

Money 2000 News



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Dear Friend of Money 2000:

Many people like to know “how they’re doing” financially. In research being conducted by Rutgers Cooperative Extension, over 10% of people attending our fall 1997 MONEY 2000 conference listed self-assessment-type answers (e.g., “how am I doing?,” “am I saving enough?”) in response to the question “The most important financial question I need answered today is...”

If you’re one of those folks who likes to check your progress, below is a helpful quiz developed by cooperative extension educators in Prince William County, Virginia. Simply read the ten statements below and write the words “yes,” “no,” or “sometimes” next to each question to describe your current financial behavior.

1. I pay the rent or mortgage payment and utility bills when they are due.
2. I plan ahead for big expenses such as insurance premiums, buying another car, major car service, etc.
3. I have a plan for how take-home pay will be spent.

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The Market Goes Up, the Market Comes Down...Stay Calm

Many new investors have entered the stock market for the first time over the last three years and they have been engaged in a great ride, mostly up. Recently, investors have experienced an inordinate amount of market volatility which has left many shaking in their boots and wondering what to do. Should you bail out now or just hang tough?

It may be helpful at this point to renew some of the golden rules of investing for long-term goals:

- All too often, investors, because of their fears, are their own worst enemy—buying at the top of the market, exiting at the bottom.
- Nobody can tell you for sure where the market is headed.

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Resolving Auto Complaints

Do you know that complaint handling programs exist for resolving automobile problems? If you are having



difficulty in resolving auto complaints such as repeated repair attempts (brakes, paint, transmission, etc.) or elusive diagnostic problems (leaks,

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- The Market Goes Up, the Market Comes Down...Stay Calm
- Take the Guesswork Out of Retirement: Plan
- Secured Credit Cards: What You Need to Know
- Dogs of the Dow: A Viable Investment Strategy?
- IRA Decision Factors Explained
- Investment Clubs Need Planning, Commitment

Take the Guesswork Out of Retirement: Plan

In various surveys, many people say they'd like to retire early—between the ages of 55 and 60. Yet, if they do, they face a shorter asset accumulation phase, while their money must last a long time, often three or four decades.

Saving as early and as much as possible is the key to financial security in retirement. In her book, *Live Long & Profit*, Key R. Shirley outlines financial needs and challenges people face as they move through life:

In your 20s: Tone down the use of credit cards and invest at least four percent of your gross income.

In your 30s: Begin to think seriously about your future. Maximize contributions to a tax-deferred savings plan. Make your car last at least seven years.

In your 40s: You may have to play catch-up if you have not been saving. This is the “moment of truth decade” but you still have time. Maximize contributions to your 401(k) or another tax-deferred savings plan.

In your 50s: “The Home Run Decade.” You are beginning to think seriously about the age you will retire. Be careful about overspending.

In your 60s: Plan on how to stay healthy and live wisely; make plans for a surviving spouse and children.

The key point to remember is that, the sooner you begin a saving and investment plan, the longer your money will have to grow and the greater the overall return. According to extension specialists at Clemson University, few of today's workers have definite savings goals based on an assessment of what their future retirement needs will be. And most people underestimate

how long they will live in retirement.

A 55-year-old American male will likely live to be 78. A 55-year-old woman has a life expectancy of 82. But, for investment purposes, you might want to add five years to your life expectancy or 10 years if you come from a line of long-lived ancestors. Why? Because your savings will have to stretch for decades.

So how much money do you need to save today to have sufficient funds for the future? There is no magical answer. Individuals need to answer this question based on their earning potential and desired lifestyle. The American Savings Education Council has developed a “Ballpark Estimate” worksheet to help you figure out how much you need to save for retirement. You can access this worksheet at www.asec.org/ballpark.htm.

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Secured Credit Cards: What You Need to Know

The Winter 1998 issue of *Consumer Action News* presented the results of a survey of secured credit cards. A secured card is a credit card backed by money that you deposit and keep in a bank account. The account serves as security for the card. If you don't pay your bill, the money in your account can be used to cover the debt.

All of the banks that Consumer Action, a San Francisco advocacy group, surveyed will accept people who have no credit history, i.e., no information on file with one of the major credit bureaus. This makes secured cards a viable option for young adults just entering the job market. Some cards are easy to get, while others have strict guidelines about income and past credit history. Most issuers require that there be no late payments recorded on your credit report in the last six months.

