

Retirement Weekly

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Tax Tips

Retirement Weekly continues its series featuring the best, but least-known, least-used tax-saving strategies. The tips will serve as the basis for an upcoming online course that *Retirement Weekly* will produce in association with Somnath Basu, Ph.D., director of the California Institute of Finance. (P. 2)

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Contact us

Please send any and all comments, criticism and compliments to Robert Powell at rpowell@marketwatch.com. Write also if you have questions about money or want a money makeover.

March 9, 2007 (Vol. 5, No. 10)

Are financial offers bona fide?

By Alan Lavine and Gail Liberman

Many people look to reverse mortgages as a source of extra income so they can have a comfortable retirement. But you can't get this type of loan from just anyone.

A reverse mortgage is a loan or credit line secured by your home. To qualify, you typically must be at least 62 years old. But you never have to repay the balance unless you move, sell the home or die.

We got hold of a solicitation obtained via a TV commercial. It suggests calling an "AARP counselor to obtain a certificate for a reverse mortgage."

We wondered whether this offer—very attractive during a relatively slow housing market—was legit.

"Government-backed program provides money for Senior Citizen homeowners," the solicitation enticed. The gentleman's credentials, according to the business card, printed "free" at "<http://www.vistaprint.com>," are as a "senior advisor."

But guess what? "There's no such thing as an AARP counselor," Ken Scholen, director of the AARP Foundation's reverse mortgage education project, assures us. AARP does not endorse any reverse mortgage product or lender—period.

We've heard of the professional designation, "Certified Senior Advisor (CSA). But a search for the person claiming to be a "senior advisor" on the official data base of Certified Senior Advisors failed to turn up the individual whose name is on the business card.

Darryl Hicks, vice president for the National Reverse Mortgage Lenders Association, notes that there is a broker-adviser program permitted by the U.S. Department of Housing and Urban Development. So it may be possible for someone to earn a portion of the reverse mortgage origination fee in exchange for services.

So an individual could promote a reverse mortgage and get part of the fee from the lender.

Reverse mortgages are among the most costly of home loans. If you truly are interested in a reverse mortgage, Scholen suggests that you wait a year or two because prices are coming down. The loans will cost less. Plus, there will be more lenders and product choices.

"The smartest thing for consumers—unless there's an overwhelming urgent need—is to wait," he says. For objective



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Are financial offers bona fide?

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information on reverse mortgages, visit <http://www.aarp.org/revmort>.

How can you check whether someone pitching a financial service is legitimate? You can examine the exact meaning of many professional designations at <http://www.nasd.com>. Click on "Investor Information" and then "Professional designations."

Always check with the NASD as well as state and federal regulators to make certain the individual is properly licensed. Check the person's experience and complaint history.

Understand exactly how you'll be paying for any financial service, and other ways the individual may be getting paid. If you are interested in a reverse mortgage, beware that this is a high-cost loan with a balance that grows over time. You need no income to qualify, but you typically must be at least 62 years old. The difference between a reverse mortgage and home-equity loan or credit line: You never have to repay a reverse mortgage until you move, sell the home or die. If you die, proceeds are repaid from your estate. Points to consider:

- Check first to see if there are special breaks, grants or lower-cost programs available. You can track these down at <http://www.eldercare.gov> or 1-800-677-1116.
- The best reverse mortgage deal generally is the Home Equity Conversion Mortgage offered by the U.S. Department of Housing and Urban Development.
- Be sure to discuss this loan with your heirs, who may be saddled with repaying the balance from your home equity.
- Visit <http://www.reverse.org> for the most comprehensive, objective information on reverse mortgages.
- Make sure that a deposit of reverse mortgage proceeds into your bank account won't disqualify you from any other asset-based state, federal or local aid you're receiving. **RW**

About the authors: Spouses Gail Liberman and Alan Lavine are syndicated columnists. Their latest book is "Quick Steps to Financial Stability (Que) You can contact them at <http://www.moneycouple.com>.

Top tax tips for retirees and preretirees

Editor's note: Retirement Weekly continues a series that details the best but least-known and least-used tax tips. Some of the tips will represent the basis for a virtual learning course that Retirement Weekly will present this month and next in association with Somnath Basu, Ph.D., director of the California Institute of Finance and professor of finance at California Lutheran University.

