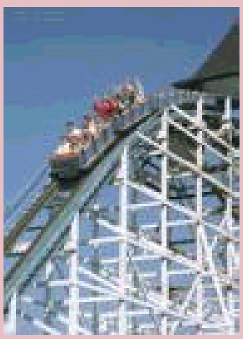
Quarter Notes
FIRESTONE CAPITAL MANAGEMENT, INC.

JACK M. FIRESTONE, CFP
CAROL G. KAUFMAN, CFP
www.firestonecapital.com

January 2001 | First Quarter 2001 | Volume 8 No. 4

Bits and Pieces

We can now e-mail you reports on demand. All you need is Adobe Acrobat reader (a free download) to view. This will be especially helpful at tax time. For instructions on how to use call us.



In this Issue

1500 San Remo Ave.
Coral Gables, FL 33146
Tel: 305-669-2119
Fax: 305-669-1976
jack@firestonecapital.com
carolk@firestonecapital.com

How Do We Measure Success When Markets are Bad?

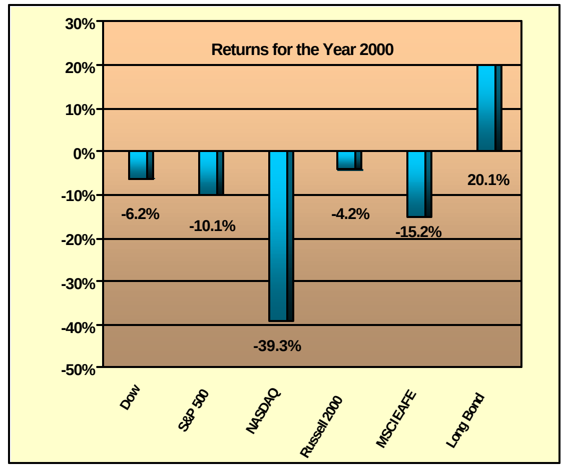
The equity markets in 2000 reminded us of the 1973-74 "Chinese water torture" decline when the S&P fell nearly 50% from peak to trough. While large stocks didn't fair that badly this year, NASDAQ did fall 50% from its March high.

A number of factors contributed to the markets' deterioration. Rising interest rates cooled an overheated economy and constrained unsustainable growth. Consumers and corporations had maxed out their ability to borrow. Higher oil prices, increased layoffs and reduced capital spending led to lower consumer confidence. Market losses have made consumers feel poorer and consequently spend less. As sales decline, so do corporate profits. Ultimately, the expectations of future profits drive stock prices. Thus, slowing earnings, even of solid, profitable companies, led to a fall in stock prices.

For companies without profits, prospects of profits or a viable business plan, the fall was most severe. The technology run-up resembled the era of the nifty 50 stocks in the seventies during which some investors believed no price was too high to pay for America's best companies. Many took years to recover, some of them like Polaroid never did. Now the Internet bubble finally burst.

With the equity markets experiencing their worst year since the seventies, how do we measure success for our clients under these difficult conditions?

Our clients, as a whole, fared much better than the indices would suggest. We measure success in bad markets on a relative basis. Our clients suffered comparatively little, with small single digit losses for our more aggressive clients and small single digit gains for our most conservative clients. The year end numbers, however, don't tell the whole story of what we have accomplished in declining markets.

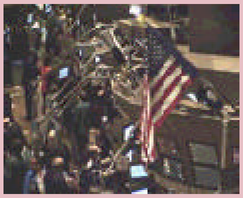


Here are some of the things we were able to do for you during this difficult year:

- *Risk management:* For clients who resisted the urge to place bets on individual stocks, we managed to shelter the worst of the market damage. The difficulties of being overweighted in technology were harder to control, given that tech has become a significant component of most indices. However, using our portfolio tools we were able to evaluate and reduce sector exposure.

- *Asset Allocation:* In sticking to our guns in promoting full complements of bonds and real estate in our portfolios, we captured the returns of the two best asset classes this year. In addition, by encouraging clients to take profits early in the year in positions which had run up in value, we protected profits and permitted the client to reap the benefits of diversification. This is validation for asset allocation and rebalancing.

