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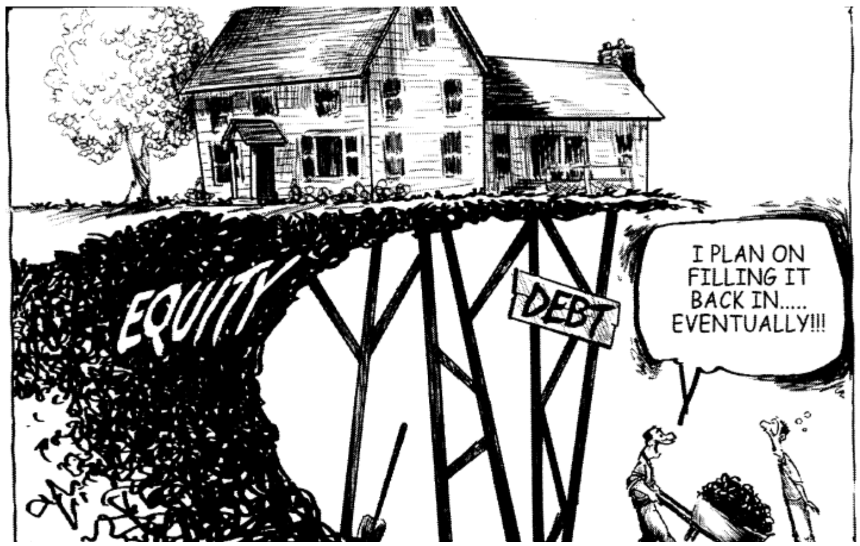
BFAS Money Line

Dow 12,000 - Time to Worry?

After a yo-yo year, the Dow has finally topped the peak it achieved in 2000. Considering the housing slump and rising interest rates, a rising stock market would seem to be a cause for celebration. However, the broader S & P 500 is still about 10% off its peak and the NASDAQ is over 50% off its peak.

The Federal Reserve has successfully met its goal of reducing inflation while puncturing the housing bubble. In doing so, they have raised short-term interest rates so high that they are higher than medium and long-term interest rates. This means **you can purchase a 12 month CD which pays more than a 10 year Treasury Note**. It also is a harbinger of a slow-down in the economy.

Higher short term interest rates than longer term rates indicates an inversion of the normal situation where the longer you hold a note (1, 5, 10, 20, 30 years), the higher interest you will earn. This **inversion of the normal yield curve frequently presages a recession**.



So here we are, celebrating a new peak in the Dow and I'm starting to use the "R" word! The housing slump alone is enough to slow the economy. While some pundits seem to think the housing slump is already over, I believe it will drag on for a couple of years and get much worse. **The probability of an outright recession is up to about 40%.**

To return to the housing issue; year-over-year housing prices have dropped for the first time in a long time. New housing starts are off dramatically. This impacts other parts of the economy as well due to reductions in appliance purchases, building materials, etc.

At the height of the real estate mania, over 25% of home purchases were speculative (bought to flip). Those at the tail end of that daisy chain are now caught with mortgages to pay and no buyers (at least at the price they need to break even).

Combine that with all the creative mortgages (interest only/adjustable rates) and you have a serious credit squeeze in real estate. Many people "bought up", that is they purchased homes they could only afford if they used creative mortgages. Now, with interest rates peaking, and their adjustable rates starting to ratchet up at the same time their home values are dropping, they are scrambling to find the cash to make mortgage payments. Money going to mortgage payments won't be circulating in the consumer economy that drives 70% of our gross domestic product.

A recent study showed 29% of home loans

had 0% equity in the house. It also showed that a 5% drop in home values would increase this number to 38%. I am already seeing anecdotal evidence of significant reductions in house prices in our area (the real estate assessor will, of course, be the last to know).

Several commercial condo/apartment projects are on hold pending a recovery in real estate. I believe **there will be significant bargains to be had in real estate within the next two years**! Remember the adage; **buy low, sell high works in real estate too!** For awhile now, it's been buy high, sell higher! That's over for now.

