Market Corner

The S&P 500 index was down 12% for the first three months of 2001. Through June 12th it has cut its year-to-date loss to less than a 5% decline. The Dow Jones had been down 8.4%, and now is up 1.5%. The NASDAQ, however, has only reduced its decline from 33% to 21%. The Fed has been steady in its campaign to lower short-term interest rates, hoping to avert a recession in which consumers and businesses decrease their spending.

Despite news of corporate layoffs, and declining profits, I continue to believe that a recession may well be avoided, that stock markets (as measured by the S&P 500) will recover by year-end to be in the black, and that corporate profitability will have recovered by 2Q2002, if not sooner.

During this decade I expect the UK to join the euro; the recent elections seem to reinforce this direction. This should bring added stability to the euro economy. Further, during this decade the euro-zone should reap ever-greater productivity benefits from the increased penetration of technology. While I do not know when this will finally translate into superior investment returns, by the end of the decade I expect European markets to shine.

Latin American economies should be very strong during the decade, with an occasional blow-up to remind us that these are risky, developing countries.

Asia can be divided into four categories: Japan, China, India, and the rest. I am not convinced that Japan's economy will recover anytime in the next several years—there are just too many obstacles. China has many factors strongly in favor of its emergence as a global leading economy. The hitch is the tremendous uncertainty regarding their political direction. Until this is clear (and that could take more than ten years), all China investments must be accepted as being quite risky. India has many factors in its favor, including a very large educated workforce. The uncertainties include a highly stratified class system, and a large portion of the country that lacks adequate infrastructure (transportation, communication, etc.). The rest of Asia will produce pleasant and unpleasant local surprises, however their futures are strongly affected by the course of the three leaders.

Top Holdings

In this section I review top holdings for client accounts (greater than $50,000 when consolidated). The data for this report comes from the June 15, 2001 positions.

Mutual Funds—Artisan Mid Cap (a new fund for clients), Columbia High Yield, EuroPacific Growth, Fidelity Diversified Int'l, Fremont Bond, Janus Overseas, Oppenheimer Real Asset, Royce Low Priced Stock, RS Diversified Growth and RS Microcap Growth, Scudder Int'l, T. Rowe Price New Asia, TIAA Traditional, fifteen Vanguard funds, and William Blair Int'l Growth are all large holdings. The Vanguard holdings include Short Term Corp Bond, Admiral Short Term Corp Bond, Index 500, Index Value, LifeStrategy Growth, Mid Cap Index, Small Company Growth (variable annuity), International Growth, and High Yield, all at $100,000 or more.

Specialized Funds—Central Securities, Royce MicroCap Trust, and Royce Value Trust are the three large holdings of closed-end funds. S&P 500 SPDRS and S&P Midcap 400 SPDRs are the two large holdings of exchange-traded funds.

Bonds—Clients hold more than $2 million in individual bonds, however all but three are in lots of less than $50,000.

Stocks—Aegon, AstroPower, D R Horton, GE, Philips Electronics, Providian, Texas Instruments, and Tyco are the large holdings of stocks.

Conference Report

In May I attended the 2001 NAPFA National Conference in Phoenix. I have reported on many of the sessions in articles in this newsletter. I attended a session describing how to work with trust companies, modern asset allocation, improving human communication, stock options, paperless offices, and planning for the future. The paperless office session has motivated me to start down that road; I have purchased some hardware and software to improve my access to historical information, while reducing my paper storage requirements. After the conference I drove north and hiked down and back up the Grand Canyon—it was great!

In June I attended the first annual Pride Planners national conference in Provincetown (on Cape Cod) for financial planners serving gay and lesbian clients. More than one hundred planners, from twenty-six states and the United Kingdom attended. Many of the issues raised at the conference affect all unmarried couples. I attended workshops on relationship contracts, income taxes, wealth transfer planning, socially responsible investing, ownership of assets issues, and on estate planning.

Financial and legal institutions have developed comprehensive guidelines that address most concerns that married couples have in a reasonable manner (such as married-filing jointly, and the rollover of IRAs to surviving spouses). This support is not as accessible for unmarried couples. I was pleased to identify resources to utilize in situations where 'traditional financial planning' fails to adequately fit these client's needs. I don't try to have the answers to all questions, but do strive to know where I can find the answers to most. After the conference I joined a morning whale watch.

I have agreed to co-chair the 2003 NAPFA Northeast MidAtlantic regional conference in Philadelphia. These come to Philadelphia every four or so years, and my study group is in charge of its organization. Other than my sprained ankle, the last one was a great success.

