Russell 2000	0.4%	9.9%	15.5%
	Benchmark Fund: Vanguard Small Cap Index Fund	-0.3%	7.9%	16.4%
*	DFA US Small Cap	-0.3%	<b>8.4%</b>	15.5%
*	DFA Tax Managed US Small Cap	-1.2%	7.5%	15.7%
*	DFA US Micro Cap	<b>-0.2%</b>	<b>7.9%</b>	15.7%
<i>Value Style</i>	Benchmark Index: Russell 2000 Value	2.6%	14.0%	19.0%
	Benchmark Fund: Vanguard Small Cap Value Index Fund	1.7%	10.2%	18.7%
*	DFA US Small Cap Value	-0.7%	<b>12.0%</b>	<b>21.7%</b>
*	DFA Tax Managed US Small Cap Value	-0.8%	<b>11.0%</b>	<b>19.6%</b>
<b>Small Cap: Developed Overseas</b>				
	Benchmark Index: MSCI EAFE Small Cap	0.5%	15.5%	26.7%
	Benchmark Fund: Morgan Stanley Intl Small Cap A	0.8%	10.9%	21.1%
*	DFA International Small Company	<b>2.3%</b>	<b>18.2%</b>	<b>25.6%</b>
*	DFA International Small Cap Value	<b>3.1%</b>	<b>19.8%</b>	<b>28.5%</b>
<b>Emerging Markets</b>				
	Benchmark Index: MSCI Emerging Markets	5.0%	20.8%	31.0%
	Benchmark Fund: Vanguard Emerging Markets Index Fund	4.0%	18.2%	29.8%
*	DFA Emerging Markets Core Equity Portfolio (inception date 4/5/2005)	<b>6.4%</b>	18.1%	N/A
	Oppenheimer Developing Markets	<b>6.5%</b>	17.8%	<b>34.9%</b>
	SSgA Emerging Markets	3.7%	<b>22.0%</b>	<b>31.5%</b>
	T Rowe Price Emerging Markets	<b>7.2%</b>	17.6%	<b>31.9%</b>
<b>Commodities</b>				
	Benchmark Index: Goldman Sachs Commodity Index	-15.5%	-21.1%	13.4%
	iPath GSCI Total Return Index ETN	-15.7%	N/A	N/A
	Oppenheimer Real Asset Y	<b>-14.1%</b>	<b>-18.9%</b>	<b>15.8%</b>
	PIMCO CommodityRealRet Strat Instl	<b>-4.8%</b>	<b>-9.2%</b>	<b>14.3%</b>
<b>Special Situations</b>				
*	Brookdale Global Opportunity Fund	N/A	N/A	N/A

\* Preferential Access Through Kochis Fitz  
Returns are stated net of managers' fees, but before Kochis Fitz fees.  
Figures in bold reflect performance equal to or better than benchmark fund.

The indices and benchmark funds included herein have been selected to allow for comparison of an individual investor's performance to that of certain well-known and widely recognized indices and funds. The inclusion of an index or benchmark fund should not be considered a representation by Kochis Fitz that it is an appropriate benchmark, in all client circumstances, for specific securities, or against overall portfolio performance, nor is it a guarantee of individual investor performance that is greater than the benchmark. The performance and volatility of an individual investor's portfolio may be materially different from those of the indices and benchmark funds. Further, an individual investor's holdings may differ significantly from the securities that comprise the indices and benchmark funds. An investor cannot invest directly in any of the above indices, but could potentially invest in the benchmark funds.

In preparing this presentation, we have relied upon and assumed, without independent verification, the accuracy and completeness of all information (including performance statistics) available from public sources.

This document is provided solely for informational purposes and is not intended to be an offer or solicitation, or the basis for any contract to purchase or sell any security or other instrument, or for Kochis Fitz to enter into or arrange any type of transaction as a consequence of any information contained herein.