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BFAS Money Line

INVESTMENTS

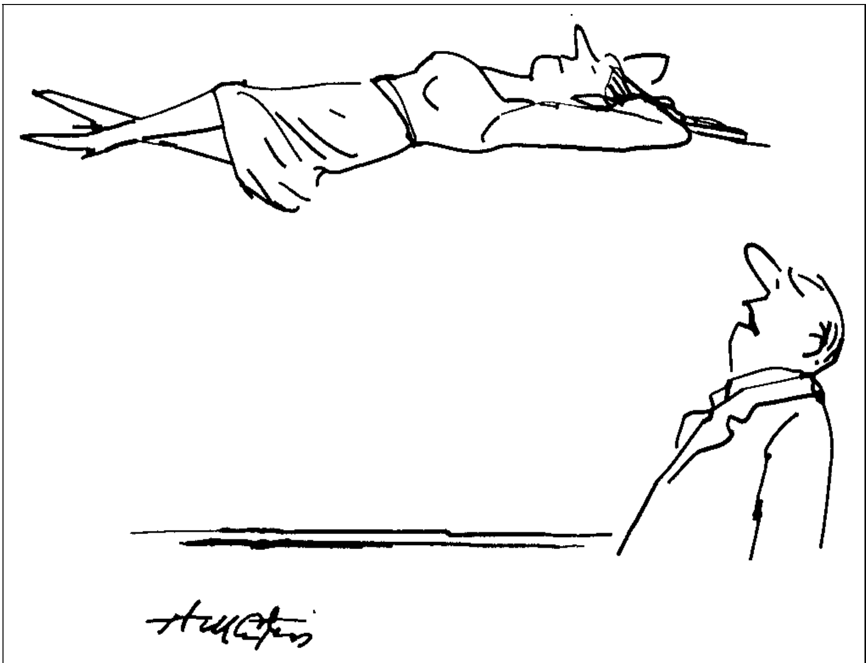
Where are the Bull's Now?

Have you noticed that there are fewer, "**It's a new economy!**" and "**It's different this time!**" quotes in the media? Those brave pundits just disappear when events prove them wrong. Too bad they can't be held accountable to the people who lost money because they believed all that hype!

Perspectives on the market differ depending upon where you started. If you have been in the market for some time, the current correction is simply a reduction in the great returns of the last few years. If you joined the market in mid-March (market peak), then you are wondering when you will finally break even.

Both investors will have suffered the same decline, but the later investor will feel it more because the losses are from "their" money rather than from the "house's" money!

Returns to date (5/28/00) are certainly ugly: **DJIA down 10%, S & P 500 down 6%, NASDAQ down 21%.**



"I see you've completed your study of stock market behavior."

Who is doing well? Last year's laggards. **Value stocks/funds, real estate, bonds**. Those who bought last year's star, Internet funds, are looking at 30% losses this year.

I saw a recent study where **a hypothetical investor in 1900 put $1 into the single best asset class each year for 100 years**. As expected, today the investor would have earned a gazillion dollars and be worth about 15,000 times Bill Gates' net worth. However, **if the investor chose the previous year's best investment, they would have $290 after 100 years of investing**.

The lesson, of course, is that **no one really knows what the best investment will be next year**. **One of the worst choices is last year's hero.**

A reasonably diversified portfolio will most likely have suffered a loss this year (depending upon the stock/bond mix), but a much smaller loss than an all stock or concentrated Internet portfolio.

Uncommon Investm'nts

Earlier this month I attended the National Association of Personal Financial Advisors' National Conference in Minneapolis. In addition to getting re-acquainted with hundreds of my Fee-Only advisor friends from all over the country, I received hours and hours of continuing education.

One area I spent time on was alternative investments. I attended a talk on **hedge funds, private placement money and ETFs**. **Hedge funds use options and arbitrage to make money**. Rather than invest in a company over the long term through a stock, they make money (they hope) by betting on the direction of a stock's movement. Sometimes they do very well; other times, such as about eighteen months ago, the can lose big.

