

PEARSON Investment Letter

Published Monthly Since 1982

www.pearsoncapitalinc.com**FEATURED STOCKS**

Abercr. & Fitch	HDFC Bank
CACI Intl	Nicholas Finc
Cal Dive Intl	Prosperity Bancs
Caremark Rx	True Religion

GROWTH & INCOME STOCKS

Bank Of America	Mercantile Bank
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INVESTMENT STORMS**BY DONALD PEARSON**

With hurricanes causing problems, and heating costs continuing to climb, the stock market has had a

conditions, or companies themselves, continue to change. Look at Microsoft. From a small unheard of company started in a garage, they grew to a large stable company minimizing volatility, and then to a cash cow now sending dividends back to the share holders. Through this period the company has gone from growth to value, back to growth, and again back to value.

For the first half of this decade value has outperformed growth, but smart shoppers looking for both can do better. With companies using their excess dollars to buy back their own company stock, they not only make a powerful statement about their company's upcoming performance, they are backing it with their cash. A company doing this is a good example of one which could be a growth company soon to be undervalued.

As we continue to build a core group of stocks for all portfolios, yields are prioritized at every check point, especially if they are being increased every year. A group of fifty-seven companies that have increased their dividends for twenty-five consecutive years can be found on the Standard & Poor's web site. Even with increasing dividends we wouldn't select them unless the value and growth elements were there too.

Another example of longer performance results would be examining Citigroup. The nation's largest bank has increased its dividend 35 percent since 2002. Their diverse business mix results with 50 percent of sales coming from lending. When Citigroup dipped because of brokerage house scandals, they still remained a financial powerhouse expected to report strong earnings for many years.

With our evaluation process we expect a growth rate of approximately 12 percent for five years along with a yield of more than 4 percent. We then can evaluate the stock to be 25-30 percent undervalued, a perfect example of value and growth combined. When we decide upon a sector or an area of the world in which we believe our clients should be represented, we can research and select an ETF that replicates our objective, thus again improving and diversifying the portfolio further. As we saw a poor performing stock market in October, coupled with the indexes being negative year to date, we can take comfort in knowing we are at the end of earnings and hurricane season, and the many quality companies that were affected can get their businesses back to what they do best, growing their business and their stock price for us the investor.

DP

very volatile month. Many times a single event such as a hurricane can trigger changes in many different sectors. When we are reviewing companies for purchase, oftentimes these variables cannot be foreseen. Healthcare providers, restaurants, insurance companies, and many more good companies have been negatively affected by these storms. So, when we see companies like Coventry Health hiccup, we know holding for the long range is the right philosophy.

Although many quality companies were a disappointment for the quarter, they must be reviewed individually before any decisions can be made as to their future with us. When one builds a portfolio of stocks, success can be more readily attained if you have a well-thought-through strategy that has been tested through good and bad times. Although many mutual funds favor growth, many others favor value, and through different periods they are often compared with a slight advantage given to one versus the other. What becomes difficult is staying true to your conviction and staying the course when you see one outperforming the other. Warren Buffet always said he was buying when others were selling and selling when others were buying. His philosophy is a good example of staying the course in good and poor market conditions.

Our opinion is similar in many ways with perhaps a small deviation. We believe one who focuses on either cannot do as well as one who focuses on both, even though it is considerably more difficult. Those account managers who are one dimensional cannot guarantee success, and neither can we by trying to do both, yet we've found that over time our formula has stood through the many diverse markets that have tested us. Our objective is finding, through extensive research done primarily through our own personnel, a diverse group of U. S. companies worth more than their current stock prices indicate. Along with this they must project rising cash flow and profit for several years. Although our economic landscape continues to change, this philosophy proves to be successful because many stocks will change as market conditions, economic



Walter D. Pearson
Chairman



Donald E. Pearson
President



Sandra Alberti
Publishing President

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SOCIAL SECURITY

By Walter Pearson

It seems the social security system has run out of money. This is the information I read in the newspapers these days. The problem I have with this story is that I happen to have been around when this issue was developed. I can still remember I was only about 20 years old or thereabouts, and I didn't care much for the idea then and I still don't. I didn't have any money and my family was broke, but I had been raised to be independent, to make my own way, and save a little, if possible, as I made my way.

