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BFAS Money Line

INVESTMENTS

Mutual Funds to be Trusted?

After two years of Enron, Worldcom and Imclone scandals, the mutual fund world was touting their long, scandal-free existence. Now mutual funds are in the headlines. **At least seven fund families (Bank of America's Nations Funds, Bank One, Alliance Bernstein, Alger, Janus, Strong and Putnam) have been cited thus far, but an SEC survey says nearly half of all fund families have had some improprieties**. This will play out over the next few months. It will be interesting to see who really is deserving of our trust!

However, even those fund families that allowed after-hours trading or market-timing for heavy hitters, are not all bad. Yes, they **violated their fiduciary duty to investors and will/should be punished severely**. Fines and more stringent oversight are in order. In most cases, individuals at the fund families violated their own written rules.

The most common problems revolved around **late trading of international funds to take advantage of late day market news**. Janus, for example, allowed late trading in Janus Overseas, Worldwide and International Growth and **market timing** in Janus Mercury, Enterprise and High Yield. Their other funds were not involved.

I am monitoring the news/leaks on funds involved and have not seen any funds I use involved. Until it all comes out though, no one can be sure.

I would like to think that **I use top performing funds, and thus would screen out funds involved with funny business because that would reduce their performance**. Time will tell if that turns out to be true.

Should you sell any funds where funny business has happened? What about if your fund's okay, but others in the family were involved?

My opinion is **if all your assets are invested in one of the suspect fund families, you might want to make a move**. Tax consequences and transaction costs would have to be taken into account.

If you have a non suspect fund in a suspect fund family, and the fund is continuing to out-perform it's peers, keep it. If you own a suspect fund, and it is out-performing it's peers even after the funny business, you might want to keep it. You may also be eligible for some compensation for the funny business.

Can It Keep Going Up?

The first week in November, the markets hit 18 month highs. The Gross Domestic Product in the third quarter was over 7% (best in 19 years). Jobs are starting to show growth.

The strong market surge reflects the optimism about the future of the economy, not necessarily current reality. Considering that the government had turned on all the taps (tax cuts, greater spending, low interest rates), it's no wonder the economy is showing improvement.

I read a wealth of newsletters and articles as well as listen to speakers on the economy. Generally, they fall into two camps. One camp says we are in a **secular bear market**, points to much-higher-than-historical price-to-earnings ratios and says the **recent market run-up is a bear-market rally**. **They expect the market to retreat over the next decade (regression to the mean) until prices more accurately reflect earnings**.

Another camp says **higher productivity, greater connectedness with the Internet and worldwide telecommunications, and globalization justifies the higher prices we are seeing and that faster earnings growth will allow price-to-earnings ratios to slowly come down without a major bear market.**

Political instabilities (North Korea, IRAQ, IRAN), resource (oil) instabilities and economic instabilities (potential EU/China trade wars, disruption due to terrorism) make the future pretty uncertain. Then again, we've lived with uncertainty for years. Think about the Cold War where total annihilation was only minutes away.

I tend to discount the rosy "it's different this time" and the gloomy "Dow should be at 5000 and will go there soon" prognostications. I think it's **more likely we will grow slowly (up 25% over the next five years?) as earnings catch up with prices.**

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

Asset Class	1 Yr Rtn (10/31/03)
S & P 500	+24.37%
NASDAQ	+52.46%
Lg Cap Gwth	+22.62%
Lg Cap Val	+22.63%
Mid Cap Gwth	+27.78%
Mid Cap Val	+25.70%
Sml Cap Gwth	+34.24%
Sml Cap Val	+29.96%
Foreign	+21.42%
Interm Corp Bds	+ 6.96%
Foreign Bds	+13.91%

Alternative Investm'nts

A look at college endowment funds shows a large move away from U. S. equities and towards alternative investments. Their **average asset allocation at the end of 2002 was: Alternative Investments 32%, Domestic Equities 32%, Bonds 21% and foreign stocks 13%.**

However, increasing a smaller investor's exposure to alternative investments can be difficult. **Alternative investments include private equities, real estate, oil & gas, timber and hedge funds**.

With the exception of real estate available through mutual funds investing in real estate investment trusts (REITs), the other options usually allow only accredited investors to participate. That eliminates most investors since you must have an income in excess of $200,000 or net worth in excess of $1 million to be considered an accredited investor.

Minimum investments of $250,000-$500,000 and up are not uncommon. Obviously, **diversifying even a $1 million portfolio into alternative investments can be difficult**. This is an area I am monitoring. I may perform due diligence for years before I risk client money in an alternative investment. If you are pitched such an investment, think twice before pulling the trigger!

Bits and Pieces

This is the **time of year to look at your unrealized tax losses.** Although the markets are up substantially in general, there may be individual stocks or mutual funds that are currently worth less than what you paid for them.

Please remember to increase your tax basis by whatever distributions you have received over time, since you have paid taxes on them already. Then **decide if you can save some taxes by selling the stock/fund**.

