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BFAS Money Line

INVESTMENTS

Election to Pump Mkt?

So far this year the market has been pretty flat, just like this time last year. Yet, last year the market finished above 20% for the fourth year in a row (unprecedented).

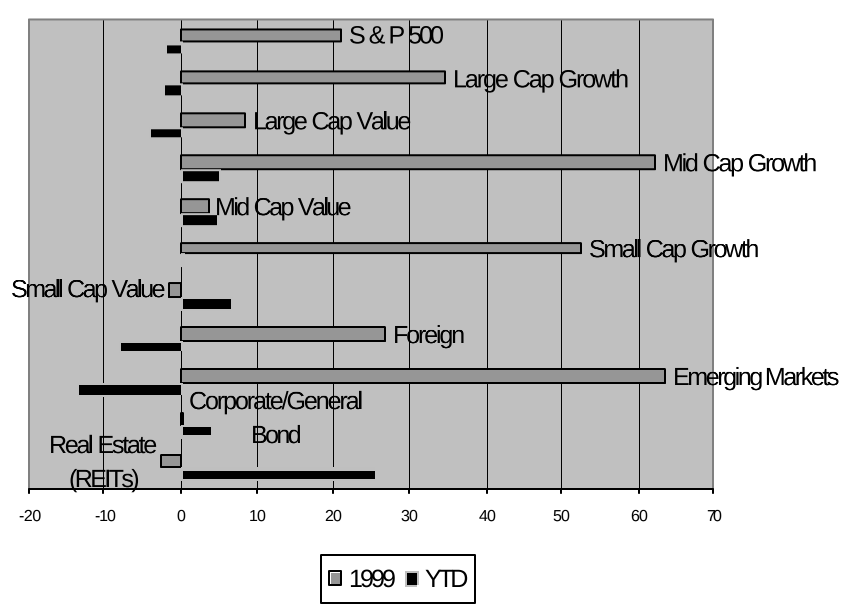
Election years have traditionally been good, and Mr. Greenspan seems to be a little less afraid of the inflation boogy man. Will that translate to great performance in the last five months of the year? Possibly.

On the other hand, the current interest-rate-curve (short term rates higher than long term rates) points to a recession in our future. Many things have pointed to a recession over these last ten years of unprecedented growth. Obviously, these things have been wrong before.

Whichever the way the market goes, you can be sure that **different parts of the market will react differently**. Take a look at the chart on the right. You can see that **in most cases last year's superstars are this year's laggards**.

"Now try not to get confused this time. Tell the audience to <u>buy</u> the stocks we're <u>selling</u>, and <u>sell</u> the ones we're <u>buying</u>."

In fact, **last year's two worst performing asset classes (Small Cap Value and Real Estate) are the best performing classes this year**. If you joined the crowd dumping their money into **Large Cap Growth** last year, you have



reaped **a –2.34% return this year**.

After two years of poor performance, no one would touch **real estate**. **Last year's –2.57% return has been replaced by this year's 25.31% return!**

How Much Cash?

One of the **most common questions I receive when counseling retirees is how to fund their living expenses**. What they would like to have is **an investment that grows 20% annually while distributing enough cash to pay all their living expenses**. If any advisor could do that, they'd be richer than Bill Gates!!

The solution is not so simple and the correct answer for one person may not be best for another.

First off, **money needed for living expenses in the next twelve months should not be invested in the stock market** (not even your cousin's sure thing). Note that this is money you will take from your portfolio over and above your income from Social Security or other retirement accounts.

Depending upon the timing of cash flows, this near-term money should be in checking, money market, CDs or very short term bonds (or a combination of the above). Money market accounts are currently paying in excess of 5%, 3 month CDs 6.25%, 6 month CDs 6.6% and short term bonds are paying 7.3%. (The CDs and bonds reduce your flexibility in withdrawing assets.)

