



Condor Capital

Investment Management

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Equities continue to struggle in the fourth quarter

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Condor Reviews Fourth Quarter 2007

Amid persistently volatile market conditions, US equities struggled throughout the fourth quarter and generally ended the period in negative territory. Stocks began the fourth quarter on a sound note on optimism that the Federal Reserve's September interest rate cut would help prevent subprime mortgage difficulties from spilling over into the broader economy. However, concerns about the adverse effects of the housing market on consumer spending, as well as a plethora of mortgage write-offs by many of the world's largest banks, reignited investor fears of a possible recession.

Increased market volatility continued to keep investors away from riskier assets, again leading large company stocks to outperform their smaller counterparts. For the period, the Russell 2000 Index, which focuses on small company stocks, posted a loss of 4.6%, in contrast to the large company dominated S&P 500 Index, which fell 3.3%. Larger companies benefited from their ability to better weather an economic slowdown, more attractive valuations, and the revenues they received from overseas operations. Meanwhile, investment style trends continued to follow their recent path, as growth-oriented stocks outpaced value-oriented issues. The Russell 1000 Growth Index experienced a quarterly loss of 0.8%, faring comparatively better than its counterpart, the Russell 1000 Value Index, which declined 5.8% for the period. The final quarter supported a trend observed throughout 2007, as the Russell 1000 Growth Index gained an impressive 11.8% for the year, while its Value counterpart was largely flat, with a loss of 0.2%. Small companies were unable to measure up against their larger counterparts, as the Russell 2000 Index posted an annual loss of 1.6%.

The Federal Reserve cut interest rates on two occasions during the quarter. At its October 31st meeting, the Fed cut interest rates by 25

basis points to 4.5%, noting that risks to inflation and economic growth were roughly in balance. At the December 11th meeting, the Fed lowered rates by another 25 basis points, suggesting that economic growth was slowing due to softening in business and consumer spending. Investors were discouraged by the latter rate cut, as many had hoped for a more significant reduction.

Investors' aversion to volatility and flight to quality was also observed in the fixed income market. Treasury and Government Agency bonds rallied, as turmoil in mortgage-backed and high-yield markets drew investors to these comparatively safer investments. The Lehman Brothers Aggregate Bond Index posted a quarterly gain of 3.0% and finished the year up 6.8%.

International markets also began to show signs of slowing down toward the end of the year, but this was not enough to counteract the area's success in previous quarters. The MSCI EAFE Index gained 9.9% for the year. A modest fourth quarter did not deter emerging markets, with the MSCI Emerging Markets Index rising 39.4% in 2007.

Outlook

While the credit crunch has had a negative effect on equity markets recently and the economy is certainly slowing, it is unlikely that the US will experience a recession thanks to an accommodative Federal Reserve, a strong labor market, and contained inflation. Moreover, a slowing economy does not necessarily lead to a weak stock market, and it can be helpful to look at history as a guide for what to expect in the future. Over the last 60 years, the U.S. stock market, as measured by the S&P 500 Index, actually rose in eight out of the ten years when the economy expanded at a rate below 1%. Six of these years corresponded with periods when the Federal Reserve was lowering interest rates.

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Penalties on Donors

The new penalty tax imposed on donors is 20% of any underpayment of tax for "substantial" misstatements and 40% for "gross" misstatements.

For income tax purposes, a "substantial" misstatement is a 150% overstatement. For gift and estate tax purposes, a "substantial" misstatement is a 65% overstatement.

For income tax purposes, a "gross" misstatement is a 200% overstatement. For gift and estate tax purposes, a "gross" misstatement is a 40% understatement.



Gifts valued at \$5,000 or less do not need an appraisal, but do require a receipt. You must also describe the property and the method you used to determine the property's value.

The Importance of Getting a Qualified Appraisal

For years, Congress and the IRS perceived that taxpayers were overstating the value of donations for tax deduction purposes. As a result, the rules regarding valuations of charitable contributions have recently become more stringent, and they include harsher penalties for excessive valuations.

Although the new valuation rules are currently focused on charitable contributions (including conservation easements), it is widely believed that Congress and the IRS will expand the new rules to all tax valuations in general. Cautious taxpayers may want to apply the new rules to any tax-related transactions involving appraisals, such as valuations required for noncharitable gifts or a buy-sell agreement.

New rules

The new rules generally require that you obtain a "qualified appraisal" from a "qualified appraiser" for donations of property worth over \$5,000 (other than cash and publicly traded securities), and you must attach an appraisal summary (IRS Form 8283) to your tax return. These rules apply to valuations for income, gift, and estate tax purposes.

