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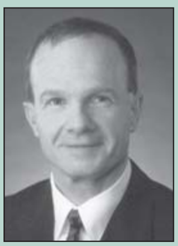

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Dealing with the Mutual Fund Mess

Unless you've been camping in a snow cave for the past month, you have no doubt seen many headlines about certain mutual funds under indictment and/or criticism for late trading and market timing practices. Here are the issues and our take on them.

Late trading after the 4:00 p.m. deadline enables certain investors to take advantage of the difference in time zones, especially with international funds. This is unfair because the late traders get to "know the future" and act on it at today's prices. The Securities and Exchange Commission (SEC) has proposed regulations to enforce a hard and fast 4:00 Eastern cutoff for all mutual fund trades.

Market Timing is subtler but legal. The allegations assert that while market timing was discouraged in the prospectuses, some companies allowed some investors to unfairly do so, and that constitutes an unfair business practice. Frequent trading increases the cost to the fund and forces it to alter its long-term buy and hold strategies. As of early December, many fund families are taking steps to prohibit or discourage market timing of their funds by both large and small investors.

Financial Impact

At this point it is too early to tell just what the financial impact on individual investors will be.

However, the amount of damages in the allegations must be put into the context of the total asset size of the mutual funds in question.

It is interesting that during this scandal, the stock market has actually gone up. That is because the value of the company managing your mutual funds and the value of your funds are two separate things. The value of your funds is based on the shares of the individual companies (GM, IBM, Microsoft, GE, etc.) that make up each fund. They are unaffected by these issues, and they are still valued at the publicly traded price each day.

What Should You Do?

There are no easy answers or "one-strategy-fits-all-investors" solution. Here is how we would approach it:

- If you have holdings in one of the fund families in question, erosion of the fund's asset base could be a concern. If the fund managers need to raise cash to meet redemptions, this may not be good for you because these transactions cost money and may be taxable. Ultimately fund costs will be spread over a smaller asset base.
- The brain drain should also be a concern as talent is either fired or leaves because of bad morale. This can be a real problem in a "star" system of portfolio management, as opposed to one managed by a team with a deep bench. Perhaps exchanging your holdings in an affected fund to a different and unaffected team within the fund family could be a temporary solution, after considering the tax implications of an exchange.
- Most of your concerns should be directed toward your international and technology funds because they appear to be the most susceptible to late trading and market timing.
- **If you transfer to a different fund family, make sure you aren't trading a perceived problem for an even bigger problem at the new fund.** There will undoubtedly be more allegations in the months ahead. (Even after our careful research we were surprised some recent allegations.) Are you certain that this new family absolutely prohibits any market timing? And are they better money managers?
- Consider the cost of the transfer. Will you have any surrender charges? Will you have any loads on the new fund? (Some fund families are waiving the loads on transfers from an indicted fund family.) Will your new fund's on-going management fees be higher? Will there be any capital gains taxes as a result of the transfer?

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The Social Security Angle of Early Retirement

Early retirement is a major financial planning goal for many people these days. But Retiring early simply costs more. In fact, when you retire and how long you live are two very important drivers of whether or not early retirement is feasible. Those two questions are also very important when considering the Social Security part of your retirement income picture.

Whether Social Security will exist or what form it will take many years from now could be a whole year's worth of articles. Not counting on Social Security is the most conservative planning approach for younger people. But for those age 55 and above, that approach could unnecessarily postpone an early retirement. It's the ones under 40 and our children's generation that we worry most about.

What's so sacred about age 62?

Even for high-income retirees, Social Security becomes an important – and sacrosanct – source of stable inflation-adjusted income. There is nothing sacred about age 62. But for many middle and lower income people, it is the soonest they can retire because they depend heavily upon Social Security payments for retirement income. If you retire before then, your benefits at age 62 will be just a little less than someone who worked right up to age 62. This is because benefits are determined using the top 35 earning years, adjusted for inflation and figuring only the maximum Social Security Wage Base, which in 2003 is $87,000. (Just 10 years ago it was $57,600 and 20 years ago it was only $35,700.)

TABLE 1
Full Social Security Benefits*

Birth Year	Full Benefit Age
1937	65
1938	65/2 mo.
1939	65/4 mo.
1940	65/6 mo.
1941	65/10 mo.
1943-54	66
1955	66/2 mo.
1956	66/4 mo.
1957	66/6 mo.
1958	66/8 mo.
1959	66/10 mo.
1960+	67

TABLE 2
Social Security Benefit Reductions at Age 62

Birth Year	Age 62 Reduction
1937	20%
1938	20.83%
1939	21.67%
1940	22.5%
1941	23.33%
1943-54	25%
1955	25.84%
1956	26.66%
1957	27.5%
1958	28.33%
1959	29.17%
1960+	30%

However, you will receive less than if you had waited for what the Social Security Administration calls "full" retirement age. That used to be age 65, but for many of us, full retirement age is now 66 or even 67. (See Table #1) Between age 62 and the full retirement age, your benefits are reduced. Your age 62 check could be as much as 30% less than if you waited to start benefits at your normal retirement age. (See Table #2) Likewise, for each month you postpone taking benefits past your normal retirement age, your check increases about 8% per year.