Therefore, **a retiree with steady, predictable cash needs could earn a slightly higher interest by having some of the annual cash need in CDs or short term bonds**. Those with less predictability may need to stay with checking and/or money market accounts.

Having twelve months of cash reduces the potential for having to sell stock assets in a down market to fund cash flow. In fact some people feel better with two or three years of cash needs set aside. This may make them much more comfortable with stock investments in their portfolio.

Selling stock to fund cash flow is perfectly okay. Although it goes against the outdated philosophy that you never touch principal, taking the "cream" off the top of stocks is a widely accepted practice in investment management today.

In addition, you pay lower taxes on capital gains than on dividends or interest. However you would hate to have to sell stock during a correction of 20% or more!

Rarely does a recession last much more than 12 – 18 months. Thus, having the cash to live on for awhile significantly reduces your need to sell when stocks are down.

ESTATE PLANNING

Death Taxes Gone?

Congress passed a repeal of the estate tax this summer. Whether or not the President signs it, **it seems certain that the estate and gift tax will change**.

While charities may well have great concern about continued gifting without tax breaks, **many of you may think you no longer need to have wills or revocable living trusts. You would be wrong!**

While some estate planning is tax driven and some techniques may become useless, **much of the planning revolves around other family goals**. These goals include **protection from divorce, asset protection planning, control over assets and management of assets in the event of illness or disability**.

Thus, there will **still be trusts used to minimize probate and protect privacy, to protect a minor or incompetent child or a spendthrift heir**. Also, family limited partnerships and limited liability companies will still be used to protect and control assets. However, **some charitable trusts and second-to-die life insurance policies may become extinct**.

Many people question whether annual gifting to family members will be reduced as well. Will as many people make gifts without the advantage of removing assets from their estate?

You should NOT, repeat NOT, change your estate planning documents until the law really is finalized and signed. If the estate tax law changes, you should review all your estate planning.

You may still wish to protect assets from later marriages, suitors, children from different marriages, a spouse's financial irresponsibility, lawsuits, etc.

Everyone should discuss their goals with their financial professional and **make sure a qualified attorney drafts the documents**.

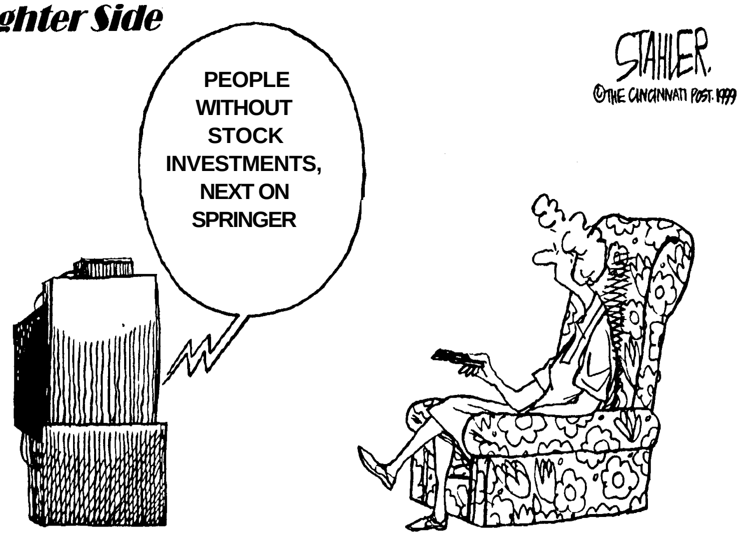
COLLEGE PLANNING

Cheaper College Travel

I recently found a **less expensive way to send your children/grandchildren off to college. TWA offers a Student Package for $548**. It provides four vouchers for one-way flights within the continental U. S. It takes two vouchers to fly to Hawaii.

Even so, $137 one way on the mainland and $274 one way to Hawaii are great fares. Of course, you are limited to TWA's routes. Check it out, you might save a buck or two!

