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BFAS Money Line

Market Turning or Just a Head Fake?

We **may be at a turning point on many fronts**. Although the government says the economy grew by .6% in the first quarter, revisions in the coming months will probably show we have been in a recession. The Federal Reserve has pretty much announced they will not be lowering interest rates any further. Thus, this recession (if it is one) would seem to be a mild one (unless you are in real estate).

Unemployment is inching up but it appears it will top out at the 5.5% - 6% that represents the long-term unemployment rate, rather than the "normal 8% - 10%" seen in severe recessions. The lowering of home values has been offset by increases in the cost of food and oil. Inflation seems to be picking up not because the economy is over-heated, but due to speculation in the oil and food markets (no real shortages).

International politics and the value of the dollar are having an inordinate amount of impact on the price of oil. The ending of a recession in the U. S. followed by a slow recovery will allow the Federal Reserve to cautiously raise interest rates again (good news for CDs and Money Market accounts). Lower consumer demand from a slower economy along with rising interest rates will likely result in lower oil prices. Inflation is not likely to remain at its current level.

To recap where we are:

- Housing prices have declined about 15% nationally – while the pain is not over, there is cause for some optimism that the worst is over
- The credit crisis has more to play out, but the end seems to be in sight
- Inflation has picked up, but should moderate due to lower demand of the slow down/recession
- Unemployment has risen, but the rise should slow although employment gains will be slow to come even as the economy picks up
- Corporate profits have dropped from 2007's historic highs, yet still remain strong outside the financial sector
- The lower dollar has dramatically increased exports (outgoing containers are in critically short supply locally). Higher exports increase U.S. jobs. Higher oil prices keep jobs here so companies can reduce the transportation cost of production

- Stimulus checks are now arriving to bolster demand. Economists estimate these checks will increase GDP by 1%

The market typically anticipates the economy. The market started down in October, the economy in December. Is the current rise in the market in anticipation for a rise in the economy this summer? (Note: a recent study showed that the market starts up about 4 ½ months prior to the economy). **Or is the current rise simply a head fake before the market tumbles further? Only time will tell. Even if the market is anticipating a rising economy, there will be rocky days ahead.**

As the following chart shows, commodities and bonds have been the only "safe havens" recently:

Asset Class	1 Yr Rtn (04/30/08)
S & P 500	- 4.68%
NASDAQ	- 4.45%
Lg Cap Gwth	+ .48%
Lg Cap Val	- 8.71%
Mid Cap Gwth	- .17%
Mid Cap Val	- 10.17%
Sml Cap Gwth	- 8.39%
Sml Cap Val	- 13.92%
Foreign	- 1.78%
Interm Corp Bds	+ 3.04%
Foreign Bds	+ 8.44%
Commodities (DJ – AIG)	+24.70%

Advisors

In difficult times like these, **many people lose confidence in their own ability to navigate the financial waters**. They may start looking for a financial advisor.

In a new book by Russ Alan Price and Lewis Schiff called "The Rise of the New Rich and How They are Changing America", the authors say that the New Rich are more active and ostentatious than the millionaires portrayed in Thomas Stanley's "The Millionaire Next Door". Both, however work long hours and advocate networking.

More germane to you is a section on **financial advisors who are millionaires** (net worths between $1 million and $10 million). The book says **82.3% of these millionaire advisors say it's extremely important to do whatever you need to do to win. 63.6% believe in taking advantage of weakness in others. More than half think one should bend the rules at times and 44.8% believe it is important to "be Machiavellian".** Almost half left a rewarding career to pursue financial success, while **only 1% believe it's important to do what you love and allow the money to follow**.

The authors have polled the **insurance and brokerage industries in the past**. I believe they would get dramatically different answers if they polled Fee-Only financial advisors.

The **National Association of Personal Financial Advisors (NAPFA) (**of which I am a member) requires all advisors to be Fee-Only comprehensive financial advisors who take an oath to act as a fiduciary for all clients. Advisors also have to have three years of experience as Fee-Only advisors and have a financial plan reviewed by peers to be eligible for referrals. To tap into this small but dedicated group of advisors, simply go to www.napfa.org and click on "Find an Advisor".

There are good insurance agents and brokers out there, but you have better odds of hitting the jackpot at roulette than finding one. Unlike the rest of advisors out there, **NAPFA advisors all put your interests first (not just say so in advertising, then do the opposite when you meet with one).**

College Savings/ Prepaid Tuition

Some of you like the idea of prepaying for college tuition. You can pay for college tuition 10 – 15 years from now at today's prices. Not long ago college tuition was frozen for four years in Virginia and prepaid tuition was not a good value. Lately, tuition increases have been as high as 10%. **Is prepaid tuition a good deal now?**

The answer is **yes, IF your student has rock-solid plans to attend an in-state public university, you already have some money set aside for room and board, and you** want to take a

conservative approach to college planning.