However, the deal went through and a portion of each person's salary would be withheld each payday. It would be put aside for him, and the government would see to it that he received a lifetime pension when he attained retirement age. It wasn't long after that the screaming started. It seemed the government wasn't doing it that way. They were using the social security money for everyday expenses. The answers came out that it didn't make any difference. The bills had to be paid; social security would be paid later.

Now the conversation we are receiving is based upon the original idea. We are being told that the system will fall apart a few years from today unless something is done. What it comes down to is that social security should be a private affair. It should be set up on a voluntary basis. You should have a choice, in or out. And, the money should be invested by professionals, not politicians.

It is my opinion that we should think of social security the way I used to. When I started in this business in 1952, I can vividly recall that I had to call Boston each day in order to enter the orders for the day. With each new customer I would also have to give the name, address and social security number. When I came to the last part, I would say, socialized and insecure, and then give the number. That's what I thought of the system then and my thinking hasn't changed.

Back in those days when talking to a new prospect who had never invested, it was often hard to get him or her to see the light. Many people felt they did not have to consider saving for the future inasmuch as social security was there to see them through when they reached retirement age. I thank my lucky stars that I did get a number of people to see things my way, or at least to consider the fact that I might just possibly be right.

One of the important things to understand these days is inflation. I think everyone understands the basic issue, but I don't believe there are many who realize how diabolic this travesty really is. I can remember as a youngster that you were sometimes told not to buy just yet. If we wait, the price may come down. With inflation, we no longer play the waiting game. However, maybe we could turn this thing around and have inflation work for us?

When the war was over, I was shipped home on a boat with 500 other men. I had been playing poker for the last year and had done quite well. In spite of the fact that there were poker games all over the boat, I decided to take home what I had. So I watched the others. After about ten days there was only one game left with two men. They each had a stack of \$10 bills in front of them. I watched one guy legally cheat the other guy out of his whole stack. He would raise a pot by counting out ten and ten and ten and would keep going until he would see his opponent wilt or look happy. If the opponent wilted, he would raise a few hundred and take the pot when the opponent folded. If the opponent got excited, he would change his mind and pull out. Eventually he had all the money.

The reason he won is that he had the answer and he put it to use. You may not agree that it was a nice thing to do, but all is fair in love or war and the war had only been over for a short time. Let's talk about inflation and how to use similar tactics. Fifty years ago a nice little five-room home sold for about \$3000. Today it sells for about \$300,000 or 100 times as much. It is easy enough to see now that we could have bought four homes for \$12,000, and today we would be sitting on more than a million dollars. Homes do not grow, they do not increase in value. The value of the money goes down and home prices go up.

Going one step further, instead of investing in a stable issue like a home, why not invest in a growing company? Consider McDonald's or Coca Cola. These companies have grown considerably through the years, so inflation gives a double whammy. Let's look at some figures. Had you bought Coca Cola in 1977, you would have paid \$1.60 a share (adjusted for splits). It is now about \$42, an increase of about 26 times. McDonald's then was \$1.34 and is now about \$28 or about 22 times. This means that a \$12,000 investment in Coca Cola 28 years ago would now be worth \$312,000. McDonald's would have brought you about \$265,000. Had you picked up Microsoft or Cisco ten or fifteen years ago, you would have seen \$12,000 grow into more than \$1,000,000 in just fifteen years.

Walter Pearson is the former President of First New England Securities, Co., Inc. and at that time, also managed the Statistical Department. He is the author of the book, "Investing for the Millions" and Publisher Emeritus for the Pearson Investment Letter. At this time, Mr. Pearson is Chairman of the Board of Pearson Capital, Inc. He is a contributing columnist for various publications and is listed in Who's Who in America.

