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BFAS Money Line

INVESTMENTS

Thoughts about Bulls and Bears!

One of the biggest concerns people have when making an investment decision is whether to **put your money in the market now or wait for a "better" time.**

Over time, the **market goes up twice as often as it goes down**. Indeed, lately it has been so long since we had a real bear market, some people are more concerned about missing upturns than downturns. Yet, those who purported to know the next movement have been proven wrong time and time again.

What would have happened if you had invested at the worst time (market peak) every year for ten years versus the best time (market low)? Between **1985 - 1994, investors investing at the worst time earned 9.92%, those investing at the best time 13.46%.** Those "waiting" earned savings rates.

So, what would have happened if you guessed wrong and invested just before a serious bear market? As the accompanying chart shows, the **recovery rarely takes more than two years (from market top through the fall to a new record high).** This measures how long investors who guess wrong and sit tight will have a loss on their books.

"There was nothing wrong with the financial plan. The trouble is you somehow managed to live past age 50."

Loss & Recovery	% Loss	New Record High
1961 - 1962	-28%	1 yr., 4 mo.
1967 - 1968	-22%	1 yr., 1 mo.
1968 - 1970	-36%	2 yr., 4 mo.
1973 - 1976	-48%	3 yr., 6 mo.
1976 - 1977	-19%	1 yr., 9 mo.
1981 - 1982	-27%	1 yr., 10 mo.
1987 - 1988	-34%	1 yr., 9 mo.
1990 - 1991	-20%	7 months

Thus, even if you pick the worst possible time to invest, generally two years will see you in the plus column.

Should you **dollar-cost-average** or put it all in a **lump sum**? Academic studies show **better results with lump sum**; mainly due to the fact that the market goes up twice as often as it goes down. If you don't have all your money in the market, you lose much of the upside potential

However, academic professors aren't the ones with money on the line. Dollar-cost-averaging generally smoothes the ride and can be easier to take emotionally. Lump sum investing can be tougher emotionally, but better financially. You make the call!

RETIREMENT

Roth's Good Deal

With few exceptions, people deciding whether to fund a deductible IRA, an ordinary non-deductible IRA or a Roth IRA **should choose the Roth IRA in 1998**. Although the contribution is not tax deductible, the growth and ultimate withdrawal is completely tax free.

Remember married couples filing jointly can contribute to the Roth IRA if AGI is less than $150,000 (singles less than $95,000). Thus, most people will be eligible to contribute to a Roth IRA in 1998 and subsequent years.

What if you are **eligible for a deductible IRA in 1998**?

While the tax deduction up front is nice, the **tax free withdrawals of a Roth IRA almost always make the Roth IRA a better deal**. I can do specific analysis and provide reports showing the results.

Another advantage of the **Roth IRA is that distributions won't trigger taxation of Social Security benefits** (up to 85%). There is also, **no mandatory withdrawal schedule**, during your lifetime. In addition, you **can contribute to the account as long as you continue to earn employment income** (past age 70 ½).

Yet, the number crunchers say the **real issue** for 1998 is **whether to convert old IRAs to Roth IRAs**. If you switch, you will **pay tax now on the current value of the money going into the new account**.

You must have an **adjusted gross income of less than $100,000** in the year you convert. If you convert in **1998**, there is a one-time good deal; **taxes on the conversion are paid in equal installments over the next four years**. After 1998, its pay up the same year.

Who should convert? This complicated question depends upon: **do you have cash outside the Roth IRA to pay the taxes, when will you need the money, what tax brackets are you in now versus your tax bracket in retirement?**

I have seen scenarios where a person nearing 70 ½ with millions in an IRA would save money in just a few years by converting. There is even talk of people who are already taking mandatory withdrawals converting.

What if you convert and they pass the flat tax? Oops! You will have paid a higher tax rate to now compared to a lower flat tax rate on your current IRA.

Everyone should **think seriously about this very important issue**. There are many variables to consider. I will be contacting all of my retainer clients to conduct the conversion analysis.

CHILDREN WITH DISABILITIES

Heart Havens

Housing for children with disabilities is one of the most critical issues facing us today. **Virginia's United Methodist Churches** are working with some parents to **provide caregiving in the parents' home after parents are gone.**

The church has set up a non-profit corporation in Virginia which **will accept a gift of an appropriate home in return for lifetime caregiving for the child with a disability**. The maintenance and upkeep on the house as well as supervision of the child is paid by contributions from Methodists throughout the Virginia.

No government money is accepted by Heart Havens; however, the child will remain eligible for Medicaid/Medicare health care.

Heart Havens will expect to place other children with disabilities in your home. In most cases the home must be left mortgage free to Heart Havens.

The first home in Virginia belongs to a parent in Portsmouth and will be turned over to Heart Havens in January 1998.

I have been very impressed by this program. It is definitely one which bears consideration. For **more information contact Reverend Art Wolz at (804) 768-6040**.

RETIREMENT

Are Variable Annuities Dead?