When Consumer Action first examined secured cards in the 1970s, many carried very high costs. A large up-front payment—called an “application” fee—

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Dogs of the Dow: A Viable Investment Strategy?

One of the most popular strategies for investing over the long term has been the “Dow Ten” strategy, a.k.a. investing in the “Dogs of the Dow.” This strategy involves buying equal shares each year of the ten highest yielding stocks of the 30 stocks that make up the Dow Jones Industrial average. At the beginning of the year, the portfolio of ten stocks is held for the entire year and is readjusted the following January 1 to hold the ten highest-yielding stocks in the new year. Often only two to four stocks are replaced each year.

Over the past 20 years, this investment strategy has an enviable track record, although it has not done quite as well over the past two years. The merits of investing in the “dogs” include:

1. It is a simple strategy and easy to track.
2. The system takes all the emotion out of investing. You don't have any decisions to make in choosing the stocks—just how much money you want to commit.
3. Transaction costs are held to a minimum because investors only purchase and sell shares once a year.
4. Since the strategy does not rely

solely on capital gains but also on superior dividend-paying stocks, the total return can be higher than other Dow securities.

5. The strategy uses a value approach for investing in stocks, which means it invests in out-of-favor stocks that offer better bargains among the Dow stocks.

The following 10 stocks began 1998 with the highest dividend yields:



Philip Morris, General Motors, J.P. Morgan, International Paper, Chevron, AT&T, Exxon, 3M, Eastman Kodak, and Goodyear. The “Dogs of the Dow” strategy can be executed in three ways with different minimum dollar requirements through:

- “Dow 10” Unit Investment Trusts, packaged and sold through various full-service and discount brokers,

usually in units of \$1,000 each.

- The purchase of the individual stocks, usually in round lots of 100 shares each, and executed through a full-service or discount broker. This method requires the most capital to implement.
- No-load mutual funds that employ the strategy, although it won't be a pure play because of diversification requirements of mutual funds. Mutual fund choices include: Payden & Rygel Growth and Income, O'Shaughnessy Dogs of the Market, and Hennessy Balanced. (These names are provided as examples only.)

Investors should note two potential drawbacks of the “Dogs of the Dow” strategy: lack of diversification and the tax law change that requires stocks be held for 18 months instead of 1 year to qualify as long-term capital gains. If the “Dogs” are held in a taxable, rather than tax-deferred account (such as an IRA), gains will be unfavorably taxed. Still, investors who want a simple and time-tested method for investing in large company stocks, may want to commit a portion of their investment dollars to this strategy. \$

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IRA Decision Factors Explained

One of the biggest retirement planning decisions that people face is whether to fund an individual retirement account (IRA). Since the passage of the 1997 tax law, which type of IRA (Roth or traditional) to establish also needs to be considered.

The first factor to weigh is whether or not you have “earned income.” This is a salary or self-employment income—not investment earnings like dividends or interest. Anyone under age 70½ with earned income can contribute

to a traditional IRA and anyone of any age with earned income can fund a Roth IRA. The annual contribution limit for either plan is 100% of compensation up to \$2,000 a year.

A second factor in IRA decisions is household income. If a couple has a 1998 adjusted gross income (AGI) of less than \$50,000 (\$30,000 for singles), they can make a fully deductible contribution to a traditional IRA. Above \$60,000

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IRA Decision Factors

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for couples and \$40,000 for singles, traditional IRA contributions become non-deductible if one or both spouses is an active participant in an employer-sponsored retirement plan. Contributions can be made, however, no matter how high your income. If neither spouse participates in an employer plan, IRA contributions are fully deductible regardless of income.

With a Roth IRA, investors receive no up-front deduction for their annual contribution but they can make withdrawals tax-free after they have held a Roth for five years and reach age 59½. This is a substantial advantage over non-deductible traditional IRAs whose earnings are fully taxable. Roth IRAs are available to couples and singles with AGIs under \$160,000 and \$110,000, respectively.

A third planning factor is an investor's time horizon. The more years an investor has before retirement, the more attractive a Roth IRA will be because contributions will have more time to compound tax-free. If you have less than 10 years until retirement, a traditional IRA could be a better.

The age at which a retiree plans to begin taking distributions is a fourth consideration. Unlike traditional IRAs, which require mandatory distributions at age 70½, Roth IRAs have no mandatory withdrawal age. This could be an advantage for retirees with high incomes or those wishing to preserve assets for heirs.