"Remember the Lord your God, for it is He who gives you the ability to produce wealth. Deut. 8:18"

PEARSON CAPITAL'S RECOMMENDED STOCKS FOR NOVEMBER 2005

ABERCROMBIE & FITCH CO (ANF) NYSE PRICE: \$51.99

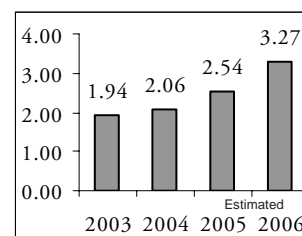
Abercrombie & Fitch Co., a Delaware corporation (A&F), through its subsidiaries (collectively Abercrombie & Fitch), is a specialty retailer that operates stores selling casual apparel, such as woven and knit shirts, denim, graphic t-shirts, shorts, personal care and other accessories for men, women and kids under the Abercrombie & Fitch, abercrombie, Hollister and RUEHL brands. During the fiscal year ended January 29, 2005 (fiscal 2004), the Company operated 788 stores in the United States. Abercrombie & Fitch Co. through its subsidiaries, is a specialty retailer that operates stores selling casual apparel, personal care and other accessories for men, women and kids under the Abercrombie & Fitch, abercrombie and Hollister brands. The Company opened 113 stores and closed 25 stores during fiscal 2004.

Type: Growth
Sector: Retail

Institutional Holdings: 313
Industry: Apparel

Ratings & Recommendations Earnings per share

Current P/E Ratio: **19.1**
Annual Yield: **1.0%**
Annual Dividend: **\$0.50**
Investor's Bus. Daily: **C-**
Pearson Growth Rating: **B**
Pearson Value Rating: **B+**
Stand.&Poor Rating: **A+**
Value Line Rating: **1-3-4**



CACI INTERNATIONAL, INC (CAI) NYSE PRICE: \$54.54

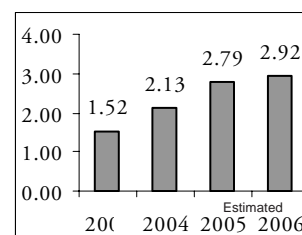
CAI is engaged in the business of simulation technology, and has diversified primarily within the information technology (IT) and communications industries. The Company primarily delivers IT and communication solutions to clients through four areas of expertise or service offerings systems integration, managed network services, knowledge management and engineering services. Through these service offerings, it provides practical IT and communications solutions by adapting emerging technologies and evolving legacy strengths in such areas as information assurance and security, reengineering, logistics and engineering support, automated debt management systems and services, litigation support systems and services, product data management, software development and reuse, voice, data and video communications.

Type: Growth
Sector: Technology

Institutional Holdings: 207
Industry: Computer Services

Ratings & Recommendations Earnings per share

Current P/E Ratio: **19.3**
Annual Yield: **0%**
Annual Dividend: **\$0**
Investor's Bus. Daily: **C+**
Pearson Growth Rating: **A**
Pearson Value Rating: **A**
Stand.&Poor Rating: **B-**
Value Line Rating: **3-3-2**



CAL DIVE INTERNATIONAL INC (CDIS) NASDAQ PRICE: \$61.54

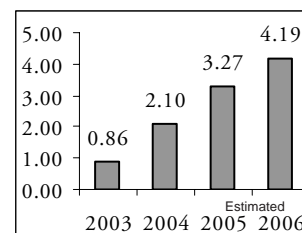
CDIS operates as an energy services company in the Gulf of Mexico, and in the North Sea and the Asia/Pacific regions. It offers a range of marine contracting services, such as marine construction, robotic services, manned diving, and decommissioning services. CDI, with its fleet of 22 vessels and 26 remotely operated vehicles and trencher systems, performs various services that support drilling, well completion, intervention, construction, and decommissioning projects. CDIS's customers include independent oil and gas producers, pipeline transmission companies, and offshore engineering and construction firms. As of 12/31/04, it had 53,204 million cubic feet of proved natural gas reserves and 10,517 thousand barrels of proved oil and condensate reserves. CDIS also owned an interest in 252 net oil wells and 91 net natural gas wells.

