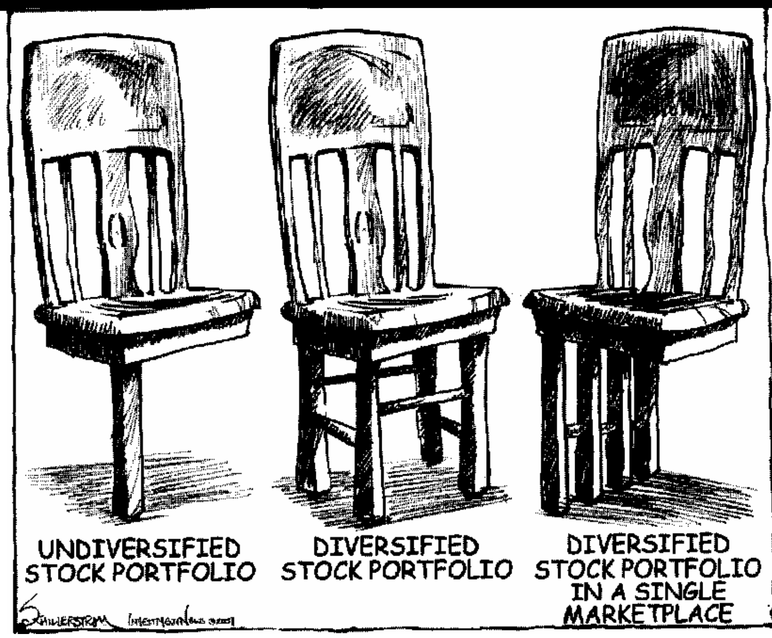
November 2007 Volume 12.4

BFAS Money Line

Which Way Now?



After a dizzying July and August, the market has made up its loss of 10%. However, as soon as the market seemed to have moved past the subprime credit problems, another bank reported billions in losses and the market tumbled again.

There are so many cross-currents at this time, it is very difficult to get a feel for whether the market will go up, down or sideways. On the one hand, **the third year of the presidential election cycle is historically a good stock year**. On the other hand, we are feeling the impact of the bursting of the housing bubble.

While the economy is growing, unemployment and inflation are low and most company profits are still very high, the housing industry is in recession. This also affects furniture sales, home improvement companies, mortgage companies, etc. All indications are that housing will not rebound until 2009. (By then, there may be some actual bargains out there!)

So, whither the market? While stocks don't seem to be overvalued, they are not undervalued either. If stocks just gain in proportion to the economy and the economy is growing slowly**, it looks like stocks will grow over the next few years but not as fast as they have historically**. However, growth could be sporadic with significant drops (like the recent 10% drop) and subsequent recoveries.

The **dollar's steep decline** raises the prices of imports (and makes overseas travel expensive). This **could cause inflation** problems and create pressure for the **Federal Reserve to reverse course and raise interest rates**.

Higher interest rates would hurt the economy. However, interest rates are likely to continue down in the short term to bolster the slowing economy and head off a recession. Foreign stocks do well when the dollar is falling and, indeed, foreign stocks have performed superbly over the last four years. However, just like real estate, foreign stocks don't just go up. Back in the 90's they were down for five years.

One problem I see in this very political season is politics coloring people's view of the economy. Two people with different political persuasions can look at the same numbers and have dramatically different interpretations.

Since many people vote on a party based upon their perception of the economy, the parties do their best to create a perception of the economy that helps their party. Hence, if the economy is doing well, the party seeking control will paint it as a hollow economy or they will assert that only the rich are doing well. If profits are up, then labor must have lost ground and “change must happen”.

I have seen people’s perception of whether to invest or not be colored by their politics. While it may be difficult to separate concern for the overall direction of the country with what the economy and the markets are doing, it is crucial to be unemotional regarding your investments. **One of the biggest values an advisor brings to investing is to get between an investor’s emotions and their money**.

