

# FOCUS

---

*Volume 18, Number 1 / January 3, 2005*

*Welcome to the  
future*

It seems hard to believe that it was only five years ago that we were celebrating the arrival of the new millennium. (Yes, you purists are correct: it should have been celebrated four years ago on 1/1/2001, not 2000. Get over it.) Bill Clinton was still in office, the stock market was still booming, and the “new economy” was still rolling along with nowhere to go but up.

How things change. Need we mention the breaking of the bubble, Enron, WorldCom, Martha Stewart, steroids, wardrobe malfunctions, Rathergate, red states/blue states, Red Socks, oil shocks,... and, sadly, 9/11, war, homicide bombers, hurricanes, and tsunamis? Indeed, how things change.

As we peer into our crystal ball (yes, we do have a real crystal ball), some aspects of the near-term future seem relatively bright, some a bit unclear, and others downright ugly. On the bright side, the economy is rolling along, albeit at a somewhat sluggish pace, especially in the tech sector. Job growth (properly measured using the household survey instead of the payroll data) has recovered, and consumer spending has held up. And, the re-election of President Bush has not led to the end of the world (to which our left-of-center friends would probably like us to add, “yet”).

Less clear is the outlook for inflation. Oil and gold prices, in parallel with the decline of the dollar, suggest that the general level of prices is under upward pressure. This will be especially true if China is forced to start charging market prices for its exports. Offsetting this pressure are the continuing gains in productivity, the decline in prices of everything technological, and the removal of a number of tariffs as of 1/1/2005.

---

What concerns us, like most everyone else, includes the prospects for a successful election in Iraq and the future of the country and the region thereafter, the nuclear threat from Iran and North Korea, China's growing military strength along with the fragile banking system in that country, and the apparent shift away from democracy and capitalism in Russia. These are relatively short-term issues.

Our biggest concerns other than terrorist attacks, domestically at least, are more long-term in nature: the future of Social Security and Medicare, and the unrelenting spiral in health care costs. Financially, the Medicare problem is potentially much larger than the Social Security problem because it is inextricably linked to the cost of health care. The good news here is that these problems are on the radar screens of a lot of people who are in a position to institute or influence reforms, including the Administration, members of Congress, academics, and many in the private sector. The next four years should provide us with some very lively (and important) political debates.

The good news is that somehow, in spite of nasty politics, wars, economic gyrations, scandals, and natural disasters, we have always survived and eventually prospered. We think we will muddle through regardless of what gets thrown at us, in the short as well as the long run. We have to be optimistic—otherwise, we couldn't survive in this business!

*If it's good  
enough for  
Russia (and  
Serbia, and  
Ukraine, and  
Slovakia)...*

What follows is an article (edited very slightly) by Dr. Alvin Rabushka of The Hoover Institution. Dr. Rabushka and his colleague, Dr. Robert Hall, were the initial proponents of the flat tax. Their arguments have influenced many and have resulted in significant change in several countries. As this article shows, their ideas work in the real world.

• • • • •

On January 1, 2001, a 13% flat-rate tax on personal income took effect in Russia.... Russia's 13% flat tax replaced a three-

bracket system, which imposed a top rate of 30% on taxable income exceeding \$5,000. The flat tax has been remarkably successful by every conceivable measure, and has encouraged such other countries as Serbia (2003), Ukraine (2004), and Slovakia (2004) to implement flat taxes of their own. Political parties in Poland, the Czech Republic, and Georgia have announced their support for the flat tax, and there is interest in Bulgaria and Romania. Even China has taken the step of translating *The Flat Tax* [a book by Dr. Rabushka—ed.] into Chinese for consideration by the Ministry of Finance.

Let's review Russia's 13% flat tax since its implementation on January 1, 2001. In 2001, personal income tax (PIT) revenue totaled R255.5 billion, an increase of 46.7% in nominal rubles, or 25.2% in real rubles after adjusting for inflation of 21.5%. PIT revenue as a share of consolidated budget tax revenue rose from 12.1% in 2000 to 12.7% in 2001. Since economic growth of 5.1% in 2001 was lower than the post-Soviet record 10.0% growth in 2000, the rise in revenue cannot be attributed solely, or even largely, to growth in 2001....

In 2002, PIT revenue amounted to R357.1 billion, an increase of 39.7% over 2001. After adjusting for inflation of 15.1%, real revenue rose 24.6%, supplying 15.3% of the consolidated budget. GDP growth in 2002 was 4.7%, a small decline over 2001....

