

# The THOUGHTFUL INVESTOR

Second Quarter 2005

## Are You Saving Enough?

**B**ack at the start of 2000, it was easy to feel confident about one's ability to retire. Thanks to record market returns, investments were doubling in value on average every four to five years, real estate was appreciating and salaries were on the rise.

Four years later, it's a different world. Despite healthy gains in 2003, the average mutual fund is still significantly below its record high in early 2000. The first quarter of 2005 saw the market take back much

of the gains made in the last quarter of 2004. Forecasts for the broad market performance are hovering around 6-8%

annually. While it's unlikely the housing market will experience a crash, appreciation rates are expected to slow as that market absorbs its excesses. There's also increased uncertainty about the future of many corporate pension plans and Social Security.

It's an environment in which one might expect individuals to increase their rate of savings and worry a bit more about how they will be able to retire comfortably. Instead, the U.S. personal savings rate is

officially hovering around 0%.

According to a Putnam Investments

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**More than half of America's 74 million baby-boomers will probably see their 85th birthdays. Hallmark Cards now sells about 85,000 100th-birthday cards a year.**

*Source: The Economist, Mar 25th 2004*

## Forecasts are Fun, But Unreliable

**W**ith the first quarter of 2005 now at an end, forecasters are out in force, predicting where the remainder of the year is likely to go. On the positive side, the Dow Jones Industrial Average has never had a down year ending in "5" since 1897.

According to the Presidential Cycle, however, the US stock market falls in the first full calendar year after a Republican wins the presidency. It is a trend that has run since 1928. Adding to the gloom is the Patriots' win in the Super Bowl. According to the Super Bowl indicator, a championship by a team that played in the American Football League before the merger of the two circuits will let the bears run.

Forecasting the market is a lot of fun. It's a great way to get into the financial

news and if you turn out right, it gets you back in the news at the end of the year. But it's a lousy basis on which to invest. For every forecast of a rising market, you are bound to find someone forecasting a decline. And, everyone will have their reasons why, many as shallow as the last number of the year.

Since the market can only go up, down or sideways, a great many of the forecasters will prove to be right at the end of the year. Not necessarily because their logic was flawless but because flipping a coin could have produced the same result.

Peter Eliades, editor *Stockmarket Cycles* market timing newsletter says with respect to market forecasts and market truisms. "What everyone knows

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## Market Forces at Work

**I**n the midst of the hue and cry for new laws to prevent investment companies from allowing short-term trading in their funds in violation of the fund family's stated policies, a few saner voices were heard to argue that the best policy was to let market forces punish the wrong-doers. A year later, the true penalty for funds who allowed and in some instances fostered violation of their own policies is obvious in the financial performance of the fund companies.

In January 2005, money manager Janus Capital Group Inc. reported lower fourth quarter profits after investors pulled out billions of dollars in assets in the wake of the trading scandal that began to hit news reports in the fourth quarter of 2003. The Denver-based company said net income for the quarter was \$18.2 million, or 8 cents per diluted share. A year earlier, the company reported net income of \$811.7 million, or \$3.51 per diluted share for the fourth quarter, after a number of items. Without these items, fourth quarter 2004 adjusted net income was \$28.8 million, or 13 cents per diluted share, compared with \$53.3 million, or 23 cents per diluted share, in the previous year.

The penalty exacted by market forces outweighed any fines or sanctions imposed by the SEC and other government actions without imposing costs on individual investors, as proposed legal remedies would have. Given open disclosure of wrong-doing, investors have a tremendous power to shape the future of companies. This is the true force of an open market system in action.

## Are You Saving Enough?

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survey of almost 2,000 recently retired workers, at least 33% of new retirees wish their former employer or retirement-plan provider had done more to encourage them to save sooner and faster. 70% wish they'd saved more and 59% wish they'd started saving earlier.

If you haven't taken a hard look at your retirement plan and what it will take you to achieve the level of financial security you want, you need to do so now. Under the lower return scenario, will you have the assets you want at retirement? Do you need to be saving more today and if so, where will those funds come from?

### Calculating How Much You Need for Retirement

Traditionally, retirement planners have advised individuals that they will need 70-75% of their current income in retirement. This assumes that the retiree's home is paid off and their expenses are lower than during their working years. That may not be true, especially with respect to rising medical expenses. How you want to spend your retirement years also affects how much you need. If you are looking forward to extensive traveling or playing golf at some of the finest courses in the world, you'll need a higher income level.

In addition, you have to take into account the impact of inflation on the purchasing power of your money. Even at 2%, inflation steadily erodes the value of your funds as the table below shows.

Longevity risk must also be considered. An individual who reaches age 65 has a 50% chance of living beyond age 85. Depending on your health, it is not unreasonable to expect to spend a quarter

of your life span in retirement. And those can be very healthy and active years.