What is a qualified appraisal?

Generally, a qualified appraisal is:

- Made no earlier than 60 days before the donation is made, and no later than the due date of your tax return (including extensions), and
- Signed and dated by a "qualified appraiser"

Who is a qualified appraiser?

Generally, a qualified appraiser is an individual who:

- Has earned an appraisal designation from a recognized professional appraiser organization, or has otherwise met "minimum education and experience requirements" for valuing the type of property subject to the appraisal, and
 - Regularly performs appraisals for pay
- "Minimum education and experience requirements" include:
- Successfully completing college or professional level coursework that is relevant to the property being valued, and

- Obtaining at least two years of experience in the trade or business of buying, selling, or valuing the type of property being valued

Again, in plain English

More simply stated, to get a qualified appraisal, you must retain an appraiser who holds a professional designation, such as ISA (International Society of Appraisers), ASA (American Society of Appraisers), or AAA (Appraisers Association of America), or someone who has received the requisite schooling and experience.

While these stricter standards are meant to improve the appraisal industry, they have actually shrunk the world of qualified appraisers, for the time being at least. For example, a knowledgeable and skilled expert with years of experience at Sotheby's, but no professional designation or time in the classroom, may no longer be qualified to make appraisals under the new rules.

Further, because the meaning of the new rules needs some clarification, some appraisers may be unsure about whether they're qualified, and they may be unwilling to risk incurring potential penalties. Needless to say, finding a qualified appraiser has become a more daunting task.

Practical guidance

Your best bet is to hire an appraiser who holds a professional designation related to the property being appraised. Contact the societies listed above for referrals. However, while it may be easy to find such an appraiser for certain types of property, like real estate, it may not be so easy for other types of property.

Here are some other tips:

- Talk to your financial or tax professional for more information
- Obtain documentation about the appraiser's education and experience, and how often he or she conducts appraisals for a fee
- Most importantly, make sure the appraiser is aware of the new appraisal rules, including what is required and the potential penalties

Taxation of 529 Plans

Since their introduction over a decade ago, 529 plans have become to college savings--an indispensable tool for helping you amass money for your child's or grandchild's college education. Yet it wasn't until 2006, with the passage of the Pension Protection Act, that the most important federal tax benefit relating to 529 plans--tax-free qualified withdrawals--became permanent. This article takes a look at the overall tax treatment of 529 plans.

Federal tax treatment

Income tax--The federal income tax treatment of 529 plans is straightforward. There is no income tax deduction for contributions, but contributions to a 529 plan (prepaid tuition plan or college savings plan) grow tax deferred, which means you don't pay taxes on the earnings (if any) each year. And, in 2006, withdrawals used to pay qualified education expenses (called qualified withdrawals) were made permanently tax free--a huge tax advantage, considering the large sums of money that all 529 plans accept.

However, if you have to withdraw money from your 529 plan for reasons other than qualified education expenses (for medical, housing, or emergency purposes, for example), you'll face a double consequence--the earnings portion of the withdrawal will be taxed at the marginal tax rate of the recipient (either the account owner or the beneficiary) and be subject to an additional 10% penalty.

Gift tax--Contributions to a 529 plan are considered "present interest gifts" that qualify for the annual gift tax exclusion, currently \$12,000 per recipient per year. So, annual contributions of less than this amount won't trigger gift tax. And there's a favorable twist: Under special rules unique to 529 plans, you can make a lump-sum contribution up to \$60,000, elect to spread the gift evenly over five years (effectively making the gift a series of smaller gifts each \$12,000 or less), and completely avoid gift tax, provided no other gifts are made to the same beneficiary during the five-year period.

This feature has made 529 plans a popular tool for estate planning purposes, particularly for grandparents. That's because a married couple can make a lump-sum gift to a 529 plan of up to \$120,000 (\$60,000 from each spouse), elect to spread the gift over five years, and avoid gift tax--all while removing

the money from their estate for estate tax purposes. Plus, if one member of the couple also happens to be the account owner of the 529 plan, they'll have the added bonus of being able to retain control over their money.

State tax treatment

Income tax--Unlike the federal government, 31 states offer an income tax deduction (typically capped at a certain amount) for 529 plan contributions--Arizona (starting in 2008), Arkansas, Colorado, Connecticut, Georgia, Idaho, Illinois, Iowa, Kansas, Louisiana, Maine, Maryland, Michigan, Mississippi, Missouri, Montana, Nebraska, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Utah, Virginia, West Virginia, and Wisconsin. Kansas, Maine, and Pennsylvania allow a deduction for contributions to any 529 plan; all other states require that the contribution be made to the in-state plan.

