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BFAS Money Line

INVESTMENTS

We Have Met the Enemy … And the Enemy is Us!!

As I watch the commercials for state lotteries and the popularity of the new game show, Who Wants to be a Millionaire?, I understand why it is **so difficult for everyone to save and invest**.

Virtually all elements of our society lionize those who "suddenly beat the odds and have become wealthy", especially those who have taken a short cut to wealth.

The media hounds lottery winners. Financial magazines feature stories on day traders who have struck it rich. Who hasn't heard a story about someone buying a stock early on (take your pick of Dell, Cisco, Microsoft, etc.) and striking it rich when the stock skyrocketed.

Even though **academic studies show we react twice as strongly to investment losses than gains and most get-rich-quick schemes fail, we seem to view these schemes as games rather than investing.**

How many stories do you see about the middle class person who lived below his/her means, saved over the long term and is now enjoying a comfortable retirement?

I recently had the opportunity to do a **money makeover of a Navy family** for Navy Times. The **23-year-old enlisted man had a wife and one child. He and his wife only keep $5 in their pocket for spending money**. They both **drive relatively new** (4 – 5 year old) cars that are debt free. With no debt at all, they have a **net worth of $87,000** including nearly $30,000 in savings and CDs. They are **saving 25% of his $28,000 annual salary**.

Continuing at this savings rate and earning 9% on the investments will make this family millionaires in 30 years!! His salary was only increased for inflation, not promotions. Thus, he would be a millionaire without ever earning $100,000 in a year!

Thankfully, the media did cover this story. It is **a story of living below your means, saving and investing**. Too often role models like this are overlooked in favor of stories about the few who make it using a get-rich-quick strategy!

Status Report

If some of your funds are having a slow year, compare them to their appropriate asset category below (Year-to-date total returns as of 7/31/99):

LARGE GROWTH	9.26%
Large Value	7.21
Mid Cap Growth	12.30
Mid Cap Value	8.43
Small Cap Growth	12.45
Small Cap Value	5.36
Foreign	11.67
Emerging Markets	31.75
Foreign Bond	-3.35
Corporate General Bond	-1.42
Govt Treasury Bond	-2.28
Muni Bond	-1.12

Y2K, What to Do?

Although Y2K has been overshadowed lately by Bosnia and the Kennedy crash, you will likely hear more and more in the coming months. While America seems to be one of the most prepared nations around, **there will surely be some disruptions in some areas of the economy on January 1st.**

The question, then, is **what is the likely impact of these disruptions.** One theory holds that this will be **"the end of the world as we know it".** Disruptions will close businesses, put millions out of work and create a depression that could last for years.

Another theory holds that there will be **severe workplace disruptions causing a recession that could last for months.**

The final theory holds that Y2K's impact will be **similar to an ice storm or hurricane**. There will be **temporary disruptions in various parts of the country that will be rapidly fixed**. Thereafter, we will continue on as before.

All three scenarios seem to point to a significant stock market decline as the New Year approaches. The thinking is that **continuing media focus on potential Y2K problems will spook investors into selling stocks**. How quickly they regain their confidence will depend upon which of the three scenarios above really takes place.

I tend to favor the minimal scenario, but my crystal ball is pretty cloudy. **Even if the minimal scenario takes place, should you do anything with your investments?**

If you have read my newsletters very often, you will know that I am not a fan of trying to time the market. I believe that, if you look back at this period 30 years from now, it will only be a blip in the market's march to higher numbers.

Another issue is **taxes**. Anyone in a taxable portfolio could incur **significant capital gains** if they tried to sell in anticipation of a market downswing.

Those with tax deferred portfolios have more options. Two costs to selling here are **transaction costs** and **opportunity costs**. Opportunity cost means if you sell and the market goes up, you lose the gain you would have had.

If you are a long-term investor (and every one of you should be), you should probably do nothing. If you are losing sleep worrying about the worst case scenario and you have a tax-deferred portfolio, you might consider moving to money market funds until the market recovers.

If you have money to put into the market, you might want to keep it in money market funds and be a buyer when everyone else is selling. I think you call that buying low!

Banks – a new era!

Changes at Citibank illustrate the **new philosophy of banks**. Customer service representatives are now "financial associates" who receive bonuses for their referrals on investment and insurance sales as well as on actual sales of the bank's in-house products.

Personal bankers, once licensed, are now "financial analysts" who receive 20% of the commissions on sales of securities, insurance and mortgages and a bonus on bank product sales.

And with even more training and licensing, Citibank's former "investment consultants" are now "financial executives" who receive 80% commissions on securities and insurance sales.

Most banks seem to be organized in a similar manner. Keep that in mind the next time you ask a question at your bank and find them very helpful with solutions!

Et tu CPAs?

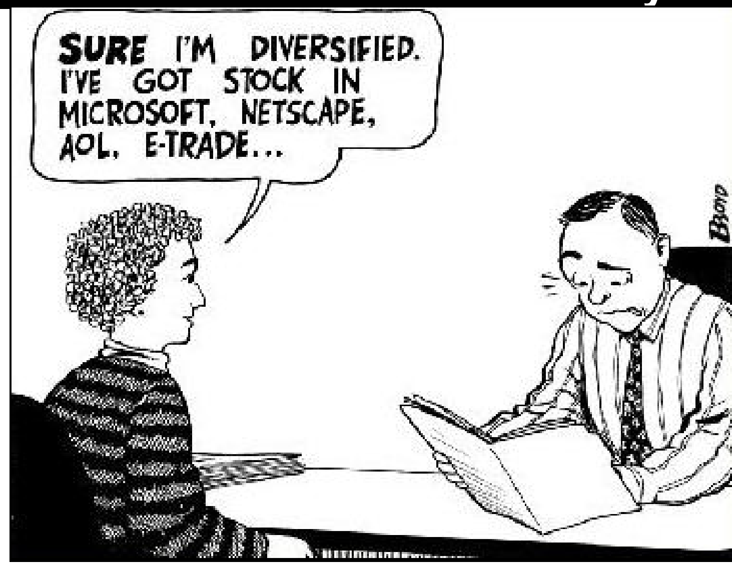
How would you like it if you doctor got paid by a drug company for prescribing its drugs to you? Inspire confidence?

What would you think if your CPA referred you to a money manager and got handsomely paid for every moment your portfolio was in the money manager's hands.

Many states, including Virginia, now allow CPAs to accept commissions. In my opinion, we are losing one of the last bastions of unbiased advice available to the average consumer.

Front Load, Back Load

In 1990, 90% of mutual fund sales incurred up-front sales charges. As a result of consumer education, many people looked for alternatives to **A shares** which **typically lop off 4.75+%** from the initial investment.



Brokers have an easy answer to those who object to "paying a commission". **B shares of mutual funds** put all of your money to work. There is no up front commission, although the broker earns about 4% commission from the brokerage plus a trailing fee for as long as you own the fund.

How can the brokerage pay these fees? By **increasing the fund's expenses by .75 – 1.0%** annually plus making you pay a fee if you remove the funds within, say, five years. The five years of extra high expenses make up for the up-front commission they pay the broker. You see the results in **lower total returns on B shares of mutual funds (compared to A shares).**

Check it out. You will see what I mean. So, if you are working with a broker who says, no problem, we can eliminate the front end load, be aware that the alternative may not be such a great deal after all!

Internet Stocks

Internet stocks have mastered the art of defying gravity with no visible means of support.

Take Dell computer. If the stock were to continue rising at the same rate over the next five years as it has over the last five, Dell would be worth $12 trillion – more than the entire gross domestic product of the U. S.! To continue the pace of computer sales, Dell would sell about 950 million computers in 2003. That's roughly one computer for every household in the world. Of course, the following year it would have to sell more!

In the June issue of Money magazine, Henry Blodgett pushes Amazon.com. He says, "Stocks don't go up or down because they have a specific value". It seems the key issue is not whether the business model makes sense and will generate profits. Later he is quoted as saying the Internet mania will end when the fundamentals at the leading Internet companies stop improving. What fundamentals?

Blodgett says, "Amazon.com has blown away expectations since its IPO, it seems reasonable to assume that it might continue to do so." Guess you have to take this on faith.

Blodgett does concede that according to the standard Wall Street model with five year projections for the size of the customer base, then the stock would be worth around $30 per share. **This is the type of cheerleading which passes for analysis today**. And this from Merrill Lynch's Internet analyst!

CREDIT

Beware this Credit Card

Providian Financial has been soaring as a marketer of credit cards to persons with blemished credit histories. They avoid those who use credit cards as a convenience and pay off balances each month. They want spenders who make minimum monthly payments and tolerate high percentage rates and fees.

Lately, Providian has been the **target of class action lawsuits accusing them of charging for products and services customers don't want, transferring balances from other credit cards without customer approval and imposing excessive fees.**

While most of you will pay off your card monthly, what about your children, especially those in college? They may think tactics such as these are normal. You might want to talk to them about it!

INSURANCE

Ins Claims

Most people buy insurance according to the price and name recognition of the insurance company. But **what about their willingness to pay claims**? A recent article in Kiplinger's suggests that **some insurers tend to offer lowball offers and stall, hoping that customers will settle for less than they are owed on claims**. It seems nobody ever evaluates that when they buy a policy.

A survey of 20 state insurance departments found 50% - 70% of complaints relate to claims. They calculated the companies with the highest number of claims in proportion to the total dollar amount of premiums.

Prudential Property & Casualty had the worst statistics, with 115 complaints per $100 million in premiums – roughly double the rate of Farmers Insurance Group, which was second worst.

The **least complained about company? USAA, with just 16 complaints per $100 million.** USAA only sells Property & Casualty Insurance to people in the military and their dependents, but they sell life, disability and Medicare Supplement policies to anyone.

Medicare Supplm'nts

While Congress in 1992 standardized **Medicare Supplement plans into ten categories (A – J),** they did not standardize prices. If you call the state **Bureau of Insurance (800-552-7945),** you can receive a premium comparison guide for every plan available.

There are 40+ plans available although you may not be eligible for every one. Some are limited to association members, such as the Mennonite Mutual Aid Assoc. Hartford Life Insurance has one of the least expensive plans, but you must be a member of The Retired Officers Association to obtain it.

AARP and Trigon have probably the biggest name recognition, yet they can be quite expensive. For a schedule F plan, Hartford charges $796. AARP costs $1,320 and Trigon costs $1,056.

As you can see, **it pays to shop around**. Check out any associations where you are a member to see if they have one of the less costly plans!

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