August 1998 **Volume 3.1**

BFAS Money Line

INVESTMENTS

Stocks on Sale Worldwide!

I am sure all you long term investors out there are **treating the current market turmoil as a buying opportunity.** Right?

Asian and Latin American markets have been on sale for some time. **Hong Kong, Japan and Singapore are trading at lows going back 10 or 11 years.** Japan's economy is key to meaningful recovery in the entire region. **When Japan turns the corner, these markets will soar.**

Anyone looking at the fundamental values without knowing which country you were looking at would recognize the great opportunities. The **tough part is to ignore the recent past performance.** Again, it **takes a long term view.**

After the recent three-year domestic stock performance, you may find it hard to believe that domestic and foreign stocks have run a virtual dead heat since 1970. Yes, the arithmetic average returns for the S&P 500 and the EAFE are 14.18 and 14.53 respectively from 1970 - 1997.

"Daddy says this is our last date until he's had a chance to review your investment portfolio."

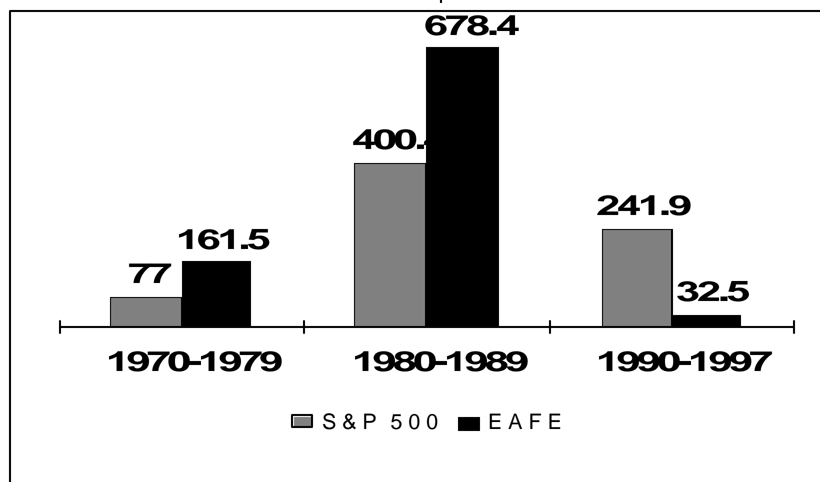
Speaking of asset classes, **how about them bonds!** At least temporarily, bonds (both domestic and foreign) have outperformed stocks thus far this year.

In fact, bonds have outperformed stocks over ten year periods in the past. I have no clue whether we are entering one of those periods (and neither does anyone else, no matter what they say). This is why I recommend including bonds in your portfolio as a hedge against the wild rides in stocks.

Diversifying among stock asset categories will normally smooth the ups and downs in a portfolio. Sometimes, it may not seem like it when for three years U. S. Large Cap stocks trounce mid-cap, small cap, foreign and emerging market stocks. The grass is always greener somewhere else.

This is one of those times when the other asset classes are important in a portfolio. Market timing (trying to pick which asset class is likely to go up next and making a big bet) is a loser's proposition.

As an example, the chart at the bottom of the page shows that the recent poor performance of foreign stocks is not a permanent



situation.

Peter Lynch Says ….

In the Fall issue of Fidelity Focus, **Peter Lynch** has this to say about the pitfalls of **which mutual funds to own:**

"The two most common mistakes are false diversification and whipsaw. If you own 14 different funds, and they're all growth funds, or value funds, or some other category of funds, you may think you're diversified, but you're not. This false diversification subjects you to whipsaw.

Here's how it plays out. Let's say your money's tied up in emerging growth funds, and emerging growth stocks do badly for three years. You're fed up with the lousy results, so you switch from emerging growth into value or "large-cap" funds that invest in big companies. Three years after that, you're fed up with value and large-cap funds, and you switch to international. You're constantly chasing your tail.

A sure cure for whipsaw is to invest in several categories of funds and adjust percentages according to results. …..