Type: Growth
Sector: Basic Materials

Institutional Holdings: 240
Industry: Oil & Gas Equip.

Ratings & Recommendations Earnings per share

Current P/E Ratio: **24.2**
Annual Yield: **0%**
Annual Dividend: **\$0**
Investor's Bus. Daily: **A+**
Pearson Growth Rating: **A**
Pearson Value Rating: **A**
Stand.&Poor Rating: **B-**
Value Line Rating: **1-3-2**



CAREMARK RX, INC (CMX) NYSE PRICE: \$52.40

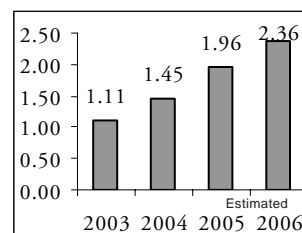
CMX is a pharmaceutical services company that conducts its operations primarily through Caremark Inc. (Caremark) and CaremarkPCS (f/k/a AdvancePCS) (CaremarkPCS) subsidiaries. The Company's pharmaceutical services are referred to as pharmacy benefit management (PBM) services and involve the design and administration of programs aimed at reducing the costs and improving the safety, effectiveness and convenience of prescription drug use. The Company's customers are primarily sponsors of health benefit plans (employers, unions, government employee groups, insurance companies and managed care organizations) and individuals located throughout the U.S. During the year ended 12/31/04, Caremark Rx managed over 484 million prescriptions for individuals from over 2,000 organizations.

Type: Emerging Growth
Sector: Services

Institutional Holdings: 615
Industry: Retail (Drugs)

Ratings & Recommendations Earnings per share

Current P/E Ratio: **29.7**
Annual Yield: **0%**
Annual Dividend: **\$0**
Investor's Bus. Daily: **A+**
Pearson Growth Rating: **A-**
Pearson Value Rating: **A-**
Stand.&Poor Rating: **A+**
Value Line Rating: **2-3-3**



PEARSON CAPITAL'S RECOMMENDED STOCKS FOR NOVEMBER 2005

HDFC BANK LIMITED (HDB) NYSE PRICE: \$44.19

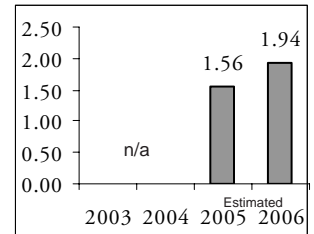
HDFC Bank Limited (the Bank) is a private sector bank in India. The Bank at present has a network of over 495 branches spread over 218 cities across India. The Company's automated teller machines (ATM) network can be accessed by all domestic and international Visa/MasterCard, Visa Electron/Maestro, Plus/Cirrus and American Express Credit/Charge cardholders. The Bank operates in three segments: retail banking, wholesale banking and treasury services. In addition, the bank provides telephone, Internet, and mobile telephone banking services. As of March 31, 2005, it operated 467 branches and 1,147 ATMs in 211 cities. The company was incorporated in 1994 and is headquartered in Mumbai, India.

Type: Growth
Sector: Financial

Institutional Holdings: 32
Industry: Regional Banks

Ratings & Recommendations Earnings per share

Current P/E Ratio: **27.5**
Annual Yield: **0.70%**
Annual Dividend: **\$0.31**
Investor's Bus. Daily: **A**
Pearson Growth Rating: **A**
Pearson Value Rating: **A-**
Stand.&Poor Rating: **N/R**
Value Line Rating: **N/R**



NICHOLAS FINANCIAL, INC. (NICK) NASDAQ PRICE: \$10.30

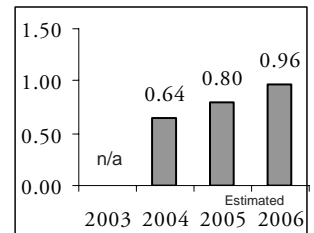
Nicholas Financial, Inc. (Nicholas Financial-Canada) is a holding company. The business activities of Nicholas Financial-Canada are conducted through its two wholly owned subsidiaries: Nicholas Financial, Inc. (Nicholas Financial) and Nicholas Data Services, Inc., (NDS). Nicholas Financial is a specialized consumer finance company engaged primarily in acquiring and servicing retail installment sales Contracts (Contracts) for purchases of new and used automobiles, and light trucks. To a lesser extent, NICK also makes direct loans and sells consumer-finance related products. NDS is engaged in supporting and updating industry specific computer application software for small businesses located primarily in the Southeast United States. Nicholas Financial was incorporated in 1986 and is headquartered in Clearwater, Florida.

