

# BFAS Money Line

## INVESTMENTS

### Bottom behind us?

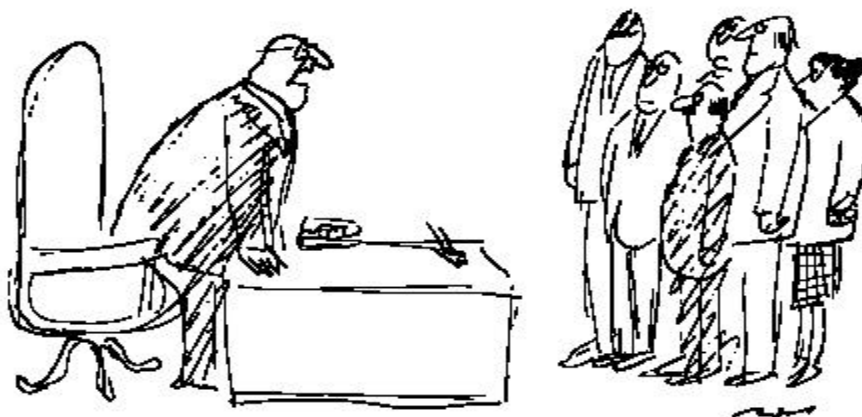
Although nothing is certain, **the market has risen 17% since the low on October 9<sup>th</sup>**. The economy continues to grow; Christmas sales seem to be starting off well. It's probably time to be **cautiously optimistic** that the worst is behind us.

No doubt, the last three years have been painful. Even after the recent rise, the **S & P 500 is still down 39% and the NASDAQ is down 71% from its peak in 2000**.

Does this mean the economy (and the market) will continue in a lock-step rally. No! **Growth will continue to be weak and the economy will Muddle Through**.

Inflation is likely to remain in check. In fact there is considerable discussion that we are close to deflation.

When you go shopping for the holidays, check out where the stuff is made. Bet it says, **Made in China**. More and more industries are having their goods made there to take advantage of low labor costs. Low cost imports have kept our costs (and inflation) down. However, **our industries can hardly raise their prices**



"I never said you couldn't issue sell recommendations. I just don't ever want the retail customers to see them."

#### when they face such competition.

If inflation stays in check, the Fed will have no reason to raise interest rates. That probably means **continued low mortgage rates, and low CD and bond returns**.

Stock prices are not likely to really rally until earnings increase. As I alluded to earlier, companies will find it difficult to increase earnings due to the price squeeze from imports.

I think we're going to see **uneven returns averaging in the 5% - 8% range for the next few years**. A big shock, like a terrorist attack or an Iraq war, can generate a steep, short-term decline. However, like

9-11 and the Persian Gulf War, this decline is destined to last only a few months with a larger increase afterwards on the upside.

Asset Class	1 Yr Rtn (10/31/02)
S & P 500	-15.10%
NASDAQ	-21.33%
Lg Cap Gwth	-18.57%
Lg Cap Val	-13.70%
Mid Cap Gwth	-17.39%
Mid Cap Val	- 6.69%
Sml Cap Gwth	-18.32%
Sml Cap Val	- 3.12%
Foreign	-12.58%
Interm Corp Bds	+ 2.55%
Foreign Bds	+ 6.34%

## CASH FLOW

## Debt, Don't Do It!

With interest rates so low, there is a **tendency to increase debt as long as the monthly payment stays the same**. That could mean a nicer car, or some other goody you can afford in your monthly spending plan (notice how I avoided the "B" word?). To the contrary, in these uncertain times **you should be minimizing your debt and adding to your savings**. Pay it off!

Another area that is very seductive in this market environment is the **401(k) loan**. Some 92% of 401(k)'s allow loans. However, **raiding your retirement savings to support your current lifestyle is trampling on sacred ground**.

But, what about taking a loan to pay off high-interest credit cards? Sure, you can take a loan of about 50% of your 401(k), pay it back over five years at an interest rate near the prime rate. And yes, this interest rate would be less than your credit card rate.

However, **loans not repaid on time are considered as having been distributed and subject to immediate taxation as ordinary income. All tax deferred compounding on the amount withdrawn is also lost**. It's true stocks have been flat over the last five years, but they were up 17% in the last seven weeks. That

does not happen often. Those who "saved on their interest expenses" by borrowing from their retirement account missed out big-time.

**Another dangerous debt practice has been the Pledged-Asset Mortgage**. Touted by many brokers as a dream way for investors to grow their stock portfolios and have a house, **borrowers simply pledged their securities as a down payment**.

Often, **you could receive a flat, low-interest rate for five years with increases thereafter**. Some people didn't have the resources after the market tanked to make the increased payments. Others **found their stock portfolio was sold at the market bottom to satisfy a margin call**. What seemed like a nifty strategy has been unmasked as a really risky way to go!

## INSURANCE

## VUL Ins - Beware!

**Variable Universal Life (VUL) Insurance** policies were hot in the 90's. These are life insurance policies where you **can invest the cash value in "mutual funds" and have them grow tax-deferred inside the policy**. The tax-deferred feature allows you to rebalance the funds without tax consequences.

Some marketing pieces tout a tax-free retirement income stream available by taking loans from the policy in retirement. Most clients were shown illustrations

using "just" a 12% return every year.

**In many cases these policies are in trouble today**. Actual life insurance costs normally increase yearly as you age. If your premiums started out near the minimum level to sustain the policy, the insurance company may be dipping into your "mutual funds" to meet life insurance costs. Most policyholders have no idea what's happening.

Policyholders are likely to receive a notice, often as they are retiring, that says their **policy will lapse unless they contribute dramatically higher premiums**. This could be tough just as a person retires. The insured is in great danger of losing both the life insurance AND the investment.

