

BFAS Money Line

INVESTMENTS

OK, War's Over, What Now?

I am sure everyone's been pleased by the **16% market rise in the seven weeks since the last market dip on March 10th**. However, it certainly does not erase a nearly 50% drop over the last three years.

Remember, it takes 100% of gain to make up for 50% losses (\$100,000 drops to \$50,000, must gain 100% to get back to \$100,000). That is one reason why diversification is so important. It can protect against the large losses that are so difficult to recover from.

Though the **economy is growing**, it is growing slowly. Corporate profits are growing as well due to cost savings (primarily job cuts). Yet, the market, before March 10th, was stagnant-to-down due to the uncertainty of the situation in Iraq.

Similar to Desert Storm, conclusion of the recent Iraq war led directly to the recent market rise (as predicted in my last newsletter, he said modestly).

That leads us to, **What Now?** While the Iraq



“... and to those of you who may think that our seven-figure salaries have made us less concerned about answering to the shareholders, I

war has certainly caused many unfriendly governments to recalculate how much they want to “beard the lion”, **the Palestinian situation, North Korea and international terrorism could once again shake up our economy and our confidence.**

Oil prices dropped as expected and inflation appears to be in check. Unemployment won't improve until the economy grows a little faster (greater than 3%). Many economists expect that to happen in the second half of the year.

Interest rates remain low (great for mortgages, bad for retirees on fixed incomes!) They are likely to remain low at least until the economy picks up (later this year?). Even when interest rates go up, they are expected to rise slowly. While mortgage rates will likely increase, they will probably still look like 1950's – 1960's rates.

We are unlikely to have a smooth market ride for the remainder of the year. Up only 3% for the year, the market could end up substantially positive or flat, too tough to call.

The table below shows what the various markets did last year:

Asset Class	1 Yr Rtn (04/30/03)
S & P 500	-13.30%
NASDAQ	-13.26%
Lg Cap Gwth	-12.21%
Lg Cap Val	-15.16%
Mid Cap Gwth	-15.23%
Mid Cap Val	-14.59%
Sml Cap Gwth	-20.55%
Sml Cap Val	-18.75%
Foreign	-16.27%
Interm Corp Bds	+ 8.17%
Foreign Bds	+17.11%

Sustained Flight

In December 2002, near the 100th anniversary of The Wright Brothers First Flight, Neal Armstrong was interviewed on CNN. He talked about having studied the Wright Brothers' history in his early years, and the influence those studies had on him eventually being the first person to walk on the moon.

He said something to the effect, "the Wright Brothers correctly identified that the thing keeping people from flying was an inability to master balance and control." It seems that people had learned to create lift with a wing long before the Wright Brothers, and continued to focus on those issues.

The Wright Brothers could see that balance and control of the ship were the missing pieces of the puzzle. Armstrong went on to say that mastery of balance and control remains the critical issue with all forms of flight, including space flight.

I was struck by how profound the observation was for many things in life, including financial planning. We all have seen people who make great incomes, but do not seem to master balance and control. They spend their lives in constant stress or even bankruptcy.

Avoiding financial stress is not the only problem. In my profession I have also seen far too many cases where people work very hard, earn high incomes and accumulate significant wealth, without achieving enjoyable sustained flight.

They lack balance and control, to the extent that they do not seem to derive pleasure from their wealth. Alongside these examples, I also see quite a few people who have accumulated significant wealth from relatively lower incomes. These people seem to achieve skills for balance and control, but they have not yet reached the highest levels I seek in my working relationships.

The 'best of the best' relationships belong to those who master balance and control, to the extent they can soar indefinitely, in quiet assurance that they deeply understand the meaning of a very important question: How much is enough?

I have done my best work when I help people enjoy this sustained flight.

(Adapted from an article by J. David Lewis, Resource Advisory Services, Inc. of Knoxville, TN.)

COLLEGE PLANNING

Savings Bonds for College

If you are one of the many people who invested in **Savings Bonds as an ultra-safe, tax-deferred, state and local-tax exempt, interest-paying way to save for college**, here are some things you need to know!

As you may recall, under certain conditions, the **owner of an EE or I bond purchased after 1989 can exclude the interest when the bond is redeemed in the same year that college tuition bills are paid**. Many investors purchasing savings bonds intended for college will ultimately be disappointed, however, when they discover that the interest they had planned to keep out of Uncle Sam's hands is subject to federal income tax.

Here are four common situations that lead to this unfortunate result:

1) **The investor originally purchased the bond in the child's name.** To be eligible for the education exclusion, the bond owner

must be at least 24 years old before the bond's issue date.

2) The college student does not qualify as the bond owner's dependent. Grandparents who own savings bonds often find themselves in this predicament. Parents will also face this problem if their child fails the tax-dependency tests during the college years (which for other reasons may produce a desirable tax result). If the tuition isn't being paid for a dependent, or for the bond owner or bond owner's spouse, it does not qualify for the education exclusion.

3) The bond owner has modified adjusted gross income exceeding allowable limits. In 2003, the phase-out range for joint filers is \$87,750 to \$117,750 and for single taxpayers it's \$58,500 to \$73,500. The fact that the owner was well below the applicable limits in the year of bond purchase is irrelevant.