The numbers in the chart below represent one-year returns (note the **significant performance differences for value over growth and foreign over domestic**):

Asset Class	1 Yr Rtn (10/31/06)
S & P 500	+16.34%
NASDAQ	+11.62%
Lg Cap Gwth	+9.20%
Lg Cap Val	+20.75%
Mid Cap Gwth	+14.82%
Mid Cap Val	+17.73%
Sml Cap Gwth	+12.80%
Sml Cap Val	+21.55%
Foreign	+27.52%
Interm Corp Bds	+ 5.19%
Foreign Bds	+ 6.10%

Beware Gimmick Mortgages

All the aforementioned problems with mortgages have led to the rise of some mortgage gimmicks that purport to improve your situation while enriching the mortgage companies. All of these **gimmicks charge higher interest for their loans, but promise you will pay less interest for your house**. How can this be?

Here's the typical pitch: you have a 6.5% fixed, 30 year, $100,000 mortgage. The mortgage company says you can use a new home-equity loan with a variable rate starting at 7.72% which will allow you to pay off the loan in 15 ½ years while paying less in total interest than your original loan. They claim you would have to have a fixed interest rate of 3.83% to pay the same interest as their new loan.

The new loan may be set up as a cash management account where you deposit your entire paycheck and all deposits immediately reduce the outstanding balance of your loan. As you withdraw money to pay your other bills, your loan balance will go back up. The company may offer free online bill-paying and free ATM/checking as further enticements.

This is **all packaged as a savings move, is easy to set up and seems like a no-brainer.** The problem is the company is using an apples-and-oranges comparison to mislead you. They assume that you will leave an extra $800/mo in the cash management account to reduce the mortgage.

The fact is, **all of the savings comes from the increased payments, which you can do on your own without the new mortgage!** A fellow planner, David Jacobs of Kailua Hawaii, calculated that **if you directly added $800/mo to the existing fixed interest rate loan, you would pay it off in 14 years and 3 months or 15 months earlier than the gimmick loan**. More importantly, **you would be saving $45,000 more in interest by paying off the existing loan early rather than using the gimmick loan**!

Thus, you can see why these companies are making these pitches. They get higher interest, loan origination fees, set up fees and cash management account fees. **If you added these extra costs to your additional payments, you would pay off the mortgage another year earlier!** As David says, "**These schemes take the simple idea of making extra payments toward your principal and make it look more complicated so they can charge for what you could simply accomplish on your own.**"

Medicare Part B

In 2007, regular Medicare Part B (doctor's care) premiums will rise to $93.50 for most of you. However, some will pay more. If you are single and make more than $80,000 or married and make more than $160,000, you will pay a higher premium.

You should take note that **Social Security will be looking at your income from three years ago (2005) to determine your Medicare Part B premiums in 2007**. You will receive a letter from Social Security by the end of the year if your premium will be increased based upon your income.

If you had an unusually high income in 2005, you might want to appeal for Social Security to use more current information in making their premium determination. **Examples include: you were still working in 2005, but are retired now; you sold a home or some other major investment in 2005.**

Over the next three years, rates for higher income seniors will rise until the highest income beneficiaries are paying 80% of the actual cost. Here is the chart of new rates:

You Pay	Single	Married
$93.50	$80,000 or less	$160,000 or less
$105.80	$80,000 - $100,000	$160,001 - $200,000
$124.40	$100,001 - $150,000	$200,001 - $300,000
$142.90	$150,001 - $200,000	$300,001 - $400,000
$161.40	Above $200,000	Above $400,000

"My wife ran off with the guy who stole my identity."

Investors Confused Over Advice

Although you won't see much in the consumer media, there are major battles currently being fought over the quality of advice you receive. Recent regulatory changes by the Securities & Exchange Commission (SEC) should have made clear the responsibilities of financial professionals.