Factor number five is an investor's current marginal tax bracket and the bracket they expect to be in after retirement. If the same or a higher tax bracket is expected after IRA distributions begin, a Roth IRA may save on taxes because withdrawals are tax-free.

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Investment Clubs Need Planning, Commitment

Why do people join investment clubs and invest in stocks? Probably for one or more of the following reasons:

- to add diversification to existing assets (e.g., CDs, bonds),
- to earn higher returns than other asset classes,
- to “grow their money” for long-term goals like retirement,
- to learn about investing in a supportive environment, and
- for fun and socialization with people with a common interest.

According to the Chicago investment research firm Ibbotson Associates, the average annual return on stocks from 1926 through 1997 was 11%, compared to 5.2 for government bonds and 3.8% for Treasury Bills. In shorter time frames, especially periods of less than ten years, however, stock performance can vary considerably. This is why stocks are not recommended for near-term goals like a new car or college in two years.

Most investment clubs align themselves with the National Association of Investors Corporation (NAIC), a non-profit organization in Royal Oak, MI that provides information for new clubs and guides for investment selection. The NAIC can be reached at 810-583-6242 or through their web site, www.better-investing.org. NAIC recommends four principles as keys to successful stock investing:

- invest regularly for the long term (e.g., \$100 per month),
- reinvest all earnings (e.g., dividends and capital gains),
- invest in growth companies averaging a 15 percent annual return (to double your money about every five years), and
- diversify by company size and industry.

Investment clubs face the dual challenge of selecting investments and maintaining a cohesive organization. Below are seven pointers for new and existing clubs:

1. Carefully consider initial “structure” decisions (e.g., dues for investing, choice of leaders, frequency of meetings).
2. Agree on an investment philosophy (e.g., value stocks, growth stocks, percentage of assets in any one industry).
3. Diversify the club: recruit members with different careers and of different ages who have a variety of life experiences.
4. Manage expectations: just because 1995 to 1997 was the best three-year period this century for stocks doesn't mean that returns over 20% are normal.
5. Do your homework: members should come to meetings prepared (i.e., serving as an officer or reporting on a company).

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Secured Credit Cards

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was usually required. They discovered in their 1995 survey that many secured cards are now available without such fees, however.

Secured cards usually have annual fees. On 17 of the 21 surveyed cards, these fees are \$25 or higher. Many unsecured cards, on the other hand, have no annual fees. Interest rates tend to be higher, as well. About half of the 21 cards surveyed have annual percentage rates (APRs) of 18% and higher.

The amount of deposit required of borrowers varies. Although the typical minimum deposit is \$300–\$500, the survey found five issuers that require \$250 or less. Most banks allow deposits—and credit lines—up to a maximum of \$5,000.

Most secured card issuers surveyed report payment information to one or more of the major credit bureaus, helping card holders build a credit history. Before signing up for a card, make sure that the issuer will not flag your card as a secured card in its reports to credit bureaus. This could hinder your efforts to build a good credit history.

Consumer Action notes that secured credit cards may be a good way to establish or re-establish credit but that they tend to be expensive. Their advice is to consider secured cards as a “stepping stone” and try to graduate to an unsecured card as soon as you can. \$

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IRA Decision Factors

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If a lower tax bracket is expected after retirement, a deductible traditional IRA may provide a larger accumulation, assuming someone has the income to qualify for a deductible contribution.

Which type of IRA is better: a traditional or a Roth? It depends on all of the above factors. The best way to decide is to order software or check the web sites of financial services firms and complete a personalized analysis. A good source of information is the web site www.rothira.com which provides links to a variety of interactive calculators.

While you’re deciding which IRA is best, also check out the calculators that determine whether you should convert an existing traditional IRA to a Roth IRA. Again, personal factors like household AGI, tax rates, withdrawal plans, and time horizon are important. Another factor to consider is whether a separate source of funds is available to pay the taxes due upon conversion.

Converting to a Roth is generally less advantageous if you have to use IRA funds to pay the taxes, for two reasons. First, there’s less money left to grow tax-free and secondly, a 10% penalty will be owed on withdrawal proceeds not rolled over into a Roth or other IRA.

In summary, IRA decisions have become more complex during the past year. Consider all of the above factors before making a move. \$

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The Market

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- It is unlikely that investors can considerably “beat” the market which is why index mutual funds make so much sense for a sizable portion of your portfolio.
- Stocks and stock-owning mutual funds, over the long-term, outperform all other investments. Research conducted by Ibbotson Associates shows that, from 1926 to 1997, stocks returned 11%, intermediate government bonds, 5.2%, and Treasury bills, 3.1%.
- Time and a consistent savings dis-

cipline can heal most investment wounds in a market downturn.