Type: Growth
Sector: Financial

Institutional Holdings: 10
Industry: Financial Services

Ratings & Recommendations Earnings per share

Current P/E Ratio: **11.2**
Annual Yield: **0.60%**
Annual Dividend: **\$0.07**
Investor's Bus. Daily: **C**
Pearson Growth Rating: **A**
Pearson Value Rating: **A+**
Stand.&Poor Rating: **N/R**
Value Line Rating: **N/R**



PROSPERITY BANCSHARES, INC. (PRSP) NASDAQ PRICE: \$30.46

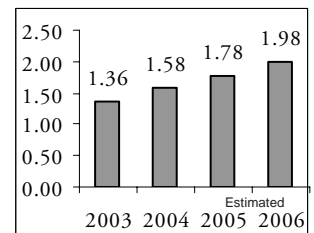
PRSP operates as the holding company for Prosperity Bank (bank). The bank provides a line of financial products and services to small and medium-sized businesses and consumers. It offers various deposit products, such as certificates of deposit, checking with interest accounts, savings accounts, and overdraft protection. The bank provides loans for automobiles and other consumer durables, home equity loans, debit cards, Internet banking, other cash management services, and automated telephone banking. As of 03/31/05, it operated 85 banking locations with 33 in the Greater Houston consolidated metropolitan statistical area; 18 in south and southwest of Houston, and south Texas; 7 in the Austin, Texas; 16 in the Corpus Christi, Texas; and 11 in the Dallas/Fort Worth, Texas. Prosperity Bancshares is headquartered in Houston, Texas.

Type: Emerging Growth
Sector: Financial

Institutional Holdings: 88
Industry: Regional Banks

Ratings & Recommendations Earnings per share

Current P/E Ratio: **17.7**
Annual Yield: **1.00%**
Annual Dividend: **\$0.33**
Investor's Bus. Daily: **A-**
Pearson Growth Rating: **A-**
Pearson Value Rating: **B-**
Stand.&Poor Rating: **N/R**
Value Line Rating: **2-2-1**



TRUE RELIGION APPAREL, INC. (TRLG) NASDAQ PRICE: \$12.51

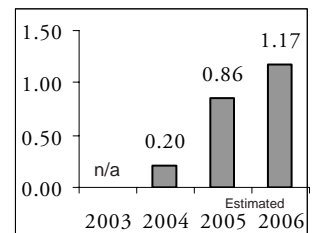
TRLG was established in Dec. of 2002 to take denim in a refreshing new direction. Its products include jeans, skirts, denim jackets, and tops. Husband and wife designers, Jeffrey and Kym Lubell have combined his love of classic rock and her love of hip-hop and R&B to produce a trendsetting line made to exceed consumers' expectations of denim apparel. Magazines including Elle, Bazaar, InStyle, NY Times, Los Angeles Magazine, Lucky, GQ, Razor, DNR, Rolling Stones, Men's Health, Vogue, Intl' Publications, Teen People, Teen Vogue, Star, People, InTouch, Life & Style, and US Weekly have recently featured True Religion Brand Jeans apparel. TRLG distributes its products in Mexico, Canada, the UK, Italy, Germany, Switzerland, Japan, Holland, France, Spain, South Africa, and Scandinavia. True Religion Apparel is based in Los Angeles, CA.

