February 1999 Volume 4.1

BFAS Money Line

INVESTMENTS

Winners and Losers

While each year some sectors in the market out-perform other sectors, rarely are the differences as dramatic as 1998. **Very large growth companies dominated the market**. **The top 25 companies** in the S & P 500 **generated over half the 28%** return realized. The **majority of stocks**, 57%, in the broad market represented by the Russell 3000 actually **posted negative returns** for the year. Here are some examples:

	Value	*Growth*
Lrg Cap	12.44%	35.95%
Mid Cap	1.40%	18.06%
Sml Cap	-7.05%	5.02%

Over the long term, value has out-performed growth and small cap has out-performed large cap. Last year was obviously an exception to the rule.

If you were not happy with the performance of one of your mutual funds last year, make sure you compare the performance to the correct category (check the prospectus). If you had a fund specializing in mid cap value stocks, don't dump it because it

"I'd like a well-diversified asset mix that doesn't include any of those risky stocks and bonds."

actually beat its peers!

So, why not just load up on Large cap growth funds and forget this diversification thing? As stated before, growth generally under-performs value and large cap under-performs small cap. Thus, the unusual returns seen last year are unlikely to be repeated this year.

If the U. S. market is doing so well, why hold foreign stock funds where returns averaged 10-12% (Europe 19%, Pacific –6%, Latin America –38%)?

Imagine that your stock market is compounding 30% per year, there has been a long period of steady growth, strong corporate profits, near-record low unemployment, low interest rates, virtually no inflation, low oil prices, consumer confidence at an all-time high.

Why would you invest internationally when everything looks so good domestically? Oh by the way, **I was describing Japan in December 1989**. Their market stood at 40,000 then; today it is at 14,000. Need I say more?

I have a new client who does not want to proceed until the markets look better. He has a long time horizon. I asked, if you wait until things look better, do you think prices will be higher or lower? They can only be higher, because that is the definition of looking better.

So, if you're looking for a good place to enter, what you want is a bunch of bad news and you want it strung through the markets and over the airwaves for the period of time over which you are phasing in your portfolio. If things start looking a little better, all you could do is buy at higher prices.

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There is no reason anyone would want a computer in their home.

-- Ken Olson, President, Chairman and Founder of Digital Equipment Corp, 1977

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RETIREMENT PLANNING

Company Stock in Your 401(k)?

Many companies allow employees to **buy company stock** (often at a discount) **as one of the options in their 401(k) plan**. Commonly, the employee upon retirement will roll all of the plan assets into an IRA.

While this is generally a good thing to do, having stock in the plan presents an interesting planning opportunity. Any assets rolled into an IRA will generate ordinary income taxes (presumably at 28% or higher) when withdrawn.

However, you have the option of withdrawing only the company stock and rolling over the remainder of your plan assets to an IRA. When you take the lump sum withdrawal of company stock, you **pay taxes on your basis** (original cost) but **defer taxes on the appreciation**. You can continue to let the stock appreciate as long as you wish and only **pay a maximum of 20% capital gains tax when you finally sell!**

Safe to say this is not a good idea if your company stock is declining in value. But if you obtained company stock at low cost, this strategy could save big dollars!

How Much to Take Out of Your Portfolio!!

There are few retirement issues more important than the issue of how much you can withdraw from your portfolio every year in retirement. This issue is vital to determining how much you need to fund your retirement.

If you can safely take 10% per year out and you want to live on $50,000 per year, then you only need $500,000 in your portfolio. However, if your safe withdrawal rate is 5%, you need $1 million to live on $50,000 per year.

What about inflation, one of the biggest risks in retirement? It may be low now, but even a 3% rate of inflation means your living costs will double during retirement. Thus, you would need $100,000 after 24 years in retirement to maintain the same lifestyle which cost $50,000 when you first retired.

The chart on page 3 shows the probability of your portfolio lasting depending upon whether you are all in stocks, all in bonds, or a mix of the two. It assumes you take out a fixed initial percentage of your portfolio and raise your annual withdrawal percentage by the amount of inflation.

Clearly, this chart shows the danger of your portfolio being exhausted if it is all in bonds (or CDs or savings accounts, etc.) The amount you could withdraw is about 3%, unless you promise to die 15 years into retirement.

As you would expect, an all stock portfolio provides the best probability of having your money last. However, the 75% stock/25% bond and 50% stock/50% bond portfolios provide nearly as good success rates.

This is important because **a 75/25 or 50/50 mix has much less short-term, downside risk than a 100% stock portfolio**. When all your eggs are in the basket, you can be hypersensitive to downturns and make inappropriate adjustments. In the last 30 years there was one two-year period when stocks dropped about 50%.

So keep a copy of this chart to show Cousin Howie when he tells you the market will go up 15% forever and you can easily take 10% per year out of your portfolio. Sure, you can withdraw 10% per year if you can stomach a risky all stock portfolio and you are comfortable with having a 1-in-3 chance of your money lasting 30 years.

I have long advocated a withdrawal rate of about 5%. You can, with this chart, choose your own comfort zone (or **raise the amount you plan to save for retirement**).

Note: The chart and the full article by Cooley, Hubbard and Walz are available in the February 1998 issue of the AAII Journal, pg. 16 (reproduced with permission of the AAII Journal).

