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Should You Change Your Investment Strategy In This Election Year?

By our count, we have counseled clients through six midterm elections and six presidential elections. It wouldn't be an election year if we weren't asked many times about the effects of an election outcome on the markets and investment strategies in light of a pending election. This year is no different, except that it seems people are asking more about the short-term effects, rather than a longer perspective.

Generally speaking, the average market return for large company stocks during all election years from 1888 to 2002 has been 8.4%. **In all presidential elections since 1900, the median return during that time period has been 8.0%.** In the 16 cases when the incumbent won, the median return was 13.3%, and in the 10 cases where the incumbent lost, the median return was 4.2%.[1, 2]

But this tells only part of the story—the part about large company stocks. Small company stocks have enjoyed over a 5% difference in average returns over large companies during election years.[2] **These generalizations about "the stock market" are why you should take this history and predictions about the effect of election results with a pound of salt.** Even with all of the above statistics, there aren't enough sample periods, and the extremes in the percentages making up the mean and median returns skew the results.

Which political party is better for the markets?

Earlier studies have shown that the stock market performs better under Democratic administrations, and the bond market performs better under Republicans.[3] But a new study challenges the conventional wisdom that the party in power had much to do with the results. Rather, the actions of the Federal Reserve correlate more with annual returns than with the political party in Congress or the White House.[4] When the Fed pursues an expansive monetary policy by lowering rates, returns of stocks and bonds are significantly higher than when the Fed pursues a restrictive policy by raising rates.

It's more than the Fed or politics

But if watching the Fed or playing the election game were all there was to successful investing, the whole investment industry and the financial media wouldn't be needed. If things were that predictable, there would be no risk, and thus no return. **The truth is, other things, such as earnings also come into play, and neither the Congress, the President of the United States, or political parties control the financial markets.** Buying stock in a company is buying part of a business. Buying a bond is loaning money to a business or a government entity. As we go about our daily lives purchasing the products and services of these businesses, we help drive the earnings of these companies and affect their bottom lines. Although public policy can affect a company's opportunities and cost structure, some do better or worse than others regardless of who is president or what the Fed does.

So, here is our election year strategy: vote with your ballot, not your financial future. Don't bet your portfolio on a certain election outcome. Too many other factors affect investment results, and elections can be unpredictable. Hopefully you will be alive for another 10, 20 or 30 election years. So let us help you create and hold a long-term diversified portfolio of different asset classes that can withstand good and bad times, pleasant and unpleasant surprises, and even an election every two years. Politicians come and go, but life goes on, kids go to college, and people need retirement income, no matter who is in office.

1 Ned Davis Research 12/03. Before 1919 the study uses S&P 500 monthly average prices. After 1919 the study uses S&P 500 closing prices. Investors cannot invest directly in an index.
2 Ned Davis Research 12/03. The time period was from 1928, two years after the Ibbotson Small Company Total Return Index was started.
3 Investment News, July 2004
4 Journal of Portfolio Management, July 2004. Johnson, Jensen, and Beyer.

Back To School: The Costs and Benefits of College

As this goes to press, Ron's second daughter leaves for her freshman year at Boston University, where her older sister also attends. He and Kathy are simultaneously looking forward to and dreading becoming empty nesters. Ron is also recovering from a sore wrist from writing large checks for college bills. Many of our clients have children or grandchildren heading back to school. So this is a good time to talk about preparing for one of life's great goals—helping your kids or grandchildren get a college education.

There is no getting around it—college is expensive, especially at out of state and private institutions. **According to the College Board website, total costs averaged $10,363 per year in 2003-04 for an in-state four-year college, and $26,854 per year at a private four-year college.** Because these are weighted by enrollment, a large university can skew the averages. At some private colleges just the tuition is more than $26,000 (Trust Ron on that one!).

Worst of all, college costs are going up much faster than inflation, especially for public universities receiving less taxpayer support. The College Board calculates that the cost of public universities increased 9.8% from 2003-04 over 2002-03, and 5.7% for private colleges. The 2004-05 average numbers aren't available yet, but comparing the increases at a small sample of colleges shows that this trend is continuing, and getting even worse for the public universities. At this rate, the total cost for four years for a child born today could easily exceed $200,000 at a public university, and $335,000 at a private university.

But a college education is still an excellent investment. According to the U.S. Census Bureau, the median income for a college-educated male over age 25 in 2001 was $53,108, vs. $33,037 for a high school graduate. Women in both categories were about 25% less. The payoff was substantially higher for advanced or professional degrees. The College Board website cost calculator estimates that over a lifetime most college graduates with a bachelors degree will earn $1 million more than high school graduates in today's dollars. And those are just the economic advantages. The expanded horizons, thinking and communication skills, social connections, knowledge about other disciplines, and appreciation of the arts could be worth far more.

Scholarships and student employment can play a big role in minimizing these costs. But as the table shows, if you wish to assist your child or grandchild with this great opportunity, your best strategy is to start saving for it early, regardless of what percentage of the cost you wish to contribute. **Some clients have told us that no matter how much you think you are prepared, it's not enough. And the savings for college expenses conflict with another great goal of life: retirement.**

There are ways to save and pay for college and integrate them into your planning for other important financial goals. Please see the companion article below for an overview.

