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BFAS Money Line

Up?

Europe seems to be controlling much investment activity these days. Will the Greeks default or accept the pain of austerity? What about Portugal, Italy and Spain? Italy must sell hundreds of billions of dollars of bonds in the next few months to sustain their economy. Will they be successful? At what price?

Europe appears to be in a recession already. **If the Germans get tired of shipping money to southern Europe and stop the flow, there will be a depression in southern Europe**. In a depression there will be runs on European banks.

Another way a European recession could become a depression is if the southern European countries decided the pain of austerity was politically impossible and the European Union dissolved. How would all this affect us? **Europe is one of the largest trading blocks in the world, so a recession or depression there will slow world trade**.

While our banks don't hold too many bonds of Europe's governments, there are **trillions of credit default swaps**. These credit default swaps are unregulated and not on any exchange so it's difficult to determine what a default in Europe would trigger here if our banks had to pay up on defaulted credit default swaps.

In addition to Europe, the dollar is hurting investing overseas. While the Federal Reserve is trying to weaken the dollar to make our exports cheaper and increase jobs here, the **problems overseas have made even a weak dollar look good.** Thus, in the last few months, a tsunami of money has flowed into the dollar; strengthening it against all efforts of the Federal Reserve to weaken it. **When the dollar strengthens, foreign stocks and bonds generally underperform.**

Finally, **European banks are the primary providers of credit for world trade.** If European financial difficulties put these banks into bankruptcy or anything near to it, **world trade could come to a halt just like in 2008**.

Thus, the possible implosion of credit default swaps and world trade lead to a **significant possibility of another world-wide financial crisis this year.** A certainty? No! But the risk is significant.

Is the solution to go hide in a hole for awhile? No. However, it might be time to take some risk off of the table.

Speaking of risk off the table, it's **probably time to give real estate some consideration**. Do I know if real estate has finally hit bottom? No! But, real estate is much less expensive than it was and mortgage rates are at a historic low.

It is much easier now to find an investment property where you can achieve a positive rate-of-return (after all expenses including repairs

and capital improvements). I have seen scenarios where the **annual rental income equals 10% of the value of the house**. This cash flow alone can make a real estate investment profitable whether or not there is appreciation on the value of the house.

One caution. Real estate, as you have seen recently can go down as well as up. **You should have no more than about 1/3 of your assets tied up in real estate**. Most people have more than that in their primary residence, hence real estate investing is not for everyone.

A few words on bonds. Foreign bonds might struggle some this year with the dollar strengthening. Last year, many (including me) fled U.S. bonds under the expectation that rising interest rates would hurt U.S. bonds.

Then, in June last year the Federal Reserve announced no interest rate increases until at least 2013 (recently extended to 2014). With these assurances, **U.S. bonds are somewhat less at risk of losing value to interest rate increases this year (and maybe next).**

As you see below, the recent rise in the dollar has hurt foreign stocks and commodities:

Asset Class	1 Yr Rtn (01/31/12)
S & P 500	+ 2.11%
NASDAQ	- 1.80%
Lg Cap Gwth	- 2.46%
Lg Cap Val	- 0.75%
Mid Cap Gwth	- 3.96%
Mid Cap Val	- 3.96%
Sml Cap Gwth	- 3.55%
Sml Cap Val	- 4.45%
Foreign	- 12.14%
Interm Corp Bds	+ 4.95%
Foreign Bds	+ 3.70%
Commodities	- 13.32%

Odds and Ends

Cosigner's Remorse – Your new high school graduate is soon to be off to college. He/she has no credit and you want to make sure they have a credit card for "emergencies". So, **you cosign for a credit card with a $500 limit**. You'd think you would be safe. Not so.

Be aware that **any late payments could hurt your credit record**. In the past, the bank could also raise the credit limit without notifying you; however the **CARD Act passed in 2010 prohibits banks from raising limits on children under 21 without your written permission**. Once the child is over 21, all bets are off.

Even if your child never misses a payment, your credit rating could suffer and cause an unpleasant surprise when you attempt to refinance your mortgage. The balance on the card affects your credit utilization ratio (the amount of available credit that you have used) which has a big impact on your credit score. Potential lenders will also include the card balance in your debt-to-income ratio when deciding whether you can afford to take on new loans.

If you are currently cosigner on a card, the only way to exit the arrangement is to pay off the card, close the account and have the child apply on his/her own.

College Planning – As your child approaches the mid-point of high school, you realize that your savings are insufficient to pay for college. You decide you will need as much financial aid as possible. **You will inevitably be approached by financial planners specializing in college planning who will promise to help you complete your Free Application for Federal Student Aid (FAFSA) to maximize your financial aid package.**

Most advisors who specialize in college planning offer free or very low cost help. They can do this because **most of their strategies involve moving your taxable assets to Variable Annuities (which are considered retirement assets and not counted by the FAFSA) or life insurance (also not counted by FAFSA).**

College planning advisors earn 6% - 10% commissions on Variable Annuities and 70% - 100% commissions on the first year premiums for permanent life insurance (whole life, universal life, variable universal life, etc.)

Selling your taxable assets might well incur capital gains taxes in order to purchase high cost life insurance products (variable annuities and whole life). Some advisors will even recommend borrowing against your home equity to purchase a life insurance policy.

While re-positioning assets might have a small impact on the amount of aid your child will receive, your income has a much higher impact. Hence, **don't make**

changes that will tie your money up for many years at high cost simply to save a few dollars in college.

There are legitimate college planners out there. Just don't plan on getting the advice for "free" and be wary of strategies that require you to purchase products!