How much should you be saving? Assuming you will live to age 85, to enjoy an annual income of \$100,000 at retirement (including Social Security benefits), you will need to have at least \$1.9 million in savings when you retire. Increase your life expectancy to age 95 and you will need \$2.5 million in savings when you retire. This is obviously a very simplistic example and does not take into account inflation, return on your savings and other factors. But it does provide a starting point to determining whether or not you are saving enough.

If you are not saving enough, where do you find more money to put towards saving? As you've probably noticed, expenses tend to expand to meet your income. To save more, you need to reduce your available funds by paying your retirement account first. As your income increases due to raises or new jobs, increase your retirement plan contribution.

Next, make certain your retirement savings are invested wisely where you have the potential to experience solid returns without assuming excessive risk. That's where we come into the picture.

Regardless of whether retirement is 30 years or 5 years away, it helps to sit down and talk about where you are in terms of saving for retirement and where you need to be. Together we can work out a plan to help you achieve the retirement lifestyle you want. What we don't want to see happen is for you to retire and then wish that you had done more to save sooner and faster. Call today and let's schedule a time to talk.

### Funds required at 2, 3 and 4% inflation rates to equal the purchasing power of \$75,000 today

Year	2%	3%	4%
1	\$ 75,000	\$ 75,000	\$ 75,000
5	81,182	84,413	87,739
10	89,632	97,858	106,748
15	98,961	113,444	129,876
20	109,261	131,513	158,014
25	120,633	152,460	192,248



## How to Live a Long, Healthy Life

Life expectancy in developed countries has been steadily on the increase, rising a constant two-and-a-half years a decade since 1840. The good news is that getting older is not synonymous with poor health. In fact, rates of severe disability in old age are on the decline.

Behind these changes are better health care from the womb onward, less smoking, less dangerous jobs and better education. But the real key, according to research published in *The Economist*, to living a longer, healthier life is to be rich and well educated. Studies conducted in both the U.S. and England suggest that being well-off and well-educated postpones by about 15 years the onset of mental and physical disability, including Alzheimer's disease.

In trying to pin down why financial well off and educated individuals live longer, healthier lives the researchers found that access to better health care had less influence than the individuals' feeling that they were in control of their own lives.

The moral? To live a long, healthy life, you need to build financial stability and continually seek to expand your knowledge base. The good news is that it's never too late to start.

# Pay Long-Term Care Insurance Premiums through Your Business

**L**ong-term care insurance is designed to cover the costs of long-term care at home or in a nursing home. The popularity of these policies has grown as Federal laws have changed, making it less likely that Medicaid will pay for long-term care. The policies are usually relatively expensive and grow even more costly as the policyholder ages.

Whether or not you need long-term care insurance depends on a number of factors including:

1. Genetics – Are you from a long-lived family that tends to have few health issues or is your family prone to old age illnesses?
2. Your personal health – Given your current health, do you anticipate future health problems or are you confident that you will continue to work hard to maintain good physical and mental health?
3. Your spouse's health and genetics – What might your spouse reasonably expect in terms of post-retirement years and health?
4. Your financial situation – will you have sufficient assets to pay long-term care out of pocket?
5. Your family situation – do you have sons and daughters who will be able to assist you should you or your spouse become ill?

If you are concerned about the impact illness or potential old age problems might have on your need for long-term care, it makes sense to investigate long-term care insurance.

When you do so, remember that a portion of the premium for long-term care insurance is deductible if the policy is purchased by “pass through” entities such as partnerships, limited liability corporations, S corporations, sole proprietorships and some professional corporations. The entire premium is deductible for a C corporation.

If you are considering purchasing long-term care insurance, and have an opportunity to pass the costs through your business, talk to your tax professional to see how this will impact overall costs.

# Why Those Incredibly Good Credit Card Offers Can Be Incredibly Bad

**B**efore you decide to take up your credit card company on its offer of an extraordinarily low interest rate on balance transfers and other financing offers, stop and read the fine print. The offers can be anything but a great deal.

If the card is one that you use regularly for credit purchases, you need to be aware that:

- You will no longer have a grace period for new purchases.
- All new charges will incur the higher interest rate at your standard card terms from day 1.
- Payments are applied first to low interest rate balances. All additional balances and purchases on your card will be paid off last. A \$500 purchase that incurs interest at 1% or more a month can end up costing you in excess of \$600 if it remains on your credit card balance for a year.
- The 0% or low interest rate offer is not indefinite and can be eliminated if you violate one of the fine print rules, the most common of which is making a late payment. When the low interest rate ends, you could find yourself

paying a considerably above market interest rate on the transferred balance.