In 2003, PIT revenue generated R449.8 billion, a nominal gain of 27.2% over 2002. After adjusting for inflation of 12.0%, real revenue increased 15.2%, supplying 17% of consolidated budget revenue. GDP growth in 2003 was a more robust 7.3%. Only corporate income tax and value added tax generated more revenue than the PIT.

The composition of PIT revenue in 2003 was as follows: taxes assessed on income at the 13% rate generated 96.9% of all PIT revenue; taxes on dividends, assessed at a higher 30% rate, 1.9%; and taxes on non-residents and individual entrepreneurs, 0.9%.

In the three years since the top rate of PIT was reduced from 30% to 13%, real flat tax revenue has risen by 79.7%. Russia's budget is relatively healthy. Tax compliance has improved. And incentives to work, save, and invest remain strong.

(Anjela and Diana Kniazeva, graduate students in the Department of Economics, Stern School of Business, New York University, provided research assistance for the preparation of this article.)

• • • • •

So, just what are we waiting for??? Bring on that flat tax!

***Tax reduction  
for the  
self-employed***

Until we get the flat tax, and even if we do, those of you who are self-employed (or whose spouses are self-employed) may wish to take advantage of a relatively new development on the retirement plan front: the individual 401(k). This plan allows self-employed individuals to sock away significantly more than is allowed in a SEP-IRA.

For example, an individual with Schedule C net business income (before retirement contributions) of \$100,000 can put about \$18,600 into a SEP-IRA. Because of its salary deferral provisions, the 401(k) plan will allow an additional contribution of \$14,000 in 2005. Moreover, if the individual is over 50, he or she can make an additional "catch-up" contribution of \$4,000, for a total contribution to the plan of over \$36,600.

Another advantage of such plans is that, depending on the custodian, you may be allowed to roll other retirement plan assets into this plan. For example, if you have an existing SEP-IRA, you may be able to transfer those assets into the 401(k), thus reducing paperwork and simplifying your recordkeeping.

While we know for sure that both Schwab and Fidelity offer these plans, other mutual fund companies and brokerage firms may as well. At Schwab and Fidelity, there is

no cost to set up or maintain these plans. The only caveat is that in order to qualify for 2005, you must establish the plan before the end of the year, although funding need not take place until the deadline for filing your taxes, most likely April 15, 2006. However, since you probably want to maximize the benefits of tax deferral, you should make your contributions as early in the year as possible, thus maximizing the compounding period. Of course, you need to be able to estimate your income for the year reasonably accurately.

As in all matters having to do with taxes, we strongly recommend that you consult your tax advisor before making any decisions about matters that affect your taxes.

***On the  
technology front***

We hereby offer two suggestions that may make your online life both safer and easier. In our last issue, we wrote about the growing number of threats to secure personal computing—viruses, spyware, etc. One of the ways that certain threats get into computers is via websites that install unwanted software. Microsoft’s Internet Explorer is notoriously unable to ward off such threats.

Fortunately, there is a new browser, named Firefox, that not only addresses many of the security weakness of MSIE but also adds numerous enhancements, such as tabbed browsing (the ability to have many pages open at once, each on a separate tab inside the browser), pop-up blocking, and others. Firefox is a free download from [www.mozilla.org](http://www.mozilla.org). It has been reviewed very favorably by many technology writers, most recently in the 12/30 edition of *The Wall Street Journal*. We have used it successfully both at work and at home and recommend it as a way to browse safely without having to install separate spyware and ad and popup blocking software.

The interesting service we like is Yodlee ([www.yodlee.com](http://www.yodlee.com)). Yodlee is an “account aggregation” service: after installing it, you enter your bank account, investment, credit card, and mileage and reward card numbers and login

information, and Yodlee tracks them for you. This way, you see everything in one place without having to go to each individual website to see your account information.

***The end of  
an era***

Some of our clients and most of our referral sources know that since the early 1990s, we have managed two limited partnerships for the benefit of clients (and friends and relatives of clients, friends of the firm, and employees) whose accounts were below our minimum account size of \$2MM. These partnerships, Libra Partners, L.P. and Taurus Growth Partners, L.P., were operated like private mutual funds but with quarterly instead of daily liquidity.