Private placement money is generally invested as venture capital in startup companies. If the company makes it all the way to Initial Public Offering, returns can be wonderful. Many don't make it.

Exchange Traded Funds (ETFs) are a relatively new creation. They **act like index funds (all are passively managed so far), but trade like stocks**. They are structured and managed such that they **generally have distributed neither dividends nor capital gains**. Thus, they could be an attractive alternative to Index Mutual Funds that do distribute some dividends and capital gains. Currently, there are only about three ETFs: SPDRs (S & P 500 Index), Diamonds (DJIA) and the NASDAQ-100 (NASDAQ).

Of the three alternative investments, I believe **Hedge Funds are the most risky**. The debacle in the Long Term Capital hedge fund last year is a good example. Private placement money can make sense as a small proportion (2% - 5%) of a portfolio. However, with $250,000 minimum investments and up, they don't fit in most of my client's portfolios.

The **investment with the most promise is the ETF**. Several companies (including Vanguard) are rolling out ETFs tracking different asset categories and sectors in the next few months. ETFs may be more tax efficient than mutual funds, even index funds. I will be keeping an eye on this development.

INSURANCE

Do You Need this Insurance?

Here are **some types of insurance that most people can do without**:

Private Mortgage Insurance – These policies primarily benefit the mortgage company and can add over 5% to the cost of your monthly payment. As soon as you have at least 20% of equity in your home, get your insurer to drop the policy.

Service Contracts – big money-maker for the seller; however, on average not worth the money for you. (If you're that rare person that always buys lemons, this may not apply to you.)

Separate policies vs. riders – Generally it is cheaper to buy a rider for your current policy than to purchase a separate policy. See if you can simply enhance an existing home or auto policy rather than buying a separate one for an RV or boat.

Flight Insurance – It certainly added to Mutual of Omaha's bottom line but is also a bad bet for you. One study says you can fly on a major airline every day for 26,000 years before being involved in a plane crash. Check your credit card fine print; many offer $100,000 in coverage simply for charging your ticket on your card.

Credit Insurance – all the various types (credit life, disability, health, unemployment) are much more expensive than they should be. Having similar coverage outside (life insurance rather than credit life) is typically ten times cheaper. (Note: For those with terminal illness, credit insurance may be an opportunity to obtain coverage not available anywhere else.)

Short-term, cash value life insurance – According to the Consumer Federation of America, it takes five years before a cash value policy shows a positive return. Even after ten years the average return is only 2%. Commissions and fees paid up front take a long time to overcome. Buy term insurance instead.

Life Insurance for Children – the primary purpose of life insurance is to protect against a financial catastrophe. Not many children have debts or dependents. As for using it to save for college, there are much better alternatives (section 529 plans such as the Virginia Education Savings Trust).

Mortgage Insurance – these policies make your mortgage payments if you die. You're better off buying straight life insurance or adding to your own existing policy.

Cancer Insurance – a GAO study showed the insurance companies paid out only 35% of the premiums they took in on such policies. 65% returns seem like a pretty good deal for the insurance companies, but not for you.

Short-term Medical Coverage – Typically used to provide coverage between jobs; you are usually better off extending your existing coverage under COBRA provisions.

"I'm not unrealistic like those dot-comers. I'd be happy with a seventy to eighty percent annual return."

Mortgage Myths

I frequently run into **outmoded thinking and beliefs in certain myths regarding mortgages**. Typically, these myths can be traced to the Great Depression when large numbers of people lost their homes because they could not meet their mortgage payments.

One myth is that everyone should make extra payments on their mortgages to pay off their loans years earlier and save thousands in interest payments. In reality, this **decision rests on factors such as: tax bracket, liquidity needs, retirement funding, educational funding and alternative investment opportunities**.

Take a $200,000 fixed-rate mortgage at 6.75% with payments of $1,297.20 a month for 30 years (total cost $466,990). Paying just $200 more per month will retire the debt in 249 months.