The new tax law lowers capital gains tax rates to 20% (long term) or 10% depending upon which tax bracket you are in. Since **money contributed to a variable annuity is taxed as ordinary income when withdrawn**, it could be at a disadvantage compared to capital gains investments.

In addition, **variable annuities** are inherently **more expensive**. There are **administrative charges** and **mortality and expense charges** in addition to **expenses for each subaccount.**

Previous studies have shown the extra expense of **variable annuities** means the tax deferred compounding takes **10 - 15 years to perform better than the same investment outside a variable annuity**. With the new tax rates these break even points are even further out.

So, should anyone still invest in a variable annuity? Here are some situations where variable annuities might make sense:

Investing in high turnover equities

Fixed income investments

People who live in high tax states who will

retire in low tax states

People looking for greater tax control

While generally not a fan of variable annuities, there are a few situations where they make sense. **If you use a variable annuity, be sure to pick one with very low expenses since this has such a large impact on performance**.

Show Your Teenager How to be a Millionaire!

Other than getting it from you, the **easiest way** to **become a millionaire is to save**. The numbers below show how the **power of compounding** makes it **doubly important to save in the early years when that fancy new car or the latest stereo looks so enticing to a teenager.**

Saving only $2,000 a year is something everyone can do. It does not matter whether teenagers become doctors or hamburger flippers.

A teenager **contributing $2,000 a year just from age 18 to 25** will have contributed **$16,000**. Earning 10% a year, here is what the IRA account would be worth (no more contributions):

30	**$40,519**
40	**$105,095**
50	**$272,590**
60	**$707,028**
65	**$1,138,676**

What if the teenager says, "I'll put money into savings when I can afford it". Let's say **age 26** is when they can afford it. They **start contributing $2,000 per year until age 65 (total $80,000)**. Results:

30	**$13,431**
40	**$69,899**
50	**$216,364**
60	**$596,254**
65	**$973,704**

If your children **start really early** with money you pay for chores or helping with your business (all duly disclosed to IRS, of course). Here are the contributions:

8	**$500**
9	**$750**
10	**$1,000**
11	**$1,250**
12	**$1,500**
13	**$1,750**
14	**$2,000**
15 - 65	**$2,000**

Having **contributed** a total of **$110,750**, here is what it would be worth:

30	**$134,494**
40	**$383,905**
50	**$1,030,814**
60	**$2,708,728**
65	**$4,375,864**

Show this to your children!

DISABILITIES

New Guardian-ship Rules

The new year (1998) marks a major change in Virginia's guardianship rules. Where previously guardianship was limited to the person or estate or both, the **new law allows more flexibility.**

Starting in January, you will be able to establish **limited guardianship which allows tailoring to the specific situation you face**. For example if a person can handle money for purchases but not their investments, you can tailor the guardianship to only provide investment help.

Guardianship will likely cost more than before because there are more protections for the individual. Completing all the work takes more legal time, hence more cost.

If you had considered guardianship before and were turned off by the near-all-or-nothing approach, **you may want to discuss this new law with your attorney.**

TAXES

Were You Over 55 and Sold a Home in ’94, ’95 or ’96?

If you sold your home in 1994, 1995 or 1996 and rolled over your gains because you wanted to save your “one time, over 55, $125,000 exemption”, **you may want to file an amended tax return**.

If you file an amended return to take advantage of the over 55 rule, you will have a **lower basis in your current home.**

Also, if you **traded down**, **realized a gain** and did not elect the exemption, you **can recoup the taxes paid.**

Another Roth Idea

Some planners are recommending people **contribute $4,000 ($2,000 each) to non-deductible IRAs during December**. Then they could **roll it over into a Roth IRA with their 1998 contribution of $4,000** and start with $8,000 in the Roth IRA. Remember, you must have under $100,000 AGI in 1998 to convert.

Also, the five year clock limit on withdrawals from a Roth IRA starts with the first dollar deposited. Apparently, it does not run on interim deposits. Thus, opening a Roth IRA early may be an advantage.

HEALTH INSURANCE

Convert Your LTC Policy?

You may remember my previous discussion of the new tax laws on **Long Term Care Insurance** policies starting in 1997. Congress passed laws making a least **some LTC premiums tax deductible** on Schedule A. In addition, **most benefits paid by the insurer are tax free.**

Congress specified language to be inserted in LTC policies to allow them to be **“Tax Qualified”.** This language is in **some cases more restrictive than that in older policies**. Congress also said policies previously issued were **grandfathered**.

One of the mandatory provisions in the new policies is that a beneficiary must be **chronically ill**. That is a doctor must certify that the triggering event must be expected to last at least 90 days for benefits to be paid.

Note that benefits can be paid and be tax free in less than 90 days. They just must be expected to last at least 90 days.

Older policies may pay benefits from day one, whether or not they are expected to last 90 days.

Thus, **if you are asked if you want to convert your old policy to a new tax-qualified policy, check very closely or consult an unbiased source**. The new policy, while maintaining your same premiums, **may result in less coverage.**

“Yes, you’ve obviously received unsuitable investment recommendations and there does appear to be clear evidence of churning in your account. But we still can’t let you file against Money magazine.”

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