Type: Emerging Growth
Sector: Consumer Goods

Institutional Holdings: 19
Industry: Textile

Ratings & Recommendations Earnings per share

Current P/E Ratio: **23.6**
Annual Yield: **0%**
Annual Dividend: **\$0**
Investor's Bus. Daily: **A**
Pearson Growth Rating: **A**
Pearson Value Rating: **C+**
Stand.&Poor Rating: **N/R**
Value Line Rating: **N/R**



WALL STREET INDEXES

Indexes	1999	2000	2001	2002	2003	2004	05/YTD
S&P 500	21.1%	(10.1%)	(13.3%)	(23.4%)	26.4%	9.0%	(0.4%)
Dow Jones	25.2%	(6.2%)	(7.1%)	(16.8%)	25.3%	3.2%	(3.2%)
Nasdaq	85.6%	(39.3%)	(21.1%)	(31.5%)	50.0%	8.6%	(2.5%)
Russell 2000	21.3%	(4.2%)	1.0%	(21.6%)	45.4%	17.0%	(0.8%)
Our CD Buster	Data available on our website			8.1%	56.7%	22.8%	(In Dispute)
CD Annual Average	4.9%	5.4%	3.0%	2.3%	1.5%	1.5%	3.5%

MARKET VIEW

Christopher Carothers - PCI's Stock Analyst

ECONOMIC FLOWS:

Monday's announcement of Ben Bernanke's nomination to replace Alan Greenspan placed an overall calm on the future of the stock market. He announced that the Fed will continue business as usual and follow the prescription of the age—fighting inflation. However, Mr. Bernanke is more fluid. He might let a little inflation appear here and there.



Key point: *The stock market remains calm regarding Greenspan replacement.*

EARNINGS FLOWS:

We are in the middle of the third quarter earnings season. November is here and, even though there are many warnings, earnings overall should grow about 13 percent. What is worrying the street is that the high gas and heating oil prices will eat into the entire fourth quarter earnings. Any type of negative announcement punishes the stock.

Key point: *Oil prices are worrying the market.*

CASH FLOWS:

One of my favorite web sites, Guru Focus.com, has a quote from Bill Miller, one of the great prognosticators from Legg Mason. His view of the market in the near future is kind of what I had in my last column. In my view, two things have kept our market from participating in the global rally: oil prices and the Fed. I think things are about to change, and soon. Indeed, they have already begun to change, and I believe the US market will begin to take notice in fairly short order. The old leadership in the market, oils, utilities, REITs, commodity related names, and housing, has all corrected more than the market in the most recent decline. This often suggests a change to new leadership. New leadership usually consists of those groups, sectors, or areas that are cheap, have performed poorly, and where expectations are low. The leading candidate that meets those criteria is the mega cap S&P 500, the group that peaked in early 2000 and that has trailed the mid and small caps ever since. Within that group, financials and technology appear most attractive, with low valuations, excellent balance sheets, and lots of share repurchase activity.

Key point: *The great man said what I said last time, large stocks look inexpensive given their potential.*

ADDITIONAL NOTES:

- Once again cash on cash rules the day. Let those companies buy back shares or give me some dividends.
- People are moving their stock money into real estate. This is causing stocks to become undervalued.

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Table of Contents

Walter's Wisdom:	2
Featured Stocks:	3
Featured Stocks:	4
Market Outlook / Pub.Notes:	5
Income Stocks:	6

NOVEMBER'S RECOMMENDED GROWTH & INCOME STOCKS

BANK OF AMERICA CORPORATION (BAC) NYSE PRICE: \$43.74

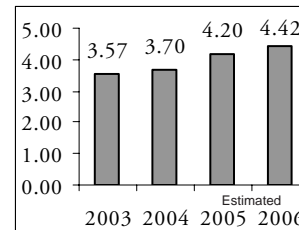
Bank of America Corporation is a bank holding company that conducts its operations through its bank and non-bank subsidiaries. The Company provides a range of financial services and products throughout the United States and in selected international markets. As of December 31, 2004, Bank of America operates its banking activities primarily under three charters: Bank of America, National Association (Bank of America, N.A.), Bank of America, N.A. (USA) and Fleet National Bank. The Company conducts its business through 25,000 locations in 44 states, the District of Columbia and 34 foreign countries. On April 1, 2004, the Corporation completed its merger with FleetBoston Financial Corporation. In October 2004, the Company acquired National Processing, Inc., a public company, which is 83% owned by National City Corporation.

