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Cash is Not a Four Letter Word

(well, not that kind of four letter word!)

Last month we took clients' portfolios into one of the largest "cash" (money market) positions we've held in over two years. Only a couple of clients have indicated discomfort with this decision, and believe me, it was not an easy one. Reducing the commitment to active assets like stocks harbors risks for a money manager who is paid for performance. Unfortunately many investors, especially neophytes, mistake money management for "Action". They have trouble understanding why they would want to compensate an advisor for "doing nothing". As we learned at the top of the technology stock driven bull market of 1999-2000, money managers who took chips off the table were later seen as heroes for protecting invested capital in an overpriced market environment. It is knowing when to hold 'em and knowing when to fold 'em that constitutes a major part of the manager's art.

In the fateful year of 1987, I learned the value of staying out of a treacherous market. I was then a Registered Representative (stock broker), and was an early believer in using independent thinking money managers to make day to day investment decisions for my clients. These were in the days before "wrap fee" accounts were embraced by the big Wall Street brokerages. On my own, I found a Registered Investment Advisor with a terrific track record, and won an investment commitment from a new client who would shortly realize proceeds from the sale of a commercial property. While we waited for his funds to arrive, a matter of months, the stock market was going great guns. During the first quarter of 1987 the Dow Jones Industrials rallied 19% and this was on top of a terrific 1986! My client's funds were transferred into his account in late March of that year. Then, to my consternation, the money manager did nothing. Nothing. After two weeks, I telephoned the management company to inquire why no stocks were being purchased. Their response: "the market appears over valued, and we don't find any compelling 'buys' at the moment - please be patient." At the time, I did not fully appreciate that forbearance is one of the disciplines brought to the investment process by a good independent advisor. Neither did my client. The market stalled in April and May, but by mid June quotations were rising again, and still, the investment advisory firm committed nothing to stocks! The client, showing he lacked integrity, refused to pay a bill sent by the manager for contracted services, saying, in effect, "no tradey, no money". To my horror, this was followed by the client moving his account to another firm, and so I fumed about the lost opportunity for the next few weeks. The Summer of 1987 progressed, and the Dow Jones Industrials reached a record 2700 in August! It seemed clear that the departed client had been correct to abandon the money manager, and I felt pretty dumb for having recommended this approach. Suddenly in mid October, the Dow Jones Industrials gave way, collapsing by 900 points in about 13 trading sessions, having lost 37 % since the market peaked in August. Many stocks traded well below their price from back in March, when that money manager refused to commit to overvalued positions.

In the aftermath, it dawned upon me that

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maybe the money management firm, with their refusal to be pressured into buying over priced stocks, had been doing the very job for which they had been hired!!

This was a lesson taken to heart. Since those days, I've had occasion to tell antsy clients that the best advice I had to give was to stay in cash.

In the "don't rush to invest" camp, we have plenty of company. The markets have generally given investors little to cheer about since March. Back then, *Morningstar. com* featured an article entitled *"Why Legendary Investors are Drowning in Cash".* This article pointed out that leading Value managers, Warren Buffet, Jim Gipson (Clipper Fund) Charles De Vaux (First Eagle Overseas Value Fund) and the team of Cates, Buford and Hawkins of Longleaf Partners were all above 20% in cash holdings at the time.

After a long time portfolio holding, Caremark, fell below the important 200 day moving average in late July, we took profits. Then two newer holdings, Mylan Labs and Corinthian Colleges both experienced rapid price declines for entirely unrelated reasons. I began to wonder however if these sell offs were isolated incidents. When one sees individual stocks reacting vigorously to the downside on negative news, yet rising only mildly to the upside on good news, this may be indicative of a larger malaise at work in the markets. The defining event that caused me to raise cash was a technical observation that appears to confirm that the next big move for stocks may be down: the U.S. value stock mutual funds held in client accounts all cracked below the hallowed 200 day average of prices. These are funds with respected track records. The pattern has been reflected in the Dow Jones Industrial Index, the Standard and Poors 500, the Wilshire 5000 and of course the NASDAQ index, have fallen below their 200 day moving averages for the first time since about March 2003[1] . As I wrote in a special email to clients on August 12: *"While I am not primarily a technical trader, many years of tape reading have given me a healthy respect for such signals. When this type of behavior is observed over a broad swath of indexes and well run mutual funds, it would be derelict to ignore such signs and leave you as exposed to U.S. equities as you were just a few weeks ago."*

In the past few trading sessions, stocks have rallied back up to their 200 day moving average, and while the advance/decline statistics have been healthy, volume and conviction appear to be lacking. This may have been a Republican convention rally, as hopes for the President's reelection brightened[2]. We see no meaningful change in trend as yet and continue to find bargain stocks a scarce commodity.

A Touching Tale of Titling

As a member of FPA's[3] Hospice Outreach team, I and my fellow members discussed financial considerations for the terminally ill with social workers at Saddleback Hospice on September 7th 2004.

This dedicated group of social workers, volunteers and medical professionals is affiliated with Saddleback Memorial Medical Center in Laguna Hills, and provides a crucial service to the community.

Families with a terminally ill member may be so distracted by the medical needs, emotional considerations and time challenges before them that they fail to deal with important financial issues. Often a patient who is suffering holds on until he or she feels that things have been "settled", especially with regard to the distribution of her possessions and estate.

One of the minefields that must be traversed is assuring that assets are properly handled while the patient is living, and properly distributed after death, and this can be accomplished through avoiding mistakes of titling. This is a source of confusion for most people, so I'd like to share with you a summary from my presentation to Saddleback Hospice.