Take the money and run?

Some people suggest taking your Social Security Benefits at age 62 because you don't know how long you may live. A 65-year old retiree today would need to live to at least 76 to catch up with one who started taking benefits at age 62 (See Table #3).

TABLE 3
TAKE OR WAIT? Projected Monthly Benefits Retiree Turning 62 in 2003

Age	Benefit	Break Even Age If Starting at Age 65/8 mo.	Break Even Age If Starting at Age 70	Single/Joint Life Expectancy
62	$1,412	76/1 mo.	79/6 mo.	81/86
65/8 mo.	$1,895	–	81/11 mo.	82/87
70	$2,580	–		83/88

One of the worst things you can do is to phase into retirement and take Social Security at the same time. If you work part-time before full retirement age, you forfeit Social Security benefits. After your first $11,520 of earnings before age 65, you loose $1 of Social Security for every $2 you make. Between 65 and your full retirement age you lose $1 for every $3 you make over $30,720. The result is the crossover point for waiting to take Social Security comes much sooner.

You need to take a hard look at your expected longevity. Remember a life median expectancy age is a 50% proposition. In other words, half of all 62-year old males will live longer than another 17.98 years, according to the Social Security's website. However, the IRS Table 1.401 (a)(9) 2002 says its 18.8 years if you use the unisex rate. That means you have a 50% chance of living less than that and a 50% chance of living longer. According to the IRS tables, a couple age 62 has a joint life median life expectancy of age 86. **So if you think you'll be better than average, you are the higher earner, and your spouse is younger and/or healthier you should seriously consider postponing taking Social Security benefits until later.**

Less, more, and longer

Decreased Social Security benefits aren't the only cost of an early retirement. You also have what we call "less, more, and longer." You have less time to sock money away in your remaining high-earning years. You have more free time on your hands to spend money during retirement (just analyze your weekend spending patterns if you don't believe us). And finally, you'll be retired for a longer period. All of these put pressure on your portfolio. How do you deal with all these variables? We'll address them in future articles. Meanwhile, for those of you contemplating retirement in the near future, there is no substitute for customized advice. We do this in two of our trademarked fee-based retirement planning processes called The Confident Retirement Vision® and The Confident Goal Analysis™.

Email Change

We receive over 400 spam messages a day! Some of this is because Ron had one of the very first financial planning websites in the United States, where his email address – ron@kelemen.com - was widely published. In an effort to curb this, starting **January 1, 2004, we are completely dropping any address at the Kelemen domain. If a message bounces back, please try again, using our first names, followed by our last name initial @ thehgroup.com.**

What Should You Keep in Your Safe Deposit Box?

We have received many positive comments about the checklist we created entitled "Our Confidential Document Locator™."* This is a tool to help your loved ones find important documents, keys, passwords, etc. in the event of death or incapacity. But in the process of filling the form out, one of our clients raised a good question about safety deposit boxes.

WHAT GOES IN? Ask yourself "If I lose this, will I be in deep trouble or very sad?" These items generally include original documents and certain irreplaceable valuables:

- Birth certificates
- Death Certificates
- Passports
- Titles
- Leases
- Stock and bond certificates
- Special jewels and medals
- Negatives for irreplaceable photos
- Marriage certificates
- Adoption and custody papers
- Deeds
- Mortgages
- Contracts
- Estate planning documents
- Rare coins and stamps
- Important family videos
- Videos or photos of your home's contents (for insurance claim purposes)
- Appraisals and/or receipts of valuables not in the box

WHAT STAYS OUT? Under a court-ordered garnishment or levy, your box may be sealed. **Never put something in a bank safe deposit box you may need over a holiday, weekend, or during an emergency.** These can include:

- Medical advance directives
- Original powers of attorney
- Funeral instructions

Other Considerations

Access by others. Policies differ by bank and state. If you are the only renter of the box, it may be sealed once the bank learns of your death. It is not enough to just give someone a key because they cannot get in unless they are a co-renter. Therefore, it's a good idea to have a trusted relative, attorney, or your executor as a co-renter. Be sure to check with your bank.

Stocks and bonds. These are best held in a brokerage account.

Important documents. These should be kept in two places – the original in the deposit box and a copy in a more convenient location for periodic review. Some documents, like life insurance policies can be fairly easily replaced. Scanning all of the above documents into your computer may be convenient, but not legally useful. Computers get stolen, data gets corrupted, and retrieving a hard drive from a burning building isn't easy. Transferring items to a CD ROM could be a convenient and very portable alternative.