Savings? $143,000 if you multiply 111 months times $1,297.20. Or $106,900 if you compare the prinicpal remaining at 249 months on the original loan. Of the two numbers, $106,900 is the better number because it includes the time value of money.

What about the tax break you would be giving up? A 28% tax bracket person would give up about $16,000 in tax savings over 249 months. This reduces the benefit to $90,900.

If you invested the $200 per month, plus the $60 a month in average tax savings, at an after tax return of 4.5%, you would accumulate $106,900 in 249 months. Which would you prefer: a free and clear house with no additional assets, or a house with a $106,900 mortgage and $106,900 in investment assets?

Should you take out a 30-year or 15-year mortgage? Most of the same factors apply. What is the **difference in interest rates and what is your tax bracket**? Can you earn more in an alternative investment than you "save" with the shorter mortgage?

There is **no one, right answer**. Both loans have their uses. The **best answer depends upon the specifics of your situation**.

Another myth is that no one should go into retirement with a mortgage. Some options, such as withdrawing 401k assets to pay off the mortgage upon retiring can have negative tax consequences, since the withdrawal is taxable income.

If there are insufficient liquid assets to pay for emergencies, **having so much capital tied up in a home could make it difficult to cover medical or other**

unexpected expenses. Yes, there are reverse mortgages available. However, they are much more expensive than regular mortgages.

Thus, **mortgages in retirement may be better than the tying up all your money in your house**. As with all these myths, you must **look at the your specific circumstances and reject the easy answer you might have learned from your parents, friends or neighbors**.

DISABILITY

SSDAC and Medicaid

While many parents understand the benefits of qualifying their disabled child for **SSI/Medicaid**, few know **what happens to those benefits when the parent reaches Social Security retirement age.**

When a **parent becomes disabled or retires** (and the child is receiving benefits for a disability occuring before age 22), the **child is eligible for an Adult Disabled Child benefit (SSDAC)**. This benefit is **equal to 50% of the parent's normal retirement benefit**. (Note: When the parent **dies, this benefit increases to 75%).**

Thus, if the parent is going to receive $1,500 monthly as a normal retirement benefit, the child is eligible for $750. This $750 replaces SSI benefits dollar for dollar. The child can receive both if the benefit is smaller than SSI. If larger, the child will lose SSI benefits.

What about not applying for it, you say? No can do! Social security regulations require you to apply for all eligible benefits.

But my child will lose Medicaid, you say? In most other cases you would be right. Medicaid is usually tied to SSI eligibility. However, **this is an exception!** Medicaid rules allow Medicaid to continue under a **Protected Adult Disabled Child Benefit**. Unfortunately, not only are parents unaware of this Medicaid benefit, Social Security and Medicaid routinely miss this benefit as well.

This is one of those areas where you need to **know your rights**. **Your child could be receiving over $1,200 per month in SSDAC benefits, and no SSI, but still be eligible for Medicaid!**

Unexpected Assets

Many times a child receiving SSI/Medicaid benefits will lose them due to an unexpected inheritance from a relative. Any inheritance causing the child's assets to be above $2,000 will lead to loss of benefits until the assets are spent down to below $2,000.

Congress, in legislation called OBRA '93, wrote language allowing the **child to set aside the inheritance in a special trust**. The child would be able to use the inheritance money for supplemental needs while still retaining benefits.

Previously, in our area, children could only go to an attorney and pay several thousand dollars for such a trust.

I recently found that there is a **low cost alternative**. There is a trust called the **Commonwealth Community Trust (CCT**) available in Richmond to solve this problem anywhere in Virginia. The CCT costs $450 to set up and an annual fee of $50 and up (depending upon assets in the trust). For this, you get the Trust Company of Virginia managing the assets and dedicated volunteers working with the beneficiary.

To find out more about the **CCT, call Joanne Marcus, MSW at 888-241-6039**.

A recent Virginian Pilot article appeared to give credence to tax protestors. For a good Q & A debunking of the tax protestor arguments, check out <http://evans-legal.com/dan/tpfaq.html>

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