With the onset of increased regulation (and the associated cost increase to investors) plus the availability of new types of securities that facilitate the management of smaller accounts, we decided to terminate these partnerships. Most of the investors have converted to our new service for smaller accounts, which uses exchange traded funds (ETFs) as the primary investment vehicle. If you know of any individuals who might benefit from this service, we would be happy to discuss it with them.

***Woof woof***

*“The reason a dog has so many friends is that he wags his tail instead of his tongue.” —Anonymous*

*“Don’t accept your dog’s admiration as conclusive evidence that you are wonderful.” —Ann Landers*

*“If there are no dogs in Heaven, then when I die I want to go where they went.” —Will Rogers*

*“There is no psychiatrist in the world like a puppy licking your face.” —Ben Williams*

*“A dog is the only thing on earth that loves you more than he loves himself.” —Josh Billings*

*“The average dog is a nicer person than the average person.”  
—Andy Rooney*

*“We give dogs time we can spare, space we can spare and love we can spare. And in return, dogs give us their all. It’s the best deal man has ever made.” —M. Facklam*

*“A dog teaches a boy fidelity, perseverance, and to turn around three times before lying down.” —Robert Benchley*

*“I wonder if other dogs think poodles are members of a weird religious cult.” —Rita Rudner*

*“Dogs need to sniff the ground; it’s how they keep abreast of current events. The ground is a giant dog newspaper, containing all kinds of late-breaking dog news items, which, if they are especially urgent, are often continued in the next yard.” —Dave Barry*

*“Anybody who doesn’t know what soap tastes like never washed a dog.” —Franklin P. Jones*

*“My dog is worried about the economy because Alpo is up to \$3.00 a can. That’s almost \$21.00 in dog money.”  
—Joe Weinstein*


### ***Inside Woodside***

The launch of our new (and we think very attractive) website is only weeks away. We’ll send out a blast email to clients and friends of the firm once it is up and running. For our clients, who will have access to a secure, client-only area, there will be numerous enhancements, including online document storage for trusts, contracts, etc. Clients will also have the ability to “aggregate” bank, credit card, investment, and rewards program information in one place so that they can see their entire financial picture all in one place. And, they will be able to choose who else if anyone can see all or part of that information. (This aggregation service will be provided by Yodlee, described above.)

### ***And, last but not least . .***

A happy, healthy, prosperous and rewarding 2005 to all! ☒

## WOODSIDE ASSET MANAGEMENT, INC.

Woodside Asset Management, Inc. is an investment management and personal financial counseling firm. Our investment philosophy is based on a time-tested strategy of diversification across six principal asset classes: cash, bonds, domestic and foreign stocks, natural resources, and real estate. The firm is registered with the Securities and Exchange Commission. All services are provided on a fee-only basis. Questions, comments and inquiries, whether about *FOCUS* or about the firm, are invited. Also, please visit our web site at [www.woodsideasset.com](http://www.woodsideasset.com) for further information. 

*Woodside Asset Management, Inc. is a wholly-owned subsidiary of Silicon Valley Bank, a Silicon Valley Bancshares company (NASDAQ: SIVB). Silicon Valley Bank serves emerging growth and middle-market companies in targeted niches, focusing on technology and life sciences, while also addressing other specific industries in which it can provide a higher level of service and better manage credit through specialization and focus. SVB Private Bank, of which Woodside is a part, offers a variety of specialized services tailored to the needs of company executives, entrepreneurs and other professionals.*

*The Bank has 11 offices throughout California and operates regional offices in Phoenix, Arizona; Boulder, Colorado; West Palm Beach, Florida; Atlanta, Georgia; Chicago, Illinois; Boston, Massachusetts; Minneapolis, Minnesota; New York, New York; Durham, North Carolina; Portland, Oregon; Philadelphia, Pennsylvania; Austin, Texas; Dallas, Texas; Northern Virginia; and Seattle, Washington. More information on the Bank can be found at [www.svb.com](http://www.svb.com)*

## WOODSIDE ASSET MANAGEMENT, INC.

3000 Sand Hill Road 2/160

Menlo Park, California 94025

(650) 854-5100

[www.woodsideasset.com](http://www.woodsideasset.com)

e-mail: [info@woodsideasset.com](mailto:info@woodsideasset.com)

© Copyright as of the date on this publication, Woodside Asset Management, Inc. All rights reserved. *FOCUS* is published quarterly. The information in this publication has been obtained from sources believed to be reliable, but its accuracy and completeness cannot be guaranteed.