The chart below shows that growth (after lagging for four years) is outpacing value:

Asset Class	1 Yr Rtn (10/31/07)
S & P 500	+14.56%
NASDAQ	+20.81%
Lg Cap Gwth	+21.57%
Lg Cap Val	+11.78%
Mid Cap Gwth	+24.85%
Mid Cap Val	+11.56%
Sml Cap Gwth	+19.00%
Sml Cap Val	+ 5.55%
Foreign	+24.91%
Interm Corp Bds	+ 4.67%
Foreign Bds	+ 7.94%

Tax Issues

This time of year is important for your pocketbook. **You should review your taxable accounts to identify any positions where you might have a tax loss**. Since real estate, bank, mortgage and home improvement companies have had a horrible year, **you may have stock or mutual fund positions that are worth less than you paid for them**. **Selling those positions can save you money**. **The losses will offset other gains you have realized or could be used to reduce your taxable income (up to $3,000). So harvest those losses!**

The other thing that happens this time of year is distributions from mutual funds. Mutual funds typically buy and sell stocks throughout the year (some funds buy/sell more than others). Mutual funds are required to distribute gains on positions they have sold by the end of the year (they don’t have to distribute gains on unsold positions). You don’t care about distributions inside IRAs, 401(k)s, etc. because the taxes on those accounts are deferred. You only care about your taxable accounts.

December is the month when most funds distribute those gains. **Note: if the fund reinvests the distribution, you still must pay the taxes on the distribution even though you received no cash**. Foreign and emerging market funds have soared this year and they will likely distribute significant gains (can be up to 10% of the fund’s value) in December. However, **even funds that have not done well may have significant distributions if they sold positions sometime during the year with big gains**.

This **annual distribution time gives you an opportunity to review your funds and their potential gains** (usually shown on fund websites). If the fund is worth about the same as what you paid for it, but is expected to distribute 10% of its value in capital gains, you might want to sell the fund before the date of distribution. If you still like the fund, you can repurchase it 31 days after you sold it to re-establish your position without having accepted the 10% distribution!

This is the time of year when you should verify that you have contributed the maximum amount to your retirement plans. I have long been a fan of Roth IRAs because the money grows inside and comes out tax free. Many people don’t contribute to Roth IRAs or Roth 401(k)s because they don’t get a tax deduction for the contribution.

Considering Congress’ plans to raise taxes to pay for war/health care/social security/… higher taxes seem to be in our future. Therefore, if you are deferring a low tax now only to pay higher taxes when you withdraw money in retirement, you are losing ground.

Many people contribute to both Roth and traditional 401(k) accounts to hedge their bets on tax rates. If tax rates go up, the Roth accounts will be the best deal. If we somehow end up with the current tax rates or go to a flat tax, the traditional 401(k) account will do best. Having some in both accounts can provide flexibility when withdrawals start. If taxes are high you can withdraw more from the Roth (tax free) to minimize your taxes. If they are low, you can withdraw more from your traditional 401(k) or traditional IRA.

One thing that homeowners must keep in

mind as they stare foreclosure in the face is the potential tax hit. Under current law, **if the bank/mortgage company forgives or cancels part of their loan, that amount will be reported to IRS as income**.

Say the house is worth less than the mortgage. You convince the mortgage company to take the proceeds of a sale to satisfy the mortgage. The mortgage company cancels the remaining debt, but sends a 1099-C form to IRS reporting the debt cancellation as "other income" to be reported on line 21 of the 1040 form and taxed as ordinary income.

Thus, just when you think you have solved the mortgage problem, you might have a tax problem (and the IRS is much tougher to deal with than the mortgage company). Note: Congress is working on legislation to eliminate taxation of this debt cancellation, but passage is uncertain.

College

Now that you've gotten your children off to college, here is one issue that you might want to address. Although you might be his/her closest relatives, if the child is over 18, you may not be notified automatically if the child has a health issue. In addition, a hospital or health care provider won't necessarily release information to parents.

This can be very frustrating if your child is hurt while at college and you are unable to get information over the phone. To prevent this happening to you, **have your child** (while home for

"As you can see, I plan to retire next week, and I haven't saved a dime. This is your chance to become a legend in your profession."