If you really like the stock/fund you can sell it, harvest the tax loss, then repurchase it 31 days later.

You should **also review your mutual fund holdings to determine whether they will be distributing short and/or long-term capital gains this year**. Most funds make distributions in December.

Due to the market losses in previous years, many funds will not be making distributions this year. That would be great. Remember, short-term gains are taxed at your ordinary tax rate, while long term gains are only taxed at 15%.

If you do find a fund planning a large distribution, you can sell it before the distribution record date, avoid the distribution, and repurchase the fund after the distribution.

These simple steps can add substantially to your portfolio's return. Tax harvesting and avoiding taxable distributions improve your compound rate of return and minimize your taxes.

Retirement Obsolete?

"Save and invest. Save and invest. Don't you financial advisors ever have any fun?"

I frequently describe what I do as, "**What I decided I wanted to do when I grew up**." Yes, I had a very successful career in the military, but that is a young-person's profession.

Nearly fifteen years ago I started searching for what I wanted to do with the rest of my life. Although still in my 40's, I had a substantial lifetime income stream. With some belt-tightening I could have played golf for the rest of my life. Since I married well, I have a very nice place to live.

And yet, I could not see myself wasting my knowledge and skills. I could have become a commercial pilot, but was put off by the time away from home after a Navy career. I could have become a consultant to the Defense Department, but would have chaffed at the bureaucracy and lifestyle restrictions (okay, I hate to wear ties!). Finally, sales has never appealed to me.

Then, one day I needed some financial planning advice, talked to a CFP and asked to learn more about financial planning for my own knowledge. I took a self-paced home-study course and passed rigorous exams. To see if I might like financial planning, I worked part-time in a financial planner's office and asked lots of questions.

Once I decided I wanted to be a financial planner, the next question was whether to work in someone else's office or start my own. Not lacking in self-confidence, I decided to have my own practice that would operate from my home. Allowing myself to be selective about those I worked with made the work very satisfying.

Thus, I created a lifestyle where I control my hours, I dress casually, I work with great people who appreciate my skills and I'm fairly compensated. I can travel where and when I want and, with the aid of modern technology, still meet my client's needs. I don't see this as a job that I need to "retire from".

I realize many people feel trapped in their jobs and live for the day when they can "retire". Retirement itself is actually a relatively recent phenomenon. However, for some people, retirement cuts them off from the activities that make their lives meaningful. Age 65 is no longer considered old. Today's 65-year-old is biologically similar to a 45-year-old 30 years ago.

It's the catharsis of work versus golf that makes golf fun. If you do nothing but golf, then it can become work.

Everyone has different goals for their future life. Nothing said above is meant to denigrate those who are joyously play golf every day.

One of my roles as a financial planner is to help a person identify "What they want to be when they grow up" at ANY age. What is their passion? What would bring them the most fulfillment?

It's not just a dollars-and-cents thing. It's a matter of identifying whatever "it" is and charting a path to achieve it. I thoroughly enjoy helping people along the journey!

DISABILITY PLANNING

To SBP or Not to SBP?

The military's Survivor Benefit Plan (SBP) is a good news/bad news situation when there is a disabled child involved. Civil Service survivor benefits have many similarities.

SBP can cover a spouse-only or children-only or spouse and children. Survivors may receive up to 55% of retired pay (35% for spouses over 62). Full spousal SBP costs about 10% of retiree pay. Children's-only benefits cost about $10-$25/month.

How does this complicate a disabled child situation? Most disabled children receive Social Security's Supplemental Security Income **(SSI) and Medicaid**. To maintain these benefits the child must not have over $2,000 in assets and can only have very limited income. A disabled child's unearned income can't exceed about $550 or earned income can't exceed about $1,150.

SSI/Medicaid benefits typically provide services for the disabled child worth in excess of $50,000 annually. Since most families would have great difficulty replacing those benefits from their own assets, they must exercise care to avoid actions that could jeopardize them.

SBP income is counted as unearned income. Therefore, if the projected SBP income would be less than $550, it **might** be okay to have it continue.

If you have SBP set up for your disabled child and now realize it would imperil the child's benefits upon your death, you need to apply to your service's Board for Correction of Military Records. Go online and locate **DD Form 149** to start the process, which is very slow. In the meantime, stay healthy!

What if the military spouse has already passed away and the disabled child is already receiving SBP? In that case, there is no remedy that I am aware of. The **payments can't be stopped, or diverted into a SNT to maintain the child's benefits.**

I find many people were not aware of SBP's impact when they made the decision to select it. **Now is the time to review whether it will help or hurt your disabled child.**

In the Civil Service benefits program, selecting survivor benefits for the spouse automatically provides survivor benefits for a disabled child. This is a situation where, **rather than selecting survivor benefits, you should purchase a life insurance policy payable to the spouse and forego the survivor benefits**. This would protect the disabled child's eligibility for SSI/Medicaid.

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