*Mark Luscombe, a federal tax analyst with CCH, offered the following: "When the lower capital gains and dividend rates were enacted in 2003 there was a lot of discussion about getting capital gain and dividend paying assets into taxable accounts to take advantage of the lower rates and have taxable interest earning assets in retirement accounts since those distributions are taxed at higher marginal rates anyway. I do not think people have paid too much attention to that advice, probably because either most of their assets are in retirement accounts anyway and if they want to diversify and hold stocks they have to hold them in retirement accounts or they think that the return potential of capital appreciation stocks is great enough compared to interest-earning investments that it is still worthwhile to have capital appreciation assets in retirement accounts. Still, I think investors should be thinking more than they are about how those assets are taxed when deciding on the most appropriate vehicle for investment. ". **RW***

Investments

Sometimes less is more

By Bruce W. Fraser

If you've heard it once you've probably heard it a hundred times from your financial adviser: Diversify, diversify, diversify. Whether you're a mature investor in your 50s or 60s or beyond or just starting out this is sound, fundamental advice. When it comes to diversification, the fundamental question is what's the right amount? How much diversification is truly needed to reduce an investor's risk?

Adding the 100th stock to a portfolio reduces risk by a much smaller amount than adding the 10th stock. So what is the proper amount of diversification for a particular individual?

That, of course, depends on many factors: for example, your age, your time horizon, how much you have to invest, and, of course, your tolerance for risk. If you're retired or nearing retirement, preservation of capital may be your overriding concern, but chances are you'll still need to generate income and/or capital gains given increased life expectancies nowadays. Diversifying your portfolio is even more critical at this stage.

You might want to check out Westport Resources Management. Diversification is a mantra to Dr. Ray Hofshi, a senior portfolio manager at the Westport, Conn., firm.

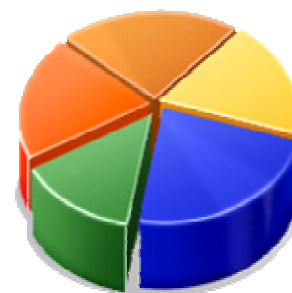
While most portfolio and fund managers use hundreds, sometimes thousands of stocks to diversify their products, Hofshi essentially believes less is more. He maintains that a mere 15 stocks, if chosen correctly, provides ample diversification.

Most money managers have a process by which they select stocks. Hofshi falls into the category of a "quantitative" value manager, meaning he has very specific computer models he has developed that evaluate the performance potential of a stock.

"When you have a quantitative process for the selection of stocks, you always pick the ones that best satisfy your criteria first," Hofshi explains. "As you add more stocks to your portfolio, each additional stock adds less value to the portfolio. While each additional stock reduces risk, it's also adding less performance potential to the portfolio."

Hofshi's approach to diversification is based on what he calls the "law of large numbers," a fundamental principle of the Theory of Probability and physics. Hofshi became acquainted with the law of large numbers as part of his development of a general decision theory model for his doctoral thesis at the University of Pennsylvania. Essentially, the law states that once you have at least 10 random variables or processes acting independently of one another, the combined probability distribution of the 10 variables will approximate a normal probability distribution, even if the individual probability distributions are different and complex in nature.

Applied to his investment strategy, Hofshi believes that 15 stocks, as long as they are sufficiently independent of each other and are each from a different industry group, ensure enough diversification to offset risk and achieve optimal performance results. In order to maximize independence, Hofshi constrains the selection process so that each



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Diversify, diversify, diversify

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stock comes from a different economic sector. "The analogy here is that each stock is a random variable, so the combined distribution of the portfolio follows the law of numbers," he says.

One of the biggest advantages in restricting a portfolio to, say, 15 stocks, is that it allows a portfolio manager to concentrate his research on a more manageable number of companies, Hofshi says.

In truth, however, Hofshi concedes that no one stock is ever totally independent of any other stock. For example, they can all be affected negatively by an increase in interest rates. But by ensuring that each of the stocks selected for the portfolio comes from a different sector, he tries to reduce the risk of underperformance in one or more sectors.

What happens should Bear Stearns and Goldman Sachs both get high ratings at the same time? Hofshi will avoid the temptation to select each for his portfolio. "We'll select only one," he says.

With his particular approach Hofshi has scored an envious success record in reducing risk and optimizing performance for clients. Most of them are small-business owners, professionals, and corporate executives. Westport Resources has a minimum investment threshold of \$500,000 to \$1 million.

Hofshi's long-term performance remains in the top 10% of all equity portfolio managers in the U.S., according to Money Manager Review, a trade publication which ranks money managers' performances. In terms of risk, studies he's demonstrated that the beta, or volatility, in his concentrated portfolios is just slightly higher than the beta of the Standard & Poor's 500 Index, usually defined as 1.