Thanksgiving or Christmas) **execute a Health Care Power of Attorney (or, in Virginia, an Advanced Medical Directive).** This will dramatically speed up your access to information. Remember to use the form for the state where your student is in college, not where the parent's reside!

Just Say No

Since seniors have the majority of wealth, they are continuously the target of "Instant Experts". There are even special "senior" designations, such as Certified Senior Advisor (CSA) which can be obtained in a weekend, and are used to convey legitimacy to those targeting seniors. If you are looking for advice, you should look for help from someone with a more robust designation, such as CFP®, ChFC or CLU.

And these "experts" are most happy to **host you at a free luncheon seminar where they will scare you into purchasing their complicated products (usually annuities).** Virtually every regulatory authority warns against these pitches, yet their warnings seem to get lost in the marketing blitz from salespeople.

Hardly a week goes by that I don't receive several of these pitches (since I am officially a senior citizen and live in a well-to-do neighborhood). I'm often tempted to go and ask the hard questions, but frankly don't have the time to waste. Neither do you. **When you get invited to a free lunch, unless it's your mother, just say no!**

Where Does the $ Go?

In fifteen years of working with people to achieve their goals, **the single most**

difficult issue preventing their success is failure to save. Most people have figured out how to live on their income, but they never seem to have any left over for their future.

They find it very hard to change their habit patterns about spending. Not just the spending part, even the tracking of their spending. Whether they fail to track their spending due to fear of negative comments from a spouse or me, I don't know.

Some people seem to be afraid that whatever is important to them (travel, charity, eating out) will get sacrificed for that nebulous thing called "retirement". They may think they will never live that long, or they will keep working or just that something will happen to provide for their future. They don't want to sacrifice their current standard of living to provide for their future.

Even if I can convince them to set aside a certain amount for their future, they will resist tracking their spending. And, it's not really that hard to do. Today's **computer software (Quicken or Money)** make the task fairly easy. You **can download your checking and credit card information from most banks and credit unions**. You can pay your bills online.

One hitch surrounds **cash spending**. Once you hit the ATM for cash, the **money seems to disappear and no one knows where it went**. My secret for tracking cash (okay, I don't track every penny, but try to track the dollars) is to **always put the cash receipts in my pocket. At the end of the day, I put the cash receipts on my desk and periodically I input them into Quicken.**

Cash spending can add up to a significant part of your overall spending. By tracking it, you can find out just how much you are spending on Starbucks, Barnes & Noble, or cigarettes, etc.

I try not to judge spending. **The purpose of tracking spending is to know where it is going so you can look at it and make your own value judgments as to whether your money is going to the best places to achieve your goals, both short and long term!**

Care Notebooks

(From the Concerned Citizens for Special People Newsletter) Families who have children with special needs frequently receive information and paperwork from many sources. One organization has created a **Care Organizer and a Care Notebook** to keep everything together in a central place.

The Care Organizer is a plastic expanding file folder with individual pockets labeled to help organize paperwork. The Care Notebook is a 3-ring binder which contains supplies to make it easier to find and share information quickly with the child's care team. The supplies include plastic pages that hold business cards and several pocket dividers that hold key papers.

The Care Notebook also contains forms that families may fill in, make changes to as your child's care changes, and save as your own file. These 39 forms are available as word documents. Families may use these pages to keep track of appointments and health care, to create a list of their care team and resources, and to create a summary their child's abilities and care needs. Most families do not want or need every page. The complete Care Notebook can be downloaded as a PDF file for printing.

You can find the Care Organizing tools at http://www.cshcn.org/resources/CareNtbk.cfm#Complete . For questions about adapting or reprinting, contact Patty Centioli at patty.centioli@seattlechildrens.org .

I have long been a proponent of drafting a Letter of Intent for your child with special needs. A Letter of Intent is one place you list your hopes, goals, history, medical information, living information, etc. for your child. The tools listed above can help you organize most of your Letter of Intent information.

Edited and Published by:

Ronald S. Pearson, CFP®, AEP

Beach Financial Advisory Service

6204 Ocean Front Ave.

Virginia Beach, VA 23451

(757) 428-6634

E-mail: ron@beachfas.com

www.beachfas.com