Security. Although bank boxes are generally safe, there is no 100% guarantee. Your contents could still sustain damage from water, smoke, explosion, etc., but probably less so than at home. Many deposit boxes were destroyed by the attack on the World Trade Center, and one of our clients' downstairs bank vault suffered water damage in the 1996 flood. Consider using Tupperware containers and Ziploc air tight bags, and think about keeping copies of contents elsewhere.

Other alternatives. A good home vault may be a good alternative for jewelry, coins, stamps, medals, special photos, and keys.

"Box Awareness." With all the bank mergers these days, it's a good idea to write down where your deposit box is, and let a trusted relative know it and the key location. Keep a list of the contents of your box, and if you have any insurance coverage on the items in the box, don't keep the policy in the box.

**If you would like a copy of "Our Confidential Document Locator™", please call.*

THE KELEMEN-WAY ADVANTAGE

Ron Kelemen and Mary Way are independent Certified Financial Planner™ certificants and jointly serve their clients as a team. 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 Oregon with 18 professionals and over $275 million under active management. They are also registered with Financial Network Investment Corporation, member SIPC, a national broker-dealer with offices throughout the United States. The H Group, Inc. and Financial Network Investment Corporation are unaffiliated.

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 a Vice President of the Willamette Valley Estate Planning Council, active in several local charities, and is frequently quoted in the press.

About Mary Way, CFP®, CPA

Mary Way, CFP®, CPA is a professional team member on Ron's team for over eight 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

As you can see from the "What A Year It Was" article, it really was quite a year. This last four-month "quarter" has been incredibly busy for us – perhaps the busiest ever! We updated the website, initiated a document scanning project, started a client service survey, and processed a phenomenal amount of new assets under management.

Lani Moore now has two adult children with spouses in their newly remodeled home, which is her way of helping them through college. She is celebrating the birth of her second grandchild born this month.

Debbie Renggli says, "I have no life," which really means that her life is very full between moving into her new home, a week's vacation to "get organized," driving her daughter to the University of San Francisco, children visits for Thanksgiving, a very active social life, and lots of extra work at the office.

Mary also had a "stay at home, get organized vacation," planting exotic flowers and shrubs on her property. She participated in a conference in Central Oregon on practice management and the Oregon CPA Society conference on financial planning. She also installed, upgraded, and got up to speed on new planning software. Like Ron and Kathy, Mary completed her mandatory securities continuing education topics.

Ron provided research for the *Wall Street Journal* Encore Section on Internet retirement planning calculators and was elected President of the Medical Foundation and Vice President of the Estate Planning Council. He also attended an advanced financial planning conference in Las Vegas. He tied his October Strategic Coach meeting in Chicago into a trip with **Kathy** to Cottey College in Nevada , MO to visit Feruza, their last year's exchange student from Uzbekistan, and to Boston University for parents' weekend to see daughter Shanti. Kathy's 6.0 mixed doubles tennis team took first place in the Northwest, so she and Ron went to San Antonio for the Nationals competition in November (they lost!). Ron's hamstring kept him out of summer and fall competitions, but he filled the time watching daughter Skyler's water polo games.

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Conclusion

Finally, are you over-reacting? A few bad apples seem to get into every barrel in every industry. But we shouldn't let that color our perspective on all the apples. Mutual funds do a lot of things right and have provided small and large investors alike with diversification, professional management, and convenience. **So if you were not in the specific funds named, or if your fund's problems were caused mostly by rogue employees, we would think twice before making any moves.**

These alleged activities are a serious violation of trust, and the offending companies and employees should be severely penalized. The mutual fund industry is now on notice that this sort of behavior will not be tolerated. Just like the Enron scandal has helped clean up corporate accounting, these developments could be better for us all in the long run.

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The Kelemen-Way Financial Perspective

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What A Year It Was!

We saw it all in 2003 – bear market, bull market, war, new IRS regulations, a new tax law, an economic recovery, and a mutual fund scandal, just to name a few.

The challenge for us this year was to adapt to all these changes and guide our clients through them. We kept all but one or two clients thought these changes, and added many more. Changes in technology and efficiency gave us more time for time with our families, community service, and the ability to serve new clientele without compromising enhanced service to our existing clients.

But none of this would have been possible without the continued loyalty, confidence, and referrals we enjoy from all of you. We are so fortunate because we get to know and work with such interesting and wonderful people. Sometimes we think that <u>we</u> should be paying them for the privilege of sitting across the table from them! **So, thank you from the bottom of our hearts. We pledge to do all we can in 2004 to continue to earn your trust. Warmest wishes for the holidays!**