Finally, all colleges are now required to post a **net-price calculator** on their website. The net price reflects grants, not loan, based upon average award for families in your circumstances. Focus on net price as opposed to net cost, which is what you get when you subtract the entire aid package, including loans, from the cost of attendance.

Taxes – Unless Congress acts (unlikely), the Bush tax cuts will expire at the end of the year. Tax rates will go up for pretty much everyone. The 10% tax bracket will rise to 15%. There will again be a marriage penalty on two income families. The child tax credit will drop to half. Taxes on stock dividends will rise from 15% to 43.4% (39.6% + new 3.8% health care tax). Capital gains taxes will rise from 15% to 23.8% (20% + 3.8% health care tax).

This leads to two possibilities. **A number of wealthy people will be looking at the 65% increase in capital gains tax rates and they may decide to sell by the end of the year to "only" pay 15% tax. This selling could drive the stock market lower later this year.**

The second thing that happens is the **rise in tax rates could prompt many people to "convert" their Traditional IRAs into Roth IRAs.** Yes, you have to pay taxes on the amount your

convert; however all future growth and withdrawals are tax free.

The higher your tax bracket, the more likely your taxes are to rise and the more likely that a Roth Conversion would benefit you. **You should have sufficient cash available in a separate account to pay the taxes for a conversion**. Also, remember that if the market falls after your conversion, you can choose to move the money back to your Traditional IRA by using a Roth recharacterization at any time before October 15th of the following year.

Dividend Paying Stocks – Some talking heads (including Warren Buffett) have said that **holding Dividend Paying Stocks is better than holding bonds**. They point out that after inflation and taxes, bonds just hold their value and don't grow. On the other hand **Dividend Paying Stocks pay bond-like dividends while providing growth above inflation and taxes.**

While this is true over the long term, it hasn't worked out recently. **Since January 2000, stocks have earned 11.6% total (including dividends) while bonds have earned 94%**. Popular dividend stocks like Bank of America, Johnson & Johnson and Altria lost 60%, 8% and 30% in 2008.

Dividend Paying Stocks act just like all other stocks in a recession and can lose a great deal of value. Bonds seldom lose value and when they do it is very little (for short – intermediate term bonds).

Bonds provide a very important diversifier for the portfolio, stable value with an income stream. More importantly, they help keep the portfolio's movements smaller which allows you to stay invested in crazy markets!

Gifting to Children – Here is **a** short discussion of several ways to gift to your children/grandchildren.

- **UGMA/UTMA accounts**: These accounts are the child's assets although a parent or grandparent serves as custodian until the child becomes 18 or 21 (depending upon which state you live in). **Pro's**: Low cost, flexible, can gift cash or stocks, get child interested in investing

  Con's: assets become child's when they come of age, assets count against them in financial aid calculations for college.

- **529 Plans**: These accounts are used for the child's college education but remain under the control of parent/grandparent if their money is used to set it up.

  Pro's: up to $4,000 state tax deduction per person for contributions ($8,000 per couple), tax free growth and tax free withdrawals if used for college, not counted in financial aid calculations, you can change beneficiary if child doesn't go to college.

  Con's: Withdrawals not used for college are taxed.

- **Roth IRA**: If an older child works, you can contribute an amount equal to his or her earned income, up to $5,000.

  Pro's: Grows tax free and is withdrawn tax free in retirement. Contributions can be withdrawn tax free to pay for college (earnings withdrawn for college are taxable)

  Con's: Money is tied up until 59 ½ unless a few exceptions are met

How Things Work

Many of you understand that your child with a disability should have almost no income and assets less than $2,000 to qualify for **Supplemental Security Income (SSI)/Medicaid benefits.** So, you've made it through the maze of paperwork and your child is receiving SSI/Medicaid.

The next hoop to jump through is finding a "permanent" living situation away from your home (since you're not going to live forever). In most cases, this entails locating a group home. When your child is accepted into a group home, his or her supervision there is paid by a Medicaid Waiver ($40,000 - $50,000/yr).

Once your child receives a Medicaid Waiver and is living in a group home, your worries focus on him or her possibly losing the Medicaid Waiver. Working and earning an income will impact SSI. The first $20 earned or unearned doesn't count against SSI ($698/mo). The next $65 earned income also doesn't count. After that, SSI is reduced $1 for each $2 of earned income. Thus, your child could earn up to $1,480 and still have $1 of SSI coming in.

Another way of impacting benefits is unearned income. This could come from an annuity left to the child. **One of the more common ways this happens is a military member choosing the "Child" Survivor Benefit Plan (SBP) option upon retirement**. Another way is a federal worker's civil service retirement which will go to a child with a disability if the spouse option is chosen.

Either one of these annuity options could eliminate SSI (which is reduced dollar-for-dollar after the first $20 for unearned income). But would they eliminate the Medicaid Waiver? Not necessarily.

Currently, **Medicaid Waiver eligibility is maintained as long as the child doesn't receive more than 300% of their SSI ($2,094/mo). If the child receives unearned income, he or she can keep up to 165% of SSI ($1,151.70) as a Personal Maintenance Allowance.** Income over that amount will go to Medicaid.

Note that the child would not want this income to accumulate, and would want to either spend it monthly or contribute it to a Self Settled Special Needs Trust to keep the personal balance below $2,000.

For those with civil service pensions, a spouse will receive 55% upon the death of the annuitant. The child with a disability will receive $485 until the remaining parent dies, then will receive $582/mo. Military SBP amounts are generally much higher (up to 55% of retirement pay).

Edited and Published by:

Ronald S. Pearson, CFP®, AEP®

Beach Financial Advisory Service

6204 Ocean Front Ave.

Virginia Beach, VA 23451

(757) 428-6634

E-mail: ron@beachfas.com