*There's no hard and fast rule that tells you how and when to adjust the mix. But **you have to consider the possibility that a category that has underperformed the others for two or three years in a row may be ready for a rise – and vice versa."***

Editor's note: Peter's comments are right on the mark as usual. **Sometimes the correct investment strategy is just the opposite of what your gut (and the popular press) tells you.**

When to Sell Your Mutual Fund

Mary Rowland, a well respected financial author, wrote an article ("How to Know When It's Time to Sell a Fund") for Microsoft's Insider (moneyinsider.msn.com). She stressed the need for discipline when either buying or selling a fund.

Critical issues for mutual funds are consistent investment style, low expenses, consistent performance and manager's track record. Here are her top four reasons for selling a fund:

1. **Consider selling when the portfolio manager leaves.**
2. **Sell stock funds when you are within three years of needing your money.**
3. **Sell when a fund underperforms it peers for two or three years.**
4. **Sell when a fund departs from its investment style.**

Another tip. Never look back at a fund you sold to see how it is doing. Set up your discipline and stick to it. **Don't second-guess yourself.**

INSURANCE

LTC Ins

I am seeing more and more creative methods of selling Long Term Care Insurance. Don't get me wrong, I believe in LTC insurance. Just not in some of its many offspring.

LTC insurance is complex. The **criteria under which insurance will pay benefits is critical.** Congress recently passed legislation making LTC **premiums tax deductible** on Schedule A and **benefits tax free, if the policy is tax-qualified.**

Unfortunately, Congress' requirements for tax-qualification makes it more difficult to collect benefits than in some older, non tax-qualified policies. **Generally, though, I favor the tax-qualified policies.**

What I am seeing is **LTC insurance wrapped in a life insurance policy.** That is, you pay one premium for life insurance and you can collect if you need LTC (with a reduction in the life insurance payout later).

I can see where the combined policy may look attractive, you need life insurance (usually) and you get LTC coverage for free (at least it seems so). **I** have found the insurance industry seldom provides something for nothing.

These policies will almost certainly cost more to cover the potential liability. But, how do you break out the cost of life insurance versus the cost of LTC? Are your premiums still tax deductible? Benefits tax free? More important, are the complex benefit triggers as good as separate LTC insurance?

My recommendation is to avoid the combined policies for now.

Another option I am seeing is one where **you only pay premiums for five or ten years.** In this case, **you are prepaying your premiums and the insurance company is assuming some imputed interest which continues the policy after you stop making payments.**

The lower the imputed interest, the higher your premiums, and vice versa. I do not know what they are using as interest, but would bet it is in the 5 - 6% range. **If true, and all your money is in a savings account or CDs, this would be a viable option for you. If you are paying from your diversified portfolio, you may be better off paying as you go with inflation reduced dollars.**

COLLEGE PLANNING

More on College $

I recently discussed the new tax advantages for those of you paying for college. Since then, several new options have come up.

Roth IRAs. One option is to fund your Roth IRA with $2,000 per year. **After five years you can withdraw your contributions tax free to pay college expenses.** This allows you to put more away than the Education IRA and to maintain more control. Also, pension assets are not normally looked at in calculating Expected Family Contributions. Downside is the lost opportunity cost of compounding that IRA money for many years.

Educate America. I just received information on this plan and have been unable to get anyone on the phone to discuss it. It appears to be **a plan where you contribute to mutual funds or annuities and the earnings are counted as tuition credits at various colleges which have signed up.** The colleges are **all small, private schools**. They will offer rewards of up to one year of free tuition or a tuition reduction equal to $13,800, whichever is less. Invested assets remain in the sponsor's name. Tax implications are unknown.

529 Plans. All I know about these plans (which are only a month old) I received from Fidelity. Hopefully, other mutual fund companies will offer such a plan. You **contribute to a plan which is invested in one of seven portfolios depending upon your child's age.**

The portfolios range from 88% stock funds and 12% bond funds for newborns to 63% stock funds, 33% bond funds and 4% short term bonds or money markets for 10 year old children to 25% stocks, 45% bonds and 25% short term or money market for 16 year olds.

There are a range of stock, bond and money market funds (all Fidelity) which can be used by the portfolio managers. You have no control of that.

While the assets remain in your name, **taxes are deferred until assets are used for college (or trade school).** When used, the **gains are taxed to the beneficiary (at presumably a lower tax rate).** Annual expenses are $30 until accounts reach about $25,000, then eliminated.