Joint Tenancy

Most married couples hold their home, savings accounts, brokerage accounts and other major assets in both names as "Joint Tenants with Rights of Survivorship". The good side to this titling is that upon the death of one, the other joint tenant will not have to run assets through Probate, an inconvenient and costly court procedure, and can continue to use and enjoy the assets as surviving "tenant". But there are risks to this titling, which become greater in the event of remarriage or when joint tenancy is created between a parent and one of several children:

- *Creditor risk* - If one of the tenants posts the jointly owned assets against a loan, (perhaps taking out a margin loan on a stock portfolio), the other is liable, even if the loan was assumed without their knowledge. Likewise, if one of the joint tenants is sued and must pay a settlement, both are liable to the extent of their jointly held assets. Someone else's mistake could cost his partner everything.

- *Inheritance risk* - In a remarriage, with each spouse having children from a previous marriage, it may be the intention to bequest assets to one's children from the first marriage and not to the new spouse or her children. If the assets brought into the marriage or purchased after marriage, such as a home, are taken as "Joint Tenants", then upon death or divorce, the second spouse is entitled to not just her half of the property but also the half owned by the deceased. Unless this surviving spouse is generous and respectful of the wishes of the departed, then children of the deceased may see none of their intended inheritance.

- *Risk of disrupting an equal bequest*- This can happen inadvertently when dealing with elderly parents in need of support or with a terminal illness. Three daughters may be beneficiaries of their mother's will in equal parts. Perhaps one of the daughters lives closest to ailing Mom, and frequently takes her to the doctor. A second daughter, financially astute, handles her bills, files insurance claims, and makes quarterly tax deposits. The third daughter comes into town for long weekends to visit and spends time with Mom, preparing special meals in which the entire family shares. As a convenience, Mom may want to open a "joint tenant" account with the daughter who pays her bills. If a large sum of money is placed in joint tenancy, then Will or no Will, the daughter named on the account gets all the remaining funds, and the other two sisters are not entitled. While it may be convenient to create such a joint tenant account, so as to make it easy to manage Mom's affairs, be careful to fund the account with only enough money to pay one or two month's bills at a time.

- *Risk of cutting out rightful heirs* - An elderly person suffering from illness could be persuaded by a non-family caretaker into opening a joint account with this individual, and depositing a considerable sum. In this way the estate may be depleted and rightful heirs lose some or all of their inheritance.

- *Joint tenancy is forever* - it cannot be changed without the consent of both tenants.

Community Property

This is a title by which married people may hold property together and assures that each spouse will retain dispositive powers over his or her half of jointly owned assets. This is a way of saying "we share while we're both living, but when I die, I can direct my half of our property to someone other than you, my spouse." Of course, this titling does not prevent you from leaving your half to your spouse, but it does leave open the option of giving some or all of your assets to your children or someone else who you designate. This can be especially important with people who may have remarried. There is also a potential income tax advantage for a surviving spouse when property is held as community. After the death of the first spouse, community assets, such as a home are revalued. This means that upon sale a large capital gain tax can be avoided.

A Single Man (or A Single Woman):

This titling applies to property you acquired while single or through divorce or inheritance. It can also apply to wealth inherited after marriage. Before re-titling such assets as either Community Property or Joint Tenants, be aware that in so doing you have gifted one half interest in your sole property to your spouse. Once re-titled, you cannot change your mind and return the asset to Single person status. It is not uncommon for people to inadvertently convert a Singly owned asset, such as an inherited stock portfolio, into joint tenancy or community property by depositing these assets into a jointly held account. This is known a commingling.

Payable on Death or Transfer on Death

Bank and brokerage accounts can be opened by an individual, naming a beneficiary who is to take ownership at the time of death. This is a simple mechanism for transferring a sum, and it supercedes a Will. It also avoids probate. Such an account could be used (or misused) to bequeath assets when those named as beneficiaries in a Will are no longer favored or a new beneficiary, not included in the Will, is to be added.

Trusts

Trusts add a dimension of control that goes beyond that available through titling and bequests made via a Will. More on this next issue.

Good Advice-Good Strategic Move

Each ownership situation is different. Titling changes should not be made without good professional advice, especially under duress such as when a person is terminally ill.

In such a situation a trained Certified Financial Planner™ practitioner may be helpful in clarifying these matters.

ANNOUNCING FINANCIAL WORKSHOP SCHEDULE :

Gary Miller, CFP™ will be conducting investment workshops this Fall. Please mark your calendar and alert friends or family who may benefit from attendance:

Financial Independence for Women

Gary Miller, CFP™ will be teaching a class called *Financial Independence for Women* at Irvine Valley College, Irvine California Wednesdays October 6, October 13 and October 20, 2004 6:30PM to 8:45PM. To register, visit Irvine Valley College at www.ivccommunityed.com or call Trusted Financial Advisors at 949-249-2057.

How to Find High Income in a Low Interest Rate World

Gary will be teaching this workshop at Saddleback College, Mission Viejo, CA Saturday October 2 from 9:00 AM until Noon. To register, visit www.saddleback-ce.com or call Trusted Financial Advisors at 949-249-2057.

For additional information see our web site www.trustedfinancial.com

(Footnotes)

1. Only the Dow Utilities stand as the exception, perhaps as investors show appreciation for high dividend paying stocks in a low interest rate environment.
2. It is generally believed that the business community and the investor class fear a Democratic victory in Washington.
3. Financial Planning Association, a national organization.