- To get the most “bang for your investment buck,” hold down investment costs and avoid unnecessary taxes. Educate yourself about no-load stocks and funds and do your trading within a tax-deferred account such as a 401(k).
- Investors should consider investing beyond the U.S. shores in foreign markets to diversity a portfolio. Choose an international mutual fund (invests 100% outside the U.S.) rather than a global fund (can own up to 50% in U.S.).

- Increasing cash investments (CDs, Treasury Bills), rather than adding bonds, can decrease the risk in a stock-rich portfolio.
- Over time, inflation is a greater risk to a portfolio than short-term volatility.
- Focus on your portfolio’s overall return rather than worrying about the individual performance of investments. Remember, that’s why you hold different asset classes—when one zigs, the other zags. This way, you won’t panic in a market downturn. \$

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Dear Friend

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4. I save at least 10 percent of my take-home income.
5. When I use my credit card, I always pay off the total amount when due so that I do not incur interest charges.
6. I plan my income tax withholding so that, when I file my tax return, I usually get very little back or owe very little.
7. I compare the annual percentage rates of interest from different lenders such as banks, credit unions, etc., before deciding where to borrow money.
8. I compare prices at several stores before deciding to buy things.
9. I have at least three to six months of take-home income saved for major emergencies such as job loss.
10. I spend no more than 12–15 percent of my take-home pay on installment payments.

Once you're done, score yourself as follows: count 1 point for each no answer, 2 points for each sometimes answer, and 3 points for each yes. To understand your total score, 25–30 points means you probably have control over your financial situation. Persons with 15–24 points are trying to gain control over their financial situation, but need to work harder, and less than 15 points mean you need improvement in your financial management skills and knowledge. To improve your score, and your personal finances, consider joining MONEY 2000. You'll be provided with information to increase savings and reduce debt. For further information, contact your local Rutgers Cooperative Extension office. \$

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Editor

Auto Complaints

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noises, etc.), you can appeal to a dispute settlement board (DSB).

A DSB is an informal dispute-settlement mechanism whose members are charged with resolving complaints based primarily on the standard of fairness. These boards offer prompt and objective resolution to consumer complaints that are beneficial to consumers, dealers, and auto companies. Composed of independent volunteers, the boards provide customers an opportunity to have their complaints heard and decided by an independent authority at no cost. Decisions are binding on auto companies but consumers are free to reject decisions and seek other remedies available under state or federal law. To be eligible for review, the vehicle must be covered under an express new vehicle warranty.

Before applying to a DSB, a wise consumer should address a concern or complaint with a local dealership and the automobile company. Local dealerships are independently owned and operate their own service centers. Therefore, quality of service repairs varies between dealerships. Under the New Jersey Lemon Law, a dealer must provide to a consumer an itemized and legible statement of all examinations and repairs at each visit.

If a consumer is dissatisfied with repairs or elusive diagnostic attempts, a dealership can provide the telephone number and address to contact the re-

gional customer service office of the auto company. Because companies have a vested interest in customer satisfaction, regional office managers are eager to resolve complaints or disputes. These offices might inspect a vehicle to aid in dealer diagnosis and suggest resolutions. Also, when regular repair procedures are not successful, a field service engineer (a highly trained technical expert), can be called on to inspect a vehicle on a limited basis.

To file a complaint with the DSB, the customer can call a dealership for an 800 number, select a dispute settlement pamphlet from the dealer, or refer to his/her owner's guide or warranty information booklet. After obtaining and completing a short application form with pertinent information, the customer mails it to an address of an independent consulting firm that oversees board actions. DSBs meet on a regular basis to review cases. Trained board members review all materials related to the complaint and, based on available information, arrive at fair and impartial decisions. Consumers have the option of appearing before the boards to present their cases. Decisions are mailed directly to consumers after review.

Generally, boards may award: a replacement vehicle, refund of the purchase price, repair, reimbursement for incidental expense, a combination of the above, or nothing. Efforts are made to render a decision within a reasonable time (approximately 30–40 days from receipt of complaint). \$

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Investment Clubs

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6. Know when to sell: monitor the performance of stocks and be prepared to sell if there is a decline in earnings.
7. Get help when needed. The NAIC, for example, has a New Jersey chapter that provides periodic courses and one-day seminars. \$

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