- *Tax Savings:* We estimate clients have saved a total of several hundred thousand dollars in capital gains taxes through aggressive harvesting of losses to offset declared or recognized gains. With this service alone, we covered our fees. *(Continued next Page Column 2)*



Quips for the Quarter

"The worse you feel, usually because the news is bad, the safer the market is. The better you feel, usually because the news is good, the closer you are to a top."

-John Train

Don't panic when the market seems to be falling apart.

Big drops in the market are almost always great buying opportunities.

It was the steady clients who kept their heads when the stock market took a nose dive in 1998, who then saw their holdings eventually recover and produce attractive returns in 1999.

Firestone Capital Management files annual updates to our ADV registration form. If you would like to be sent a copy of the form when it is filed, please call the office we will be happy to send you one.

Long Term Health Care Revisited

Until recently, long term care insurance was designed for the modestly affluent. The very wealthy could afford to self insure entirely and those of modest means could qualify for Medicaid.

This is still true. However, our concept of those who should completely self insure has changed over the past few years. As medical advances have lengthened lives, they have also expanded the time for which some additional assistance might be necessary.

In the event of an incapacity, most of our clients would prefer to remain in their own homes to receive extended care rather than in a nursing home. In South Florida, it currently costs about $8,000 a month to have 24/7 care from a semiskilled care giver. Nursing home care costs about half as much.

For many of our clients, paying for this type of care would not jeopardize their financial futures or those of their loved ones, but for those who would suffer financial difficulties by paying for this care, buying long term care insurance makes sense.

The National Association of Insurance Commissioners *(www.naic.org or phone 816-842-3600)* offers a comprehensive guide to long term care insurance. We are available to discuss this issue with you individually.

IRA Required Minimum Distributions

If this is the year in which you will turn 70½, you need to make certain decisions regarding your IRA accounts and Qualified Plans. You must begin taking at least the required minimum distributions (RMD) by April 1 of the year following the calendar year in which you turned 70½. *(However, if you wait until April 1st, you will have to recognize 2 years worth of distributions as taxable income in the same year.)*

Your method of calculating your RMD requires some decisions among complicated options, so give yourself some time to evaluate the choices. We have an extensive presentation we can review with you regarding your options

Schwab can calculate and/or distribute the required minimum distribution from your IRAs if they are all held at Schwab. But you still have to decide which calculation method you want to use. Please let us know if you want us to prepare the necessary forms.

Continued from Page 1 Column 2

- *Estate Planning:* We guided clients through estate planning, working with their attorneys on wills and trusts and to evaluate family and charitable gift opportunities.

- *Repositioning:* By quantifying and reducing portfolio risk, curbing aggressive instincts and reducing portfolio costs, we believe we have positioned our clients well to take advantage of investment opportunities ahead.

We want to thank you for the opportunity of serving you and wish you a healthy, happy and prosperous New Year.

Capital Gains Rate Changes

Long-term capital gains will be lowered under a new law which takes affect on January 1st 2001.The new rates allow those currently in the 15% tax bracket to be taxed at 8% on long term capital gains and those in the higher tax bracket to be taxed at a rate of 18% on long term-capital gains on assets held over 5 years.

The new rules won't be of much benefit to most clients now for existing holdings, but can be used very effectively for gifts to minors who pay taxes in the lower brackets.

The rules are different for investors in the lower tax bracket. The gift giver's original holding period as well as cost basis are transferred to the receiver once the gift is completed. Therefore, they only need to hold the assets for 5 years by January 1st, 2001 in order to take advantage of the lower rates. This represents a significant planning opportunity for investors who are gifting to minors in the lowest tax bracket. This strategy can result in turning a potential 20% tax liability into an 8% long-term capital gains tax.

In order for an individual in the higher tax-bracket to take advantage of this rate decrease, the asset must have been bought after January 1st, 2001 and held for 5 years. However, an investor could report capital gains on assets bought before January 1st, 2001 as if they were sold and bought back on this date and future gains could be taxed at the new lower rate. The downside of this action, however, requires you to pay capital gains taxes now even on assets you don't sell. Further, you must hold the postion another five years to benefit from the lower rate.