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The Mallard Message

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Frequently Asked Questions

1. **What's this I hear about a recent college savings (section 529) plan change?** In the recent tax law change, all distributions from 529 plans are exempt from federal income taxation. Previously the portion of the distribution that represented earnings was taxable. Like almost all of the tax changes, this will expire in ten years if not renewed by Congress. While that may sound like a long time, it isn't for a parent with a young child more than ten years away from college. This change has made the 529 plans even more attractive as the preferred college savings vehicle for most families.

2. **Where is the market going?** The best that I can offer is an educated guess. I continue to suspect that the US markets will have staged a rebound by the end of 2001, and will be at least 5% higher than they are now by then. I expect that a business rebound will take longer, perhaps up to a full year from now.

3. **How is business going?** Since my fees are directly tied to my clients' portfolios, when their portfolios decline, so do my fees. The S&P 500 has fallen for four straight quarters, and with it, the fee I charge my clients. Yet for several reasons, I don't despair. First, I believe strongly in this approach in which my fees are intricately tied to my clients' portfolios. Second, I believe that the painful market drops are a normal event that will eventually be followed by a recovery. Third, I had four new clients in early 2000, and four new clients in late 2000, bringing my number of clients to twenty-four, with almost $13 million under management. Just as I counsel my clients to be patient with their investments, I need to be patient with my business.

Summer Plans

My next conference is not until mid-October. During the summer I do expect to take a few long weekends, for camping, hiking, or beach time. Most of these long weekends will fall in August, to enable me to be in the office enough to prepare the 2Q01 quarterly reports in July.

Whenever I expect to be away from the office for more than one business day, I send an email to my clients. I also check my phone messages and return all urgent ones while I am away, and often I check my 'traveling email account'—<mamcorp@yahoo.com>.

Inside This Issue

It's the Economy

In this article I will cover issues raised by the three economists who spoke at the NAPFA 2001 National Conference I attended in Phoenix in May.

Peter Leyden co-authored The Long Boom, A Vision for the Coming Age of Prosperity. As the title implies, he is fairly optimistic about the future. He feels that the advantages of digital technologies have been building in the past twenty years, and that we are likely to enjoy an explosion of benefits, as digital technology pervades our culture, both here and abroad. Indeed he points out that in past cycles (such as the post WWII period), Europe typically followed the US in economic expansions, and he therefore expects that in this decade Europe will catch up quite a bit to the US. Leyden does not suggest that recessions won't occur during these booms, but rather that our economy will survive each recession and emerge stronger.

He points to advances such as biotechnology (will our kids live well into their 100's?), the emergence of hydrogen cell energy, and nanotechnology (manufacturing from the atomic level up, with no waste and no excess energy requirements) as being the most likely catalysts for future economic advances.

Leyden does, however, point to several potential 'Scenario Spoilers', including an anti-globalization backlash (e.g. violent protests at the WTO meetings in Seattle), epidemics slowing down trade (mad cow, hoof and mouth, AIDS), a major environmental crisis.

Peter Leyden's talk was quite enjoyable, as he as looking years in the future, instead of weeks. He provided a fresh big-picture take on the future. His website is www.gpn.com.

Richard Hokenson works at Credit Suisse First Boston, and has been an economist for more than thirty years. He provided the hard numbers, the demographic data.

In the US, the 40-59 year-old age groups have been growing, but most of the 0-39 age groups have been shrinking. This, of course, does not bode well for Social Security. Hokenson suggests that a dramatic reduction of benefits is required (benefits should not begin until age 72 by year 2020).

He points out that developed countries are generally growing in the 30-59 and in the 70-79 age groups, but are shrinking in the 0-29 year groups. This is worrisome, as the 20-29 age group drives new household creation, which drives much consumption. The aging of the populations does support confidence in financial services, and leisure industries, but is a concern for consumer goods, services providers, and a concern for government retirement benefits.

Japan's population growth is almost exclusively in the 50+ age groups, with sharp declines in the 10-19 and 40-49 year age groups. Hokenson points out that Japanese households often include three generations, and occupy 900 square feet. These homes are far too small to justify any substantial new consumer purchases (large-screen TVs, etc.), which is one reason why Japan has been unable to crawl out of its decade-long recession.

Latin America's population growth has been terrific, especially in the 10-59 year age groups, all of whom can be consumers (for local, and US exported goods). This pattern is typical for almost all developing countries, and is quite healthy economically. The exception is China, where only the 30-49 age group is growing. This is a result of the China One (one child per family) policy, and decades of chaos.

Horace (Woody) Brock is an 'economist of uncertainty'. His talk focused on comparing the US to the rest of the world. He defines an Innovation Quotient (IQ), the amount of innovations developed in one region compared with the world, divided by the amount of production in that region compared with the rest of the world.