Type: Growth & Income
Sector: Financial

Institutional Holdings: 966
Industry: Money Center Banks

Ratings & Recommendations Earnings per share

Current P/E Ratio: **10.6**
Annual Yield: **4.50%**
Annual Dividend: **\$2.00**
Investor's Bus. Daily: **C**
Pearson Growth Rating: **B-**
Pearson Value Rating: **A-**
Stand.&Poor Rating: **C**
Value Line Rating: **3-2-3**



MERCANTILE BANK CORPORATION (MBWM) NASDAQ PRICE: \$38.15

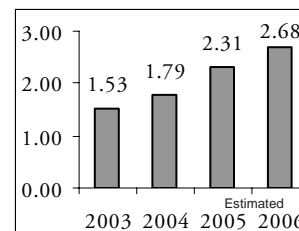
MBWM is a bank holding company of Mercantile Bank of West Michigan, which provides commercial and retail banking services to businesses based in and around the Grand Rapids and Holland metropolitan areas. It makes secured and unsecured commercial, construction, mortgage and consumer loans, and accepts checking, savings and time deposits. Courier service is provided to certain commercial customers and safe deposit facilities are available at all branch locations. Through a joint brokerage services and marketing agreement with Raymond James Financial Services, Inc., the Company offers its customers financial planning, retail brokerage, equity research, insurance and annuities, retirement planning, trust services and estate planning. Total deposits were \$1,159.2 million at December 31, 2004.

Type: Growth & Income
Sector: Financial

Institutional Holdings: 53
Industry: Regional Banks

Ratings & Recommendations Earnings per share

Current P/E Ratio: **16.5**
Annual Yield: **1.10%**
Annual Dividend: **\$0.44**
Investor's Bus. Daily: **C**
Pearson Growth Rating: **A-**
Pearson Value Rating: **A**
Stand.&Poor Rating: **D**
Value Line Rating: **N/R**



IRAs FOR 2006

By Donald Pearson

The Individual Retirement Account (IRA) is celebrating its thirtieth birthday this year. It's hard to believe IRAs represent only 25 percent of Americans' retirement savings, especially after seeing how much they have helped us to save and improve our quality of life. Many people eligible to have one do not, because they just don't understand how they work. If you are one of the 75 percent I'm referring to, you need to learn how and why an IRA can benefit you immediately.

Starting next year, you will be able to contribute to a NEW Roth 401k at your work place. Unlike the regular Roth IRA, there is no income limit on who may participate. Anyone can put away up to \$15,000 annually and \$20,000 if you're over fifty. If you leave your place of employment, you can roll this over into a regular Roth IRA. Another benefit of the new Roth IRA is no required mandatory withdrawals starting at age seventy and a half. If it's your choice to leave all or some of it to your heirs, or not take any until a later date, you can. The only downside to this is that at the start of the year, many companies won't have the necessary requirements set up. Businesses estimate about 30 percent will be ready to do this at the first of the year. Now is a good time to begin asking your employer about yours.

The conventional IRAs will remain the same for 2006 as they did for this year. The contribution limit will again be \$4,000 and \$4,500 if you're fifty years of age or older. Salary and other requirements or restrictions also remain the same. You can, and should, contribute as soon as possible once we've entered the new year. Many believe you must earn the money before making your annual contribution, but this is simply not the case. The government honors a leap of faith, assuming you will meet the requirements within the calendar year. For those who believe their interests are best served by splitting the proceeds between both their traditional IRA and their Roth, this can also be done any way you decide. Roth IRA withdrawals are never subject to income tax if certain conditions are met. Simply said, all the growth and profit belongs to you. What are you waiting for?

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Pearson Value Rating measures current value in terms of potential for the dollar. **Investors Business Daily** measures growth and relative price strength. **S&P** measures financial quality and growth potential. **Value Line** measures timeliness, value and safety.