College Costs And Savings Required Per $10,000 Of Today's College Costs

Assumes 5% inflation rate and a hypothetical 8% non-guaranteed investment return

Years From College	Annual Costs Freshman Year	Total Amount Needed	Lump Sum Now To Meet Total Need*	Monthly Sum To Meet Total Need*
18	$24,066	$103,728	$24,693	$216
10	$16,289	$70,207	$31,629	$383
5	$12,763	$55,009	$36,993	$649

**By start of freshman year. Costs and required investments would be more if investments earned less than 8% and if college costs inflate at current rate, which is higher than 5%.*

Back To School—Paying For College

Besides retirement, providing a college education for your children can be one of the most expensive purchases you will ever make. Quite often, college expenses hit close to retirement time, so you need to start planning for it early. The following is a brief commentary on some of the many strategies that may be appropriate for our clients.

Scholarships

Much of the formula driving needs-based financial aid is based on income. **So, unless you have a lot of children and you make less than $100,000 AGI, your chances of getting a needs-based scholarship are slim.** On the asset side of the ledger, you are not expected to completely deplete your assets, but your child is. Therefore, if you want to try for a needs-based scholarship, you are better having most of the assets in your name, rather than the child's. The federal formula doesn't count certain assets, such as life insurance cash value or home equity, but most of the individual institutions do.

The news is much better for merit, athletic, and artistic scholarships. The most prestigious universities rarely offer merit-based scholarships, but many of those just a notch below in prestige often offer merit-based scholarships to attract bright and talented students, particularly for their honors programs. This helps boost the institution's rankings in the rating game. Besides campus-based merit scholarships, many scholarships are available from other foundations and organizations. The College Board website (www.collegeboard.com) has a search of 2300 available scholarships.

Employment

Even if your child received a needs-based scholarship, the package most likely would include a combination of grants, loans, and campus-based employment. If you worked your way through college, chances are that you value your education even more. We have observed that most students can handle a part time job and a full academic load, and many of those that do actually get better grades than those without jobs.

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Back to School – Paying for College . . . continued from page 2

Loans

At today's interest rates, student and parent loans are a pretty good deal, as long as you keep the total amount borrowed reasonable. However, if your children are young, interest rates could be much higher by the time they enter college. So saving in advance is a better strategy.

Current Earnings

Many families cover the shortfall of aid, employment, and savings by paying as they go from current earnings. With paid off mortgages and a good household income this is doable, and most colleges let you spread the payments over most of the school year. **But remember, to pay $20,000 of annual costs, you may need to earn $35,000 before taxes. Clearly, paying from assets at lower tax rates makes more sense then paying from income.**

Savings

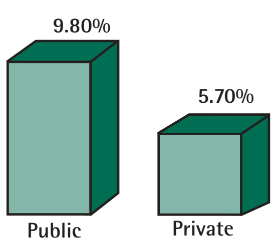
Socking the money away early is your lowest-cost alternative, provided you have adequate life and disability insurance, and are maximizing your retirement plan. There are several ways to save for college. They all have pluses and minuses. Keep in mind these criteria:

1. **Your long-term rate of return should be higher than the college cost inflation rate.** Savings and baccalaureate bonds fall way short in this criterion, even after their tax advantages are considered.
2. **Match your investment strategy with the timing of when the funds will be needed.** In other words, don't make short-term investments for a 10-year-old, or speculative investments for a 17-year-old. Remember, too, that not all the money is needed the day your child enters college.
3. **Control and flexibility.** Sadly, not all kids stay out of trouble or go to college. If the account is in their names, you may have no say in the matter. Strategies that do "double duty" for more than one purpose or goal are worth considering.
4. **Keep an eye on taxes, but don't let taxes drive the entire strategy.** Either shelter the college account from taxes or shift the tax burden to your child when appropriate (see Control above). This is best done by transferring assets to the student as needed. Appreciated assets and dividends are taxed at 24% Federal and Oregon Taxes, but may be only 19% or less for your child.

Space doesn't permit us to describe all of the various college savings vehicles, but of all the choices available, our favorite is the Section 529 College Savings Plan because it gives you the ability to meet all four criteria listed above. Oregon and most other states offer them, but some have better investment choices and lower fees than others.

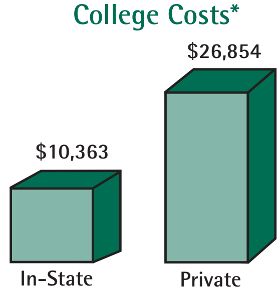
The best approach is probably a combination of strategies that fit your unique situation, and we would be happy to help you design a plan that takes everything into consideration. Whatever you decide to do, get started! Your child or grandchild will be knocking on a campus door before you know it.