For instance, if a country makes up 10% of the world's innovations, and has 10% of the world's production, the quotient would be 1. However, if the country had 20% of the world's innovations and only 10% of the world's production, its IQ would be more than 1, an overachiever. Brock concludes that the US's IQ versus the World is currently 17, a very high number, and that the US's IQ versus the Euro countries is 10, still a very high figure.

Brock suggests that there are four requirements for an economy to achieve a high relative IQ. It must be involved in a scientific and/or technological revolution. There must be a flexible factor market (with few obstacles to adding/removing labor, raw materials, financial capital). The society must provide institutions that assist the market (functional justice system, and a solid rule of law). Finally, there must be optimism, amongst entrepreneurs, investors, and consumers.

The existence of these "complementarities" can be shown mathematically to imply accelerating productivity growth for the nation in the form of an S-curve. We are still in the bottom half of the "S", and have one or two more decades to go before the productivity gains from going digital inevitably decelerate. This view that we still have substantial benefits to harvest from the current technology boom (not to be confused with a technology **stock** boom) echoed Peter Leyden's earlier comments.

Tax Law Changes

In this issue Pam Baumbach shifts her focus from offering comprehensive facts to lists of resources. As the kernel of wisdom goes—if you give a man a fish… She will identify a topic of interest, exploring the resources available and reporting back to you what she has found. A prime source would be the Internet, noting how user friendly the sites were, which sites have useful information, and miscellaneous tidbits she finds. If you do not have access to the Internet you can contact Pam and she will send you the information you seek.

As my first topic, I wanted to explore how the new tax law impacts our clients. The Economic Growth and Tax Relief Reconciliation Act of 2001 was signed into law by President Bush on June 7, 2001. I started by reading the summary document prepared by the Joint Committee on Taxation (found at www.house.gov/jct/). But what does it mean?

What is the tax bill all about? The most comprehensive web site I found was www.taxplanet.com/prez/prez.html. This site is well organized. On the web site you can view the summary mentioned earlier. My favorite aspect of the web site was that you can choose a specific topic to explore (like Education IRAs or Child Tax Credit) and link to a page that explains, in plain language, that area of the tax bill. This specialized page will explain the impact and may show tables to illustrate rate changes or phase in periods. You can also follow links to related articles.

How are college savings plans changed? One area of special interest was the Section 529 plans. Joe Hurley, with his in-depth knowledge of 529 plans and clear writing style, was my first source. At www.savingforcollege.com I found two articles explaining the effects of the tax reform law on 529 plans.

How does this affect me? On the web site www.heritage.org, along with more tax information and interpretation, I found a tax calculator. You can input basic tax information and it calculates your tax liability after 2001 and what it would be when all provisions are in effect. To get to the Heritage Tax Calculator, go to www.heritage.org/taxcalculator. The information you can enter is limited but offers an interesting exercise.

What is the sunset rule? In order to comply with budgetary laws, most of the changes made will revert back (ala Cinderella) on December 31, 2010 unless Congress specifically extends them. Since this makes the ongoing effects of the changes uncertain, it needs to be considered whenever using the changes to develop long-term strategies. Specific information on the Congressional Budget Act of 1974 (law establishing the sunset rule) can be found at www.house.gov/rules/jcoc2y.htm.

I hope that these resources will help in your understanding of the tax law changes. If you do not have access to the Internet, feel free to contact our office at (302) 737-4546 or by email (pam@mallardasset.com) and I can mail you copies of the information you request. Please let me know any suggested topics you would like to see explored.

Transformations

The theme of the 2001 NAPFA National Conference was "The Great Transformation". The financial planning industry has transformed greatly in the past ten years, as even firms such as Merrill Lynch that had been rooted in commission-based services have begun testing the waters of fee-based compensation. Like most industries, financial planning has also been transformed by the Internet, and by the increased financial education of the US population.

As the preeminent Fee-Only™ professional organization, NAPFA is examining how we have gotten to this point, and is planning how to approach the future of its ever-changing industry. We often find ourselves in the midst of transformations, as children go to college and/or move out on their own, as we change employers or careers, and as we encounter retirement. All of these life events have financial ramifications, and during many of these transformations the anxiety can be reduced through planning, and through execution of that planning.

Every few years we often find ourselves asking "what am I going to be when I grow up?" Mallard has been providing comprehensive money management to clients for four and a half years. My goal has been to help my clients integrate their financial with their non-financial lives, helping to synchronize clients' hearts, minds, and wealth.

I see Mallard increasing its use of technology, delivering higher-quality information to my clients faster. One step in this direction is the website now being developed. By the end of the summer, www.mallardasset.com should be up and operational.