As for tax-free qualified withdrawals, all states follow the federal government and offer this tax benefit (except for the nine states that have no income tax). But one state, Alabama, requires that the withdrawal be made from an in-state 529 plan.

Regarding nonqualified withdrawals--those made for purposes other than qualified education expenses--state laws vary, so consult a tax professional who is familiar with the laws of your state. You may owe income tax on the withdrawal. Also, at one time, before the 10% federal penalty was imposed, states levied their own penalties. If a state's penalty isn't officially "off the books," you might be subject to a state penalty too. Finally, gift tax rules differ from state to state, so make sure you understand your state's rules before making a large contribution to a 529 plan.

	Federal	State
Deduction for contributions	No	31 states offer a deduction
Tax-deferred growth	Yes	Yes
Tax-free qualified withdrawals	Yes	Yes, all states (but one requires in-state plan)
Penalty for nonqualified withdrawals	Yes, 10% penalty on earnings, and taxed at recipient's rate	Depends if state penalty still on books, also possible income tax ramifications



What's a qualified education expense?

In the context of 529 plans, it's payment for tuition, fees, books, supplies, equipment, and room and board. However, room and board qualifies only if the student is enrolled at least half time, and computers count only if the college requires (and not just recommends) one to attend.



Important note

Before investing in a 529 plan, you should consider the investment objectives, risks, charges, and expenses associated with such plans. More information about specific 529 plans is available in each issuer's official offering statement, which should be read carefully before investing.



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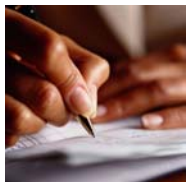
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Ask the Experts



I'm planning a cruise to the Caribbean this winter. Do I need a passport?

Not yet. New passport rules requiring passports for all land and sea travel between the United States and Mexico, Canada, the Caribbean, and Bermuda were originally scheduled to take effect in January of 2008. But a massive backlog of passport applications (caused by another requirement that all travelers flying to these destinations have a passport by the fall of 2007) prompted the federal government to delay implementation of the new rules until sometime between the summer of 2008 and June of 2009. The precise implementation date will be announced later, with at least 60 days notice given.

In the meantime, beginning January 31, 2008, Americans traveling by land or sea to Mexico, Canada, the Caribbean, or Bermuda will need to show a government-issued photo ID, such as a license, and a birth certificate or other proof of citizenship.

And if you're planning to travel by land or sea to any of these destinations later this year or in 2009, consider applying for a passport as soon as possible. The State Department re-



ports that the current wait time is 4 to 6 weeks, but recommends allowing 10 weeks during busier times like the summer travel season (during peak application periods in 2007, waiting times reached 16 weeks).

The State Department estimates that 23 million passport applications will be filed in 2008, and 30 million in 2009. So don't delay.

For more details, visit the State Department's website at <http://travel.state.gov> and click on the link "Passports for U.S. Citizens," or call the National Passport Information Center toll free at 1-877-487-2778.

How do I apply for a passport?

In most cases, you'll need to apply for a passport in person, which you can do at one of the more than 9,000 public places nationwide that accept passport applications, typically U.S. post offices and government offices. For a list of facilities near you, check the State Department's website at <http://travel.state.gov>.

You must apply in person if: (1) you are applying for a passport for the first time, (2) your previous passport was lost, stolen, or damaged, (3) your previous passport was issued more than 15 years ago or when you were under age 16, (4) your name has changed since your passport was issued and you don't have a legal document formally changing your name, or (5) you are under age 18.

When you apply, you'll need to provide: (1) a completed one-page application, which can be obtained at the passport acceptance facility, most travel agent offices, or from the State Department's website, (2) proof of U.S. citizenship (a certified birth certificate is acceptable), (3) proof of identity, such as a valid

driver's license, (4) two recent, identical passport photos (many passport acceptance facilities offer photos on site), and (5) a fee of \$97 for adults or \$82 for children age 15 or younger. Passports are valid for 10 years for adults or 5 years for children age 15 or younger.

In some cases, you may be eligible to apply for a renewal passport by mail. The fee is \$67. If you need a passport quickly (2 to 3 weeks), you'll need to file an expedited application, which costs an additional \$60. And if you have a "life and death" emergency involving serious illness, injury, or death in your immediate family that requires you to travel within 24 to 48 hours to a country that requires a passport, you must appear in person at one of a handful of Passport Agencies for emergency service. Call the National Passport Information Center at 1-877-487-2778 to schedule an appointment at the Passport Agency nearest you.