Yet, a survey by Penn, Shoen & Berland Associates, Inc. shows that **only 26% of investors were aware that stockbrokers are NOT required to disclose all conflicts of interest before providing financial advice**. It also found that **63% said they would not seek financial advice from stockbrokers if they knew that brokers provided fewer investor protections than Registered Investment Advisors (RIAs).**

Also, **70% said they would not use a stockbroker if they knew brokers were not required to act in their best interest in all areas of a financial relationship.** Finally, **54% thought that BOTH stockbrokers and RIAs have a fiduciary duty to act in their best interests.** In actuality, only RIA's serve as fiduciaries (are required to disclose conflicts-of-interest and act in your best interest).

The Financial Planning Association (FPA) has sued the SEC to reverse an SEC ruling that allows wirehouses/stockbrokers to continue to "masquerade" as a financial planners looking out for your best interests. Remember all the commercials you see from the wirehouses? Don't they all infer that they are on your side in helping you achieve your goals?

Arguments were recently heard and a ruling is expected soon. A ruling against the SEC may cause Congress to overhaul all the rules concerning investment and financial planning advice. If so, maybe they will finally and clearly make a distinction between those who are selling products (which may or may not be necessary) and those who provide advice in your best interests while disclosing all conflicts-of-interest.

No one has a problem with the wirehouses/stockbrokers providing financial planning advice as long as they step up to the table and accept the commensurate fiduciary responsibility. We would all be better served if that was the case!

Other Social Security Benefits for Disabled Children

Once parents are able to obtain Supplemental Security Income (SSI) and Medicaid benefits for their disabled child, they are usually sensitized to the need to limit their child's receipt of assets ($2,000 limit) or income (no more than $20 of unearned income) to maintain these benefits. Thus, they can be surprised and alarmed when they reach retirement age, start to receive Social Security retirement benefits, and **find that their disabled child also receives a substantial check each month**.

While SSI and Medicaid are needs based programs, **a disabled child is also eligible for Social Security benefits based upon their parent's payments into Social Security while working**. If either parent is considered Social Security insured**, their disabled child will receive benefits whenever the insured parent reaches Social Security retirement age, becomes disabled or dies**. The disabled child will receive a check equal to 50% of the insured parent's Social Security payment if the parent is retired or disabled, 75% if the parent dies.

Often these checks to the disabled child can exceed their SSI payments. Since this is unearned income, any amount over $20 reduces SSI payments dollar-for-dollar. The maximum SSI payment in 2006 is $603. Thus, a Social Security check larger than $623 will reduce SSI payments to zero. Because SSI is a prerequisite for Medicaid in most states, there can be a fear that critical Medicaid benefits can be lost as well. Thankfully, there is **an exception in the regulations that says, if the only reason the disabled child would lose Medicaid benefits is due to a parent's retirement, disability or death, the child is to be treated as if SSI benefits were still in place**.

For example, take Johnny Smith who is aged 30, receiving SSI and Medicaid and the disabled child of Mike and Mary Smith (both 60). Mary has been Johnny's caregiver and is not considered by Social Security to be "fully insured". Mike, the breadwinner, is "fully insured". Mike's projected Social Security retirement payment when he is eligible for full retirement at age 66 is $1,800 per month (for example sake, his disability payment would also be $1,800/mo). In this situation, Mary's becoming disabled would have no impact on Johnny because she is not "fully insured". On the other hand, Mike's disability before age 66, or his retirement (for Social Security purposes) at age 66 would cause Johnny to receive $900 per month from Social Security. Since this is more that Johnny's SSI, Johnny would keep the $900 per month, lose his SSI payment and maintain his Medicaid using the exception mentioned above. Whenever Mike dies, Johnny's payment will increase to $1,350 per month permanently.

So, **don't be alarmed when your disabled child starts receiving benefits from your Social Security account**. Just **make sure that Medicaid remains available for your child.** This is also a reason to obtain SSI/Medicaid benefits for your child as soon as possible. Your disability, retirement or death before your child is receiving SSI/Medicaid will likely prevent them from ever being eligible for those benefits.

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