**What should you do** if you have one of these policies? **Ask for an up-to-date in-force policy illustration**. This will show how long the policy will sustain itself based upon current cash value, current premiums and a realistic investment return (7% - 8%?).

**To fix any problems, you can increase premiums, pay a lump sum into the policy or cut the death benefit**. If you roll the VUL policy into a term policy or a Variable Annuity, you may run afoul of significant surrender charges up to 10 or even 20 years after you bought the policy. You **might consider dropping the death benefit, holding onto the policy, then converting when the penalty period expires**.

I have **analyzed a low cost VUL policy and could not find any tax bracket**

where a VUL policy was a better investment than investing in mutual funds outside the policy. The biggest problem was overcoming the 3.5% Virginia premium tax in addition to mortality and administrative expenses.

#### CASH FLOW

## Long Distance Bill Paying

There are two primary situations where you need the ability to pay your bills while away for an extended time: **someone taking an extended sabbatical and a Reservist called up to active duty for an extended time.**

Since we may have thousands of Reservists called up in the near future, many, many people could face this situation. I recently taped a PBS show (Right on the Money) on this topic (Show will air nationally in January – but not on WHRO).

One of the first things to consider is **what to do with the house.** If you don't have family living there, will you leave it empty for months? Do you need to winterize? You **might want to consider a temporary renter.**

Check with a local rental agent to see if there is a company looking for a rental to save on motel costs for a person who may not live in your area, but visits frequently. Typically, such a renter can vacate on relatively short notice; and the income can help cover your costs.



“Do you really expect this court to believe you had no idea my client was speculating your retirement portfolio in emerging market currency futures?”

Note: **disconnect your phone service and notify your home insurance company!**

**Paying bills from afar could be as simple as logging onto your bank checking account and paying all your bills electronically.** Many banks and credit unions have electronic bill paying. Maybe you will use **Quicken or MSN Money.**

While you are away you can use a VISA card to access a money market account. Using it at ATMs gives you money in the correct currency wherever you may be and also provides the best exchange rate on your purchases.

But, what about those **bills that you just can't pay electronically?** If you have a spouse at home, the spouse could pay them. Otherwise, you **need to find a trusted individual (relative, friend, CPA, etc.) and give that person a special power of**

**attorney to pay your bills and file your taxes.** You will probably want to have your mail forwarded to your friend or to a P. O. Box for pickup.

**Reservists** have additional issues. Since they may receive less pay while on active duty, **they need to minimize debt now and build up as emergency fund equal to 3-to-6 month's expenses.**

Reservists are also **eligible for a 6% limit on the interest they pay for credit cards, car loans, mortgages or other debts.** They are also **protected from eviction if their rent is less than \$1,200.**

The Reservist must notify the lender of their intent to invoke the 6% cap in writing, along with proof of mobilization/activation to active duty and evidence of the difference in the person's military and civilian pay. Subsequently, the creditor

must comply or apply to a court for relief.

Reservists can also delay filing their tax returns if they are on extended duty outside the U.S. Additionally, they can delay civil court proceedings.

Finally, **employers must hold a job for Reservists.** Not necessarily the same job, just an equivalent job.

## Taxes

Although you may have long since stopped opening your investment statements, this is **prime time to save yourself some tax money.** Most stock mutual funds (and individual stocks) have lost money this year.

Now is the time to sell them and buy a similar replacement fund. Note that I am not saying get out of the market; I'm just saying **"harvest your losses"** for tax purposes. You will still be fully invested, just not in the same funds. And you will be happy come tax time. Remember, you **can count up to \$3,000 in losses against your ordinary income** and can carry over any unused losses to future years!

### DISABILITY

## Medicaid Waivers

With the money crunch in Virginia (and most other states), **access to Medicaid Waiver services is more difficult than ever.** These services are vitally important because they provide personal and/or nursing support

that allows family members to continue working.

**Medicaid is ½ funded by the state and ½ by the federal government** with the state funds being matched by the federal funds. Thus, the state funding shortfalls are magnified since we lose an equal amount of federal funds as well.

At a recent talk by Martha Adams, head of Virginia's Department of Mental Health, Mental Retardation and Substance Abuse, she said that **the state has 5500 funded slots for Medicaid Waivers.** As we all know, there are **waiting lists: 800 on the emergency list, 1,400 on the non emergency list.** There is a class action lawsuit being filed asking the courts to order the state to eliminate the waiting lists.

One bright spot in the dismal landscape is that **funds are guaranteed for care in an Intermediate Care Facility for the Mentally Retarded (ICFMR).** These facilities support the medically fragile.

The problem here is a **shortage of beds in ICFMR facilities.** One eight-bed facility was opened in Virginia Beach this year. It was paid for and built by the volunteer organization, **BIZNET.**

BIZNET has also purchased two condominiums and a four-bedroom home for housing the mentally retarded. If you wish to volunteer or contribute to BIZNET, contact **Tom Laidlaw at 757-437-6278.**

## SSI Lump Sum

Occasionally, when you apply for SSI benefits, Social Security will backdate the benefit start date and pay you a significant lump sum of money. I once saw a person receive \$20,000.

SSI rules say a single person may have no more than \$2,000 in assets (some assets aren't counted). Does that mean the person automatically loses SSI while waiting to spend-down?

**No, Social Security gives you six months to spend-down the lump sum benefit.** What to spend it on? Many times I see situations where the family has been spending its own money supporting the disabled person. The family can **calculate the amount of that support and have the disabled person repay for that support.**

You can also **take the disabled person on a nice trip** using the money to pay for yourself as a companion. Other items the money can be spent on include: **Personal articles, Jewelry, Music, Videos, Dental Care and Funeral Arrangements.**

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