0% financing offers typically include a transfer fee of 3% of the transferred balance. If you plan to pay off the balance in three to four months, it may be less expensive to leave your debt where it is now.

The best way to take advantage of low or no interest rate offers is to do so with a credit card that you don't use that has a zero balance. This way you are not penalized for existing balances or new purchases. Set up an automatic payment of the minimum balance due every month from your checking or savings account to

make certain you do not trigger any late payment fees and revocation of the low interest rate. Then, have a plan to pay off the balance before the low interest rate offer ends.

Credit card debt is one of the most seductive and difficult to eliminate. Ideally it should be used for convenience, not to finance purchases. Credit card companies are betting that most of those individuals who switch to their 0% or low interest rate accounts will soon be paying large fees on large balances. Make certain your family members are not among those individuals.

## Forecasts are Fun, But Unreliable

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*in the stock market is usually not worth knowing.”*

It's not what everyone knows or expects that ultimately shapes market performance, but what we don't know. That's why betting on forecasts is seldom a good investment strategy. What matters more is where the market is going day by day.

# Mutual Funds Can Be Dangerous Investments

**W**e spoke recently with a potential client who explained that he had given up investing in individual stocks and had turned solely to mutual funds. Part of his rationale was that mutual funds are managed by professionals with a lot more information than he had on investing and that this knowledge would keep his portfolio out of trouble.

If only life really were that easy. It's an illusion to think that mutual funds are safe. History abounds with failed mutual funds even in good markets. You usually don't see the evidence because fund companies have a habit of sweeping failed funds under the rug by merging them into successful funds. Thus, the poor fund's performance disappears and the fund family proudly reports its record of successful management.

Fidelity Magellan should be one of the best run mutual fund companies in the market given its tremendous resources and experienced professionals managing the fund. Yet, Fidelity Magellan dropped from a high of \$146 in March of 2000 to \$72 in October of 2002, a loss of 51%. The fund's shares are still 30% below its 2000 high.

Magellan is not the exception. An investment in Putnam New Opportunity B fund in 2000 would be down roughly 60% today. If you had tried to stop the losses by selling, you would have incurred a back-end load based on the original

purchase price.

In bad markets, professional management has not proved capable of keeping mutual funds out of trouble. **90%** of stock mutual funds reported negative returns in 2002, according to Weiss Ratings, Inc., the nation's leading independent provider of ratings and analyses of financial services companies, mutual funds, and stocks. 2002 was the third consecutive year that investors suffered declines in stock funds, averaging losses of -19.22%, -12.5%, and -4.45% in 2002, 2001, and 2000, respectively.

The facts are that the vast majority of mutual funds do not protect investors from market downturns. The larger the fund, the more likely its results will mirror the broader market.

Funds that strive to outperform the market by concentrating their investments in hot sectors are typically the biggest losers when the market turns against them. Part of the problem is that mutual funds do not have the ability to move a sizeable portion of their assets to cash when the market turns against them. They have to stay invested and that hurts.

Among legendary investor Sir John Templeton's memorable advice to investors is to write down the value of their entire portfolio should it drop by 30%. "If what you see makes you uncomfortable," he said, "do something now to regain

your comfort." As the market decline of 2000-2002 proved once again, mutual funds are not immune to drops of 30% or more. If this makes you uncomfortable, you need to take another look at how you invest in mutual funds.

The old adage of "Find a good mutual fund and invest for the long haul," does a disservice to investors by ignoring reality. Investing in a mutual fund carries no guarantees and can offer considerable risk. You need to take that risk into consideration when building and managing your portfolio. Mutual funds, like equity investments, need to be managed.

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## Average Annual Total Returns <sup>1</sup> (%) as of 03/31/2005

	Putnam New Opportunities B Fund	Fidelity Magellan Fund
1 Year	-1.40%	3.14%
5 Years	-15.97%	-5.30%
10 Years	6.13%	8.97%

<sup>1</sup> Putnam New Opportunities Class B share returns reflect the applicable contingent deferred sales charge (CDSC), which is 5% in the first year, declines to 1% in the sixth year, and is eliminated thereafter. Fidelity Magellan is a no-load fund.

The performance data featured here represents past performance, which is no guarantee of future results. Investment return and principal value of an investment will fluctuate; therefore, you may have a gain or loss when you sell your shares. Current performance may be higher or lower than the performance data quoted.

Consider the investment objectives, risks and charges and expenses of the investment company carefully before investing. The fund prospectuses contain this and other information about the funds and companies. To obtain a prospectus on Fidelity Magellan, visit [www.fidelity.com](http://www.fidelity.com). Information on the Putnam New Opportunities Fund can be found at [www.putnam.com](http://www.putnam.com)

