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CERTIFIED FINANCIAL PLANNER™

*Objective Advice to Help You Reach
Your Goals & Find Peace of Mind*

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Greetings,

We hope that you had a fantastic summer.

We recently received a fraudulent e-mail purporting to be from the Virginia Credit Union. At first it appeared legitimate, but we realized it was a phishing scam when it asked for an account number. Remember that the financial institutions you deal with will NOT ask you for social security numbers or account numbers by e-mail. As a rule of thumb, we recommend that you never use e-mail to communicate important numbers to anyone.

Housing Market and Credit Crunch – Delinquent loans and foreclosures of “bad” mortgages, mostly in the subprime market, are causing thousands of people to lose their homes. And there are too many vacant homes, causing existing homes in many areas of the country to lose value. This unhappy scenario may last through 2008 and possibly well into 2009. How will this affect other areas of the economy, such as retail sales? The problems with the housing market and sub prime loans are so complicated that no one is really sure what the extent of the fallout will be.

Fed Rate Cut - The Federal Reserve cut rates by half a percentage point last week. For those of you holding Adjustable Rate Mortgages (ARM's), this is good news if your rates are tied to the Fed funds rate. Interest rates on home equity loans, credit cards, and automobile loans may come down slightly. However, for those with subprime loans tied to the libor rate (an interest rate charged by banks for short-term loans to each other) or other loans not tied to the Fed funds rate, the recent Fed rate cut will not help. Long-term

fixed rates may go up in the not-too-distant future, and very large (jumbo) loans may be much more difficult to obtain than they have in recent years, even for people with good credit scores.

Financial writer Suze Orman recommends putting down at least 10% on a mortgage loan. She also recommends paying for private mortgage insurance (PMI) up front to save money over the lifetime of the loan.

As always, keep money you will need in the next few years in liquid investments and not in the stock market. As always, stay diversified and rebalance periodically.

Higher oil prices are on the horizon. If you use oil to heat your home, plan on budgeting 10% – 20% more than you did last year. Of course, outdoor temperatures and usage will play a role in your actual cost.

Natural gas costs are not expected to go up at this time.

Online Banking – Online banks - ING Direct, HSBC Direct, Emigrant Direct, et al. – are able to pay attractive interest rates because they have less overhead in buildings and salaries than local banks. Online banking began with savings accounts that had no fees or minimum deposits and were federally insured. These savings accounts could be tied to checking accounts at any bank, and clients could bank by phone or mail.

Interest-paying checking accounts are now available at attractive rates, and programs to help with budgeting are on the drawing board.

Because online transactions can take three days to complete, we suggest keeping some emergency money nearby in local banks.

Savings - How much money are you saving for your children's education? How much are you spending on dining out? An article in the August 2007 *Investment Advisor* Magazine states: “. . . 58% of parents surveyed spent more on dining out in a given year than they saved for their kids' education, according to the Alliance Bernstein [Investments] research.”

College Savings Vs. Retirement Savings - On this topic, the experts are unanimous! Retirement savings must take priority over college savings. Who wants to borrow money after they retire?

Health and Education Exclusion Trust (HEET) – Designed for the wealthy (suggested net worth \$10 million), HEET's are a way to pay tuition for any level of education for one generation or more. To avoid a generation-skipping transfer tax, you must include two features in the HEET. First, payments from the Trust must go directly to the educational institution (for tuition only) or health care provider. Second, a charity must be the beneficiary of the trust. Some HEET's are set up so that the charity receives the annual income of the trust. If you are thinking about a HEET, you need to contact a good

tax attorney. And remember that you will still need to fund a 529 or make some other arrangement for room and board.

Portfolio Building/Reallocating - How many mutual funds or exchange traded funds do you have in your portfolio? Have you been adding funds to existing funds for years? If so, you may have too many funds that serve the same objective and still not be diversified sufficiently. Sometimes, fund objectives change and no longer suit our purposes. For example, a new fund manager may change the way a fund invests. A small cap fund may start investing in mid cap companies. A mid cap fund may start investing in large cap companies. A fund that was considered low risk may take on more risk, and so forth. Have you added funds because they were doing well only to have them tank? You need to do an analysis (x-ray) of your portfolio to see how your objectives are being met and what steps you might need to take.

If you are just beginning to build a portfolio, consider a balanced fund which invests in growth and value companies, international businesses, and bonds. Later, you can add small percentages of small cap, mid cap, and sector funds. Balanced funds do well in tax deferred retirement accounts. You might consider adding tax free bonds and tax managed funds in a taxable account.

Generally speaking, stocks are best left to large portfolios so that enough different stocks can be purchased to cover different sectors of the market.

Municipal Bond Market - Virginia is one of 43 states that taxes the interest on the municipal bonds of other states but does not tax interest on its own municipal bonds. Is this practice constitutional? The issue revolves around possible unfair restriction of interstate commerce. In the next few months, the Supreme Court will hear arguments in Commonwealth of Kentucky vs. Davis and come to a decision. If the case goes against Kentucky, the Virginia assemblies will have to decide whether to begin taxing the interest on Virginia bonds or whether to discontinue taxing the interest on bonds of other states.

Survivor Guide - A widow or widower will need at least 10-15 copies of a death certificate to go to the Social Security Administration, insurance companies, and financial institutions. Accounts need to be put in the survivor's name and new provisions for beneficiaries need to be made. Make sure to notify a spouse's employer (or former employer) as soon as possible to secure all benefits to which he or she is entitled. These might include health care insurance, and there could be a time limit on notification. The Virginia Retirement System, for example, requires notification within 30 days if a spouse wishes to retain health coverage under his/her spouse's policy.

Estate Planning – Common mistakes in estate planning include:

1. Not having an attorney draw up estate documents – dying without a will.
2. Not having existing estate documents reviewed periodically.
3. Putting off naming a guardian or trustee
4. Failing to establish a revocable living trust to avoid probate

This is especially important for singles without children.

5. Failing to re-title financial accounts to fund a trust
6. Failing to set up a credit equivalent trust if your estate will exceed \$2 million
7. Not sharing your plans with your family – Let relatives know your intentions and your reasoning, especially if you plan to leave more to one child than another. A good family discussion can prevent broken relationships and future lawsuits.
8. Leaving a hodgepodge of unorganized records or no records at all
9. Failing to change beneficiaries on life insurance policies, annuities, and qualified retirement savings accounts – A will cannot change the beneficiary named on these documents
10. Having too much property in one spouse's name only
11. Forgetting to make plans for pets
12. Not using an Irrevocable Life Insurance Trust (ILIT) to shelter large amounts of life insurance (over \$500,000)

You will need a good estate planning attorney to assist you in working through your wishes and needs and in producing the legal documents necessary to implement them.

Emotional Vs Rational Gift Planning – Current rules allow gifts of \$12,000 per individual without tax consequences. Mistakes in gifting include:

1. Distributing money when children are too young or not ready
2. Holding on to money too long – until you are disabled, for example
3. Giving too much money and giving up tax savings
4. Giving unequal amounts. This bears repeating: Good communication with family members prevents resentment.

At the office, William Drinnon has left Financial Solutions to work full time with Bay Sys. This is a wonderful opportunity for William, and we wish him well. He and John expect to work together again on a few projects after things settle down.