4) The qualified higher education expenses are less than the bond redemption proceeds. This doesn't necessarily mean the bond owner didn't spend the entire proceeds on college. But only the tuition and fees are counted, not room and board, books or supplies. And even the tuition and fees can be chewed up by the Hope or Lifetime Learning credit, or by tax-advantaged distributions from 529 plans and Coverdell education savings accounts (ESAs). Savings bonds are near the bottom of the barrel when it comes time to allocating expenses under the anti-double-dipping rules.



To the rescue: 529 plans (and maybe Coverdell ESAs) Contributions to 529 plans and Coverdell ESAs are treated as qualified expenses for purposes of the bond education exclusion. This makes it possible for qualified bonds to be redeemed tax-free prior to the college years simply by putting the proceeds into a 529 plan or Coverdell ESA. (Be sure the income and bond ownership requirements are satisfied!) Here's you might want to do this:

4) More expenses can be counted. If you (let's assume a married couple) intend to redeem \$15,000 of qualified EE bonds for your child's college expenses, but tuition is only \$10,000—room and board total \$5,000—you can avoid the tax you would otherwise owe on one-third of the bond interest by first transferring the bond redemption proceeds into a 529 plan and/or ESA for the child. Room and board counts for a 529. Voila! (But watch out for gift tax consequences on the transfer.)

3) Income limitations can be avoided. If you are within the bond income limits now, but are worried that your income will rise above the limits by the time your child enters college, you should consider redeeming your savings bonds this year and contributing the proceeds into a 529 plan or ESA for your child. The withdrawals taken for college (or even for K-12 expenses if coming from an ESA) will be tax-free no matter how high your income is. Voila! (Caution: this strategy may backfire if the 529 withdrawals occur after the 2010 EGTRRA 529 tax-free qualified withdrawal sunset and you happen to stay under the bond income limits. Remember, the income limits are increased each year for inflation.)

2) The dependency requirement may be sidestepped. For parents, the strategy outlined in #3 above may work here as well. You may transfer bond redemption proceeds into a 529 or ESA for the child while still a

dependent. Dependency status won't matter when withdrawals are taken from the 529 or ESA. For grandparents facing the non-dependent student problem, a loophole appears to permit the tax-free redemption of a qualified bond when the grandparent/owner simply names himself or herself as the beneficiary of the 529 account. Once the bond proceeds are safely tucked inside the 529 plan, the beneficiary can then be changed to a grandchild and withdrawals taken tax-free for college. Double-voila! (But make sure you gets the OK from a tax professional. The IRS has not yet ruled on this strategy.)

1) **Sorry, but 529 plans and ESAs are not the solution when savings bonds are owned by the child.** Instead, you should determine if an election to report accrued interest each year on the child's return offers a low-tax or no-tax solution. It may even be possible to re-register the bond in the name of the purchasing adult (see www.savingsbonds.gov for information.)

Article adapted from www.savingforcollege.com

RETIREMENT PLANNING

Retirement Planning

Some people have not contributed to their retirement plans this year after being shocked by losses last year. This decision is unfortunate since contributions in the first

quarter would have grown about 8% in April alone.

Also remember that **contribution limits are higher this year!** For IRA's (Roth or Traditional) you can contribute **\$3,000 in 2003** plus an **extra \$1,000 if you are over age 50**. You can **contribute \$12,000 this year to your 401(k), 403(b), or 457 plans** plus an **additional \$2,000** if you're over age 50. This year you can **contribute \$8,000 to a SIMPLE IRA** plus an **additional \$1,000** for over age 50. Take advantage of pre-tax investing, **make your contributions!**

DISABILITY PLANNING

Which Trust?

I recently participated in meeting with experts on all versions of trusts for disabled children. Representatives talked about lawyer-drafted **Special Needs Trusts (SNT), the Virginia Beach Community Trust (VBCT) and the Commonwealth Community Trust (CCT).**

All, of course, have their pros and cons. If you want maximum flexibility, have the resources to pay for an individual trust and have a trusted and knowledgeable person to serve as trustee, a lawyer-drafted SNT might be best. The difficulty with these is finding someone who can manage the assets and someone who knows what the SNT funds can purchase without losing government benefits.

The Virginia Beach Community Trust for twenty years has had the advantage of being free and having trustees who are knowledgeable. Downsides include long distance requests for support if you or the child move away, and slower response to needs than having your own checkbook for a lawyer-drafted SNT.

The Commonwealth Community Trust in Richmond is not limited to Virginia Beach, has knowledgeable trustees and modest costs (\$550 to set up, and \$75 annually until funded). Downsides are similar to VBCT.

If the disabled child receives money directly from an injury settlement or inadvertent inheritance, the VBCT can't help you. Only specially drafted (OBRA '93 or (d)4(a)) trusts available from the CCT or a specially trained lawyer can provide for supplemental needs without causing the disabled child to lose government benefits. For more info, here are the points of contact:

VBCT – Joanna McAnulty (MR), 437-6079 or Tommie Cubine (MH), 437-5778

CCT – Joanne Marcus, 888-241-6039

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