Inflation-Adjusted Portfolio Success Rates: 1926 to 1995

(Percentage of all past payout periods supported by the portfolio after adjusting withdrawals for inflation)

	Withdrawal Rate as a % of Initial Portfolio Value									
Payout Period	**3%**	**4%**	**5%**	**6%**	**7%**	**8%**	**9%**	**10%**	**11%**	**12%**
100% Stocks										
15 Years	100	100	100	91	79	70	63	55	43	34
20 Years	100	100	88	75	63	53	43	33	29	24
25 Years	100	100	87	70	59	46	35	30	26	20
30 Years	100	95	85	68	59	41	34	34	27	15
75% Stocks/25% Bonds										
15 Years	100	100	100	95	82	68	64	46	36	27
20 Years	100	100	90	75	61	51	37	27	20	12
25 Years	100	100	85	65	50	37	30	22	7	2
30 Years	100	98	83	68	49	34	22	7	2	0
50% Stocks/50% Bonds										
15 Years	100	100	100	93	79	64	50	32	23	13
20 Years	100	100	90	75	55	33	22	10	0	0
25 Years	100	100	80	57	37	20	7	0	0	0
30 Years	100	95	76	51	17	5	0	0	0	0
25% Stocks/75% Bonds										
15 Years	100	100	100	89	70	50	32	18	13	7
20 Years	100	100	82	47	31	16	8	4	0	0
25 Years	100	93	48	24	15	4	2	0	0	0
30 Years	100	71	27	20	5	0	0	0	0	0
100% Bonds										
15 Years	100	100	100	71	39	21	18	16	14	9
20 Years	100	90	47	20	14	12	10	2	0	0
25 Years	100	46	17	15	11	2	0	0	0	0
30 Years	80	20	17	12	0	0	0	0	0	0

Note: Number rounded to the nearest whole percentage. The number of overlapping 15-yr payout periods from 1926 to 1995, inclusively is 56; 20-year periods, 51; 25-year periods, 46; 30-year periods, 41. Stocks are represented by S & P 500 Index, bonds by long-term, high-grade corporates, inflation on CPI. Data Source Ibbotson Associates.

College Planning & Taxes

New tax rules provide some opportunities for blended families with college age children.

Carol is living with her mother and step-father who are claiming Carol as a dependent. Carol's real father pays her educational expenses directly to the school. Her real father can not claim Carol as a dependent. IRS treats the education payments as if they were made by Carol. As such, **Carol's mother and step-father can claim the Hope & Lifetime Learning Credit on their tax return.**

This assumes that all the other requirements for the Hope & Lifetime Learning Credit were met.

Did you know you must work longer today to provide for a college education than thirty years ago? In 1966, a year of public college required 133 hours of work.

In 1996, the same year of college required 260 hours of work.

LIFE INSURANCE

When to Keep Whole Life Ins!

Like virtually all Fee-Only® financial advisors, I **generally recommend clients use term insurance for their life insurance needs and invest the difference**. There are, however, situations where obtaining/keeping **whole life insurance is the appropriate alternative**:

- To leave a legacy to children or grandchildren
- Name charity or school as beneficiary
- To help pay estate taxes for illiquid estate
- You have poor health history
- Other tax-qualified investments are fully funded (i.e. SEP/401(k))
- Policy has fair internal rate of return
- Agent is a golfing buddy

DISABILITY PLANNING

Travel for the Disabled

Travel can be great fun at any age. Those with disabilities may find it difficult to find appropriate support. **Travel for the person with a disability can provide a wonderful experience and, possibly, a respite for the caregiver.**

Since cost can sometimes be an obstacle, you **might want to contact the local Lions, Rotary, Civitan, Optimists, Kiwanis Club, etc. to seek funding.** The following organizations provide travel and vacation programs for people with special needs. I do not endorse any of them. You should contact them for further information. Please check out fees, eligibility criteria, staff ratio, references, etc.

- The Guided Tour, Inc., 7900 Old York Rd. Suite 114-B, Elkins Park, PA 19027-2339, ph. 215-782-1370
- National Sports Center for the Disabled, P. O. Box 36, Winter Park, CO 80482, ph. 303-726-5514
- Summit Program (Travel and Camp), 110-45 71st Rd., Forest Hills, NY 11375, ph. 800-323-9908
- Sundial Special Vacations, Inc., 600 Broadway, Suite #4, Seaside, OR 97138, ph.800-547-9198
- Frontier Travel Camp, Inc., 1573 Pennsylvania Ave. #3, Miami Beach, FL 33139 ph. 305-532-6205
- Confidence Learning Center, 6260 Mary Fawcett Memorial Dr., Brainerd, Minnesota 56401, ph. 218-828-2618

For Military Families Only

Creating a special needs trust for your disabled child can be an important part of **preserving the child's eligibility for government benefits**. These trusts can cost $1,000 and up in the private sector.

Recently, a colleague and I had the opportunity to educate **Army, Navy and Air Force legal assistance officers on the need for special needs trusts. As a result, any active duty or retired military member should be able to obtain a will with a simple testamentary special needs trust**.

No, they will not do sophisticated estate planning; but, **at no cost, you can solve some very important issues for your disabled child**.

Community Choices

If you are a resident of Virginia Beach, set aside March 20th on your calendar for a day of information sharing. The Community Services Board has developed a program of great import to consumers, families and professionals wanting to learn about mental retardation, mental health or substance abuse issues.

Festivities start at 8:30 at the DoubleTree Hotel (next to the Pavilion and last until 4:30. Registration fee is only $5. Call 437-5787 for details. See you there!

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