The answer is **no if you think your student might attend a private or out-of-state university. In Virginia, if your student attends a private school, you will get your payments back plus actual earnings (capped at an amount equal to the highest public university tuition and fees). If your student goes out-of-state to school, you get your payments back plus interest at money market rates.**

Thus, if your student chooses to go to an out-of-state school, you have a huge opportunity cost (difference between money market rate and typical investment rate over 10 – 15 years).

In Colorado, the state stopped accepting people into their Prepaid Tuition program in 2002 due to the down market's impact on investment results. Colorado gave participants the choice of withdrawing a full refund (no gain) or earning a maximum return of 5.5% in each coming year regardless of how high college costs rose. Virginia is one of the few states that say they (unlike Colorado) will cover shortfalls with other state revenues if the Prepaid Tuition plan investments don't keep up with college costs.

The uncertainties of the Prepaid Tuition plan explain why I normally recommend one of the two Virginia 529 investment plans. Virginia's Education Savings Trust (VEST) has both age weighted plans (stock vs. bond mix changes as child ages) and fixed stock/bond mixes. Investments are primarily in low cost mixes of Vanguard

"Are you telling me you won't even ask the computerized navigational system for directions?"

Funds. It is only available by contacting the plan directly (888-567-0540, www.virginia529.com).

Virginia's College America plan is only available through financial advisors. In College America, **you** (with the advisor's help) **choose one or a mix of two dozen American Funds**. There are three classes of the funds (A, B, C) that charge commissions (for advisors paid by commissions) and one class (F class) that has no commissions (for Fee-Only advisors).

The 529 investment plans place the investment risk on you while the Prepaid Tuition plans place the investment risk on the state.

Another of the 529 investment plan advantages is the opportunity to help with **estate planning**. Many times grandparents have accumulated significant wealth, are not inclined to financially help their children (who they think are spending too much already), but **want to help their grandchildren get educated.**

Anyone can gift up to $12,000 to anyone with no gift tax consequences. With a 529 plan, you are allowed to give five years ($60,000) all at once. By gifting this much upfront, all the growth is compounding in the child's estate, not the grandparents'. If both grandparents are gifting, they can gift $24,000 annually or $120,000 total to a 529 plan for each grandchild. By doing so, they are also avoiding $54,000 in estate taxes (at 45% of $120,000). Where would you rather that $54,000 went, to your grandchildren's education or to the federal government?

Think $120,000 is too much to put aside for college?

Four years at an in-state school currently costs about $55,000. At 6.2% inflation that cost grows to $160,000 in 18 years. Double it if they go to private school.

What if the grandchildren don't use all the money? The beneficiary of the 529 plan can be changed to pay college expenses for future generations (children of your grandchildren). Beneficiaries can be changed to children, stepchildren, grandchildren, parents (who want to go back to school), grandparents, aunts, uncles and first cousins. Thus, **a 529 plan can be an educational dynasty with generations of tax-free growth.**

One of the best aspects of these plans is that the **grandparents retain full control of these assets**. They can even withdraw money for their own use is they are willing to pay the taxes and a 10% penalty on earnings. If one of their grandchildren receives an **athletic or academic scholarship, the grandparents can receive a tax-free refund up to the amount of the scholarship**. If the grandparents are owners, the money in the plan **does not count against the child's eligibility for financial aid**.

So, think about setting up 529 plans as an education dynasty for your grandchildren!

Deductible School Tuition for Special Needs

In a recent ruling, the **IRS has allowed a person to deduct as a medical expense the tuition paid to a special school for the benefit of a special needs child**. The child was diagnosed with several developmental disorders along with delayed motor, cognitive, and social development skills. A medical report stated that the child would need a support program for two of these conditions if the child were to attend college.

The child was referred to a particular school that had courses designed for the child's conditions. The school offered students with learning disabilities the help they needed to be successful in completing college and to become competent and responsible adults.

The school did not provide any actual college courses, but provided courses to students who were enrolled in at nearby colleges and technical schools. The school provided a 12-month program that included tutoring and specialized social, academic, and independent living skills to help students be successful in a college environment. The school provided specialized remedial training prior to and while attending college due to one of the child's conditions.

The IRS normally does not allow a medical deduction for ordinary education expenses. But, while ordinary education is not medical care, the cost of attending a "special school" to alleviate a physical or mental handicap is considered "medical care". This also includes the cost of care and treatment of a mentally or physically handicapped individual at an institution.

Evidently, the determination of **what constitutes a "special school" is based upon the content of its curriculum** (which may include ordinary education as long as that is secondary to the primary purpose of helping students compensate for or overcome a handicap). Please note that the **following facts seem to be necessary to substantiate a medical deduction**:

- **School was established to help children with special needs**
- **Child was diagnosed with certain developmental disorders and the school focused on those disorders**
- **A physician recommended the child to attend the school**

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