Hofshi developed his numeric stock models in the 1970s as special cases of his more general probabilistic statistical decision models developed in his doctoral dissertation. He confines himself primarily to domestic companies. When he ventures outside the U.S., he uses electronic traded funds, or EFTs, to give investors exposure to foreign markets. "It provides a little more diversification," he says.

Gerald Appelbaum, a financial adviser associated with broker-dealer National Planning Corp. in Stamford, Conn., recommends some of his wealthier clients to Hofshi. Because of his engineering background he takes a holistic approach to investing. He first considers the goals and objectives of clients and then tries to find products to help achieve those goals over the long term.

"If the client still wants to be exposed to stocks and needs hands-on direction, I refer them to Dr. Hofshi," he says, "because that way clients are not left to their own devices and will be guided to a disciplined approach. They can buy what he recommends and he watches it for them."

There is a risk-reward ratio with Hofshi's strategy in that an investor may gain increased performance, but will take on some element of risk. "But over a long period of time, the risk is usually less," says Appelbaum. "It's like a tide coming in that will raise all levels of stocks over a period of time. When it goes out, the tide will lower all levels of stocks. Essentially, everyone is looking for a safe harbor, where the tides will affect you less, and that tends to be value investing." **RW**

About the author: *Bruce W. Fraser, a freelance financial writer in New York, contributes to many publications, including Wealth Manager, Financial Advisor and Boomer Market Advisor magazines. He co-edited the recently published book, "Sixty Things To Do When You Turn Sixty."*

Retirement Living

More than your home away from home

By Bruce W. Fraser

You've earned it. You deserve it. And maybe if you're approaching retirement you already have one—a vacation home. It's a place to relax. And, by the way, don't scoff at other benefits. It can be a good investment.

Whether you plan to purchase or upgrade such a home or already own one, the property should be integrated as part of your overall financial strategy, says George Chamberlin of Wealthcare Capital Management, (<http://www.wealthcarecapital.com>).

Aside from the financial value, whether it's a significant asset or not, investors also have to consider the vacation home in the context of the extended family and the place it holds for each family member. "It isn't just a matter of enjoying and using it," Chamberlin says, "it's the role your vacation home plays in your extended family and what happens to it when you can no longer enjoy it."

Keeping it in the family

Let's say you wish to pass your vacation home to the next generation or from there to future generations. What do you need to think about?

Chamberlin suggests you consider the perspective of your heirs. Are they interested in the vacation home and the costs associated with maintaining it? If there are more than a few heirs, will they cooperate in sharing both the use and the responsibilities?

In more complex situations, Chamberlin says a family agreement or a trust may be helpful to address these issues.

What about taxes? How are the estate taxes attributable to the property going to be paid? Getting some professional help – in advance -- with this may be wise, whether it's a tax professional, estate planner, or even your financial adviser.

Or you may have a charitable purpose in mind for the property. Chamberlin says this doesn't mean the planning issues go away, they're just different. For example, it makes a difference whether it's a public or private charity that is to receive the vacation home, particularly given the recent changes enacted with the new Pension Protection Act, restricting the activities of private charities and, potentially, your deductions.

Another aspect to consider is the location of your vacation home. Often, it's located in a different state and sometimes is in a foreign country. When you're planning for the future of that vacation home, its location and the laws that apply may affect your ability to transfer the property when or as you wish or to keep it in the family. Here again it's important to consult with a professional who practices where the vacation home is located to ensure a smooth transition.

Selling Your Vacation Home

You bought it. You love it. But now that you don't want it or need it anymore, how easy will it be to sell?

"Clients often fail to consider the uncertainties," Chamberlin says. "For example, what is the market for the property and will it be easy to find a buyer at your price when you want or need that buyer? This may be problematic where the client needs the money at a particular time and hasn't considered the vagaries of the real estate market," he said.

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Retirement Living

More than a home away from home

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It's important to obtain a good appraisal and to work with professionals on tax issues, as well as in handling the sale of the property. "There's a lot more in your vacation home than just your enjoyment," says Chamberlin. "It's never too early to think about what you may want to do with it."

Remember, it's important to engage your family members and your advisors in weighing your choices. After all, you've enjoyed the vacation home as part of your life, and you want to make the most of it in your financial strategies which ever way you choose to go. **RW**

About the author: Bruce W. Fraser, a freelance financial writer in New York, contributes to many publications, including *Wealth Manager*, *Financial Advisor* and *Boomer Market Advisor* magazines. He co-edited the recently published book, "Sixty Things To Do When You Turn Sixty."

