July 15th, 2002
Volume 1, Issue 1

Intelligent Money

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Special Notes of Interest:

- As of July 1st, Stafford Student Loans charge an interest rate of 4.06%, the lowest rate in 37 year history of the program - See page 2
- Fixed Income Exchange Traded Funds (ETFs) begin trading on July 26th
- Corporate earnings season begins this week in earnest as one third of the S&P 500 membership releases earnings for the 2nd quarter

Current thinking from Haven Financial Advisors

Real Estate as an Asset Class

The dizzying decline in the financial markets has caused many investors to reevaluate their portfolio allocation. One obvious area of strength for most is the buoyant market values of their homes.

Some investors are attempting to increase their participation in the real estate market by purchasing homes that are larger than their requirements. The extra square footage is held for investment purposes.

I am a believer in real estate as an investment asset. Real estate has historically offered returns well in excess of fixed income assets with minimal correlation to the broad market. Most recently, the value of real estate assets has increased in the face of the largest stock market selloff in the last 30 years.

However, the family residence is not the appropriate vehicle for such an investment. The home is for personal use, not as an investment asset. Selling one house to capture gains necessitates the purchase of another home at similar price levels. To the extent that a family has "overbought" its residence, the slack capacity is a poorly diversified foray into the real estate market.

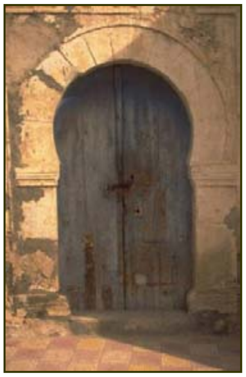
There are much better alternatives. Real estate as an asset class is not as extensively securitized as most industrial assets. Times are changing, however, Real Estate Investment Trusts (REITs) have evolved as a reliable public investment vehicle for real estate assets. REIT management packages commercial, office, apartment, and retail property and passes the income back to investors. REIT investors become diversified landlords. Today, there are over 100 REITs trading on the various exchanges.

The best way for the average investor to take advantage of the REIT market is through a passive market basket approach. The Vanguard Group offers an index that invests in the REITs comprising the Morgan Stanley REIT index. However, many brokerage platforms such as Charles Schwab do not support transactions in this mutual fund because of its low expense ratio.

Fortunately, there is an alternative. The Streettracks REIT index product trades as an Exchange Traded Fund (ETF) on the American Stock Exchange. Like the Vanguard mutual fund, it invests in a market basket of REITs and has low expenses. Unlike the mutual fund, it trades like a stock. It is priced throughout the day. Anyone can buy it regardless of their brokerage platform.

The case for real estate in an investment portfolio is compelling. And it is not simply because it's been "hot" the last two years. In the long run, the aggregate stock market will likely outperform real estate assets.

The real portfolio benefit of real estate is that its value has historically been independent of major market movements. Like bonds, it makes a good hedge. Unlike bonds, real estate returns have outpaced inflation by a significant margin.



College Funding: Financial Aid and Savings Plans

There has been a lot written about college funding in the news over the past year. The tax bill signed into law last June liberalized the tax advantages available to families putting funds aside for education. Both Section 529 plans and Education IRAs shelter the income of qualified distributions against income tax.

These savings options are important but, for many families, their child's eligibility for financial aid remains a key concern. I would like to address today's financial aid picture in the context of family wealth and the titling of their assets.

The most common form of financial aid is the loan. 60% of financial aid comes in this form and most are guaranteed by the federal government as Stafford Loans and Parents Plus loans. The former are made to students while the latter are made to parents.

The current interest rate environment has reduced borrowing costs significantly. Stafford and Plus rates are reset each July 1st and were most recently quoted at 4.06% and 4.89%. These are the lowest rates in history and the interest may be tax deductible. Subsidized loans are an attractive way to fund a college education and many dual income families are eligible.

Most universities follow federal guidelines in determining financial need. In principal, a family's financial resources are evaluated and an *expected family contribution* is computed. The difference between the cost of college and the *expected family contribution* serves as the benchmark for financial aid packages.

Each applicant must complete the Free Application for Federal Student Aid (FAFSA) and submit it to the federal processor after January 1 for the upcoming school year. The processor will send the results to the colleges listed on the application. Schools award money on a "first come, first served basis" so it is best to apply before March 1, or by the college's priority deadline. The size of the financial aid package is a function of the assets and income of both the student and the parents. For the purposes of calculating the *expected family contribution* to a college education, federal guidelines assign much greater weight to assets and income titled in the name of the student rather than the parent.

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That raises an interesting issue. The Education IRA shelters the income on assets committed to educate the child. However, assets so committed are held in the name of the child thereby reducing the financial advantage of the program. For every dollar in his name, the student is expected to contribute $0.35 to college expenses. For every dollar retained in the parent's name, the expected family contribution increases by nor more than $0.055.

Census data indicates that only 51% of the population over 25 has attended college and only about half of those folks graduate. There is no guarantee that your children will take full advantage of the funds that you've set aside for them. Moral to the story? Tax-advantaged savings vehicles are great but they commit a family's assets to educational expenses that may never be required.

Indexed equity products are well suited to the long investment horizon of a child's college education. They also realize little in the way of taxable income and can remain within the custody of the parents. For these reasons, I usually counsel that parents retain control of a significant share of the assets that they are reserving for their