The Lighter Side



RETIREMENT PLANNING

Stock in 401k

A recent situation illustrates the **value of rolling company stock out of a 401k plan rather than rolling it over into an IRA**. A person had **$400,000 of company stock in a 401k plan**. He had contributed $100,000 in stock to the plan over time.

Thus, his **tax basis in the stock was $100,000**. His normal tax bracket was 31%. He could roll over the stock to an IRA with no immediate tax consequences and sell it to diversify his portfolio, or sell it over time to generate cash for living expenses. Remember, IRA money is subject to mandatory distributions starting at age 70 ½.

Withdrawals would be taxed at 31% federal and 5.75% state or about 35% overall. If the stock maintained its value, the **$400,000 worth of stock would cost $140,000 in taxes**.

But, what about pulling the stock out of the plan altogether? He would receive $400,000 in stock but **pay taxes only on the $100,000 in tax basis**. Thus, he would **pay $35,000 in taxes immediately**.

If all the stock was sold immediately, **additional taxes of $60,000 would be due on the difference between the tax basis and the full market value ($300,000).** This amount, called Net Unrealized Appreciation, is taxed at Long Term Capital Gains rates (20%) even if sold immediately!

Therefore, in this situation, the person can **save $45,000** (difference between $140,000 and $35,000 + $60,000). That's a 32% reduction in taxes!

In addition to the initial savings, any future appreciation of the stock could be taxed at 20% versus 35%. If held until death, the stock would receive a stepup in basis for heirs.

Rolling the stock out of a 401k is not the best solution in every situation, but it is certainly worth looking at!

DISABILITY

Medicaid Waiver Problems

Over and above the benefits Medicaid provides, the **Medicaid waiver program for those with Mental Retardation (MR) provides residential, day and nursing support**. In many cases, Medicaid waiver support can **mean the difference between a parent being able to work or having to stay home with a child**.

Recently, all the local Community Services Boards turned over control of these dollars to the state's Department of Medical Assistance Services (DMAS). **DMAS reports there is no new money to provide either additional support to those already receiving the MR waiver or to serve any new individuals, even those with emergency needs.**

Since the state legislature must appropriate matching dollars to receive Federal Medicaid waiver dollars, this critical money situation is likely to last at least a year or longer. A recent decision by the Supreme Court (**Olmstead Decision**) made it clear that **people in need must be given support in a reasonable time frame**. The current Medicaid waiver waiting list has **people who have waited over five years**. This is **obviously not a reasonable time frame**.

Only forceful advocacy will turn this around. If you have been denied services for a new family member or additional services for a family member in the program, **you should appeal that denial decision to DMAS and send a copy of your request for the appeal to the Region III Office of Health Care Finance Administration (HCFA)**. HCFA is the federal agency reponsible for the Medicaid program.

If you have requested services and been placed on a waiting list because of a lack of funds, you should write a letter to the Federal Office of Civil Rights. You should explain in the letter that you believe your family member is being denied services in **violation of the Americans with Disabilities Act**.

Also, **write your delegate and senator to the Virginia legislature** as well as your **representatives to the U. S. House and Senate**.

I am aware of at least one attorney contemplating a class action lawsuit. **This is a crisis and only strong advocacy will convince Virginia to provide the legally required support**. Here are mailing addresses:

Region III Office
Health Care Financing Administration
Public Ledger Bldg., Ste 216
150 S. Independence Mall West
Philadelphia, PA 19106-3499

Paul Cushing
Office of Civil Rights
Public Ledger Bldg., Third Flr
150 S. Independence Mall West
Philadelphia, PA 19106-3499

Appeals Division
DMAS
600 East Broad St., Ste 1300
Richmond, VA 23219

"We don't like their sound, and guitar music is on the way out." Decca Recording Co. rejecting the Beatles, 1962.

"There is no reason anyone would want a computer in their home." Ken Olson, president, chairman and founder of Digital Equipment Corporation, 1977.

"640k out to be enough for anybody" Bill Gates, 1981

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