If the expected child does not attend college, **another family member including adults can use the money.** Worst case you can get your money back minus taxes and a 15% penalty.

These **plans may be especially attractive to high income parents who are not eligible for the Hope Scholarship, Lifetime Learning Credits or Education IRAs.**

These plans allow payment of college expenses anywhere in the country and will pay for room and board, supplies and equipment as well as tuition. This seems to make them more flexible and attractive than state pre-paid tuition plans. Contact Fidelity at 800-544-1914 for details.

MORTGAGES

15 or 30-Year Mortgages?

A recent article in the Journal of Financial Planning by Drs. Goff and Cox analyzed these two popular mortgage options. They found some situations where one was better than the other and vice versa.

Many home buyers benefit greatly from taking a 30-year mortgage and investing the difference in a tax-deferred investment plan. It **especially favors home buyers in high tax brackets purchasing relatively expensive homes.**

Thirty-year mortgages also work out best when mortgage rates are relatively low and the spread between 15-year and 30-year rates is relatively small.

While I like the early payoff and lower interest rates available in a 15-year mortgage, 30-year mortgages can be paid off in 15 years if the owner chooses to do so.

In the final analysis, individual sensitivity to debt, investment discipline and current rates will drive the decision.

DISABILITY PLANNING

Cancel SBP?

Those who have discussed the military's Survivor Benefit Plan

(SBP) with me know that **I am a supporter of SBP**. Only in a few situations (where you are fairly certain to be financially independent without SBP at age 65) does it make sense to "buy term insurance and invest the difference". The military subsidizes SBP to the tune of 25 - 40%. This makes it hard to beat it, even with term insurance. I realize that there are many insurance salespersons who would take issue with this, but I can't get their numbers to match mine.

SBP is especially lucrative if you have a disabled child. The deduction for children's benefits is very inexpensive ($20 or less monthly) and a disabled child will receive 55% of your benefits, inflation adjusted, for life. No way you can buy enough insurance to match that.

The **rub is how this SBP income is treated with regard to government benefits.** Insurance proceeds left to a Special Needs Trust or a Community Trust are not counted as the child's assets when determining eligibility for benefits.

However, **SBP income can not go directly to a trust except as a representative payee.** This means that the **child (or trust) receives the payment as income as far as the government is concerned.**

Since most disabled children would normally be eligible for SSI/Medicaid, income is important. **Unearned income offsets SSI dollar for dollar (after the first $20) and income over about $500 per month would eliminate the SSI entirely. In Virginia, loss of SSI usually causes loss of Medicaid.** Note that in a number of other states (those with income caps for Medicaid eligibility), Medicaid can continue even though SSI is lost.

Thus, those whose child would receive less than $500 per month from SBP will only see a reduction in SSI. Those with SBP over that amount have to review whether or not to keep it.

We are currently in a one-year window (for most people **until May 16, 1999) where you can cancel your SBP.** If you have your spouse signed up, you must have her written permission to cancel. No permission is required for children.

I am working with some people who are trying to get the federal code and DOD Instructions modified to allow SBP to go to a "Trust for the benefit of disabled child" directly rather than as representative payee. This would solve the loss of benefits problem. However, it is a long-shot.

Thus, **those of you who have selected the SBP for children option for your disabled child have nine months to review the pros and cons and make a decision.** There is no one answer for everyone.

Qualifying for Disability

To prove disability, you must show that the individual:

1. Lacks the ability to engage in any substantial gainful activity.

2. By reason of one or more medically determinable physical or mental impairments.

3. Which can be expected to result in death or

4. Which has lasted or can be expected to last for a continuous period of not less than 12 months.

Once Social Security accepts your application, they forward it to the **Disability Determination Service (DDS).** There, **a team consisting of a physician (or psychologist) and a disability evaluations specialist will consider all the facts in your case and decide if you are disabled.**

Your **claim will be significantly enhanced by furnishing all medical documentation** you can when you file your application. If more is needed, get it to SS quickly.

The **most important evidence is a well written examination report from your doctor**. This carries great weight. It should be based upon a recent examination.

Your doctor can not determine whether or not you are disabled. Only the DDS can do this. Yet, **if your doctor's report addresses the issues numbered above, you should have a much improved chance for approval**.

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