News in Brief

Do traders win? A new Vanguard study on trading and portfolio performance finds that traders and nontraders earn the same risk-adjusted returns. However, certain types of trading, such as participant rebalancing or rebalancing via a balanced or lifecycle fund, are beneficial. Meanwhile, high-turnover trading is costly. Learn more at <https://institutional.vanguard.com/iip/pdf/VCCRDTW.pdf>



Duly noted...

AIM Investments has launched the AIM Independence Funds, a series of six target-date maturity portfolios that the firm claims are the first in the industry to combine actively managed mutual funds and "intelligent" rather than market-cap weighted indexing. The funds will use a core-plus-satellite construction using strategically selected PowerShares ETFs and AIM mutual funds, which are managed across eight AMVESCAP investment centers in the U.S., Canada, and Europe. Each fund holds 15 to 21 underlying products, more than many other target maturity funds.

Worth reading...

Health care cash: How much is enough? How much does a (person) need to save for out-of-pocket health care costs in retirement? It's a question even the brainiest, actuarial propeller head will wrestle with. But with recent studies pointing to the comparatively poor health of retiring baby boomers, it's probably more than you think. Learn more about *Registered Representative's* article at <http://registeredrep.com/wealthmanagement/health-care-cost-newsletter/>.

■ Editor's note: Please copy and paste below urls (if not hyperlinked) into your browser. **RW**

HealthWatch

Prescription drug prices for U.S. residents ages 50 and older increased at about twice inflation rate: AARP

Manufacturers' prices for the 193 prescription drugs most commonly used by U.S. residents ages 50 and older increased at about twice the rate of inflation in 2006, according to an annual report released this week by AARP.

AARP found that manufacturers' drug prices on average increased by 6.2%, while the Consumer Price Index (CPI) increased by 3.2%.

According to the report, average drug prices since the end of 1999 have increased by nearly 54%, while overall inflation increased by 20%. The report found that the insomnia pill Ambien, manufactured by Sanofi-Aventis, had the highest price increase, up 30% in 2006. Prices for the respiratory drugs Combivent and Atrovent, both manufactured by Boehringer Ingelheim, had the next highest rates of growth, up 18% and 17%, respectively, in 2006, according to the report.

David Sloane, senior managing director for government relations and advocacy at AARP, said, "Over time, escalating drug prices will make Medicare drug plans unaffordable for older Americans. One way to address high drug prices is to take full advantage of Medicare's bargaining power and allow Medicare to negotiate lower drug prices." He added, "We need to send a loud and clear message to the pharmaceutical industry that Americans cannot afford to continue to pay the highest prices for prescription drugs in the world."

The pharmaceutical industry, meanwhile, called AARP's report "inaccurate and misleading," citing data from the Centers for Medicare and Medicaid Services (CMS) and the Bureau of Labor Statistics that show increases in prescription drug spending slowed for the sixth year in a row and retail drug prices increased by 1.5% in 2006. Ken Johnson, vice president of the Pharmaceutical Research and Manufacturers of America, said, "Expert data strongly suggest that AARP's numbers simply do not reflect the true amounts paid by seniors for their medicines. And they do not reflect the clear downward trend in prescription drug price growth."

Read the study at http://assets.aarp.org/rgcenter/health/dd154_drugprices.pdf.

Duly noted...

- The Medicare prescription drug benefit is "financially irresponsible," U.S. Comptroller General David Walker, head of the Government Accountability Office, said in a segment on CBS' "60 Minutes" this weekend, Reuters reports. Walker called the drug benefit "probably the most fiscally irresponsible piece of legislation since the 1960s ... because we promise way more than we can afford to keep." Walker said that \$8 trillion would need to be invested immediately to cover the difference between what Medicare will take in and what it will owe to beneficiaries over the next 75 years. He cited the long-term financing problems Medicare will face because of the impending retirement of the baby-boom generation. Walker said that "when those boomers start retiring en masse, then that will be a tsunami of spending that could swamp our ship of state if we don't get serious."
- *Editor's note: The above is a recap of health-related news as reported by the Kaiser Daily Health Policy Report and other organizations. RW*



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Robert J. Powell, III is President of Unison Associates LLC, a Salem, Mass.-based financial education, communication and consulting firm. Powell, who has more than 20 years of experience in the financial services industry, is author of "20 Tips for Retirement Investors," co-author of "Decoding Wall Street", executive producer of PBS' "More Than Money" and a member of the expert faculty at the California Institute of Finance. Previously, Powell served as editor-in-chief of DALBAR's *Mutual Fund Market News* and columnist for *The Boston Herald*. Powell owns no shares of any investment mentioned in this week's issue. He currently provides consulting services to the Financial Planning Association and Major League Investments, in which he also holds a minority interest.

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