2003-04 College Cost Inflation Rates



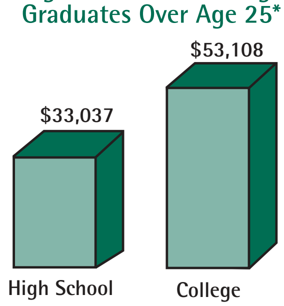
Source: Collegeboard.com

2003-04 College Costs*



**Four-year colleges, enrollment weighted.*
Source: Collegeboard.com

Median Earnings of Male High School and College Graduates Over Age 25*



**2001 earnings. Female about 25% less. Graduate and Professional degrees are higher.*
Source: U.S. Census Bureau

THE KELEMEN-WAY ADVANTAGE

Ron Kelemen and Mary Way are independent Certified Financial Planner™ certificants and jointly serve their clients as a team with 31 years of combined experience. Their fee-based practice focuses on wealth planning and management for professionals, business owners, and retirees. Together, they have developed *The Planning Vision Process®* and several other unique processes. They are both advisory associates of The H Group, Inc., one of the largest independent fee-based registered investment advisory firms in the Northwest with 18 professionals and over $380 million under active management. They are also registered with Financial Network Investment Corporation, (unaffiliated with The H Group, Inc.) a national broker-dealer with offices throughout the United States, Member SIPC.

About Ron Kelemen, CFP®

In practice since 1981, **Ron Kelemen, CFP®** is a contributing author of the definitive book on retirement planning: *Ways and Means: Practical Answers from America's Foremost Financial Advisors and Retirement Planning Attorneys*. His other contributory book, *Strictly Business—Planning Strategies for Privately Owned Businesses*, is now available from Ron or Quantum Press. He is Vice President of the Willamette Valley Estate Planning Council, active in mentoring and in several local charities, and is frequently quoted in the national press.

About Mary Way, CFP®, CPA

Mary Way, CFP®, CPA is a professional team member on Ron's team for over nine years. She is also a non-practicing CPA with 16 years experience in banking, business, and finance. She is active in Salem Rotary, the Financial Planning Section of the Oregon Society of CPAs, The Oregon Financial Planning Association, and The Willamette Valley Estate Planning Council.

Team Update

It's been a busy summer with both work and play. With clients and many other professionals on vacation, we have more time for research projects and update meetings for our snowbird clients. We have also spent extra time counseling clients and analyzing the markets in light of current events.

Lani Moore worked extra hours to cover for Debbie's vacation. She attended a family reunion in Utah on her way to daughter Holly's home in Maryland to assist in the care of her third grandchild Evalyn, born the day before Lani's arrival.

Debbie Renggli has been busy processing the paperwork for clients who have instructed us to more broadly diversify their managed portfolios with the real estate and commodity asset classes. She and husband Bob spent a few days in Neskowin and at Black Butte Ranch.

Mary has been getting caught up on a long list projects for clients and covering for Ron while he was gone. Her weekends have been filled with social events, and her free time has consisted of gardening, rafting the Mackenzie River, bird watching on the Willamette River, and as editor of the Salem Rotary's newsletter.

Ron has been enjoying the early morning daylight by putting in lots of miles on his new road bike before work. He was made speechless for the first time in his life when the Salem Rotary Club honored him with the club's first Outstanding Service To Youth Award for his mentoring and exchange student activities. He helped chaperone the Leslie Middle School Spanish Club trip to Oaxacca Mexico for two weeks and also chaperoned a Venture Crew campout at the coast. The highlight of his summer was watching daughter Skyler's Red Bull Flugtag team launch a flying pig 30 feet into the Willamette River before a crowd of 30,000 spectators. They came in 5th place, and best of all, nobody got hurt.

The Future Of The Financial Planning Industry?

Ron was named as one of six panelists featured in *Financial Planning Magazine's* annual round table of industry leaders. The article, featured in the July issue of *Financial Planning*, discusses trends affecting the financial planning industry. These included regulations, competition, succession planning, technology, marketing, and client service. As a writer himself, Ron was impressed with how the moderator was able to distill the lengthy discussions down to a few concise pages. Ron found the other panelists to be very interesting, and notes, "We had a lot of diverse opinions and enjoyed the process. And although we couldn't predict the future of the financial planning industry, we felt good about its prospects."

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The Kelemen-Way Financial Perspective

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Term Insurance Rates Increasing

Level term insurance has been an outright bargain. If you bought a level term policy a few years ago, chances are it's cheaper to buy a new one today, even though you are now older. But not for long. After years of steadily declining, term life insurance rates are starting to climb. According to the July 20 Wall Street Journal, **overall term rates could rise 10% to 20% by the end of the year.**

This is because of a little-known insurance regulation called XXX, or "triple X." Effective in 2000, it required insurance companies to hold larger claims reserves for their term policies. Insurance carriers have been able to do this by shifting some of their reserve obligations to foreign re-insurance companies, but those companies are raising the prices they charge US insurers.

Although we are starting to see these rate increases, what we are really noticing is how many companies have tightened up on their underwriting requirements. They are paying more attention to driving records, family history, and uncontrolled cholesterol. When our clients are offered "Standard" instead of a "Preferred" rating, that to us is a big rate increase.

So, this may be a good time to reexamine your insurance needs and coverage, possibly upgrading your policy to a fresh 10, 15, or 20 year period. We can help you navigate the many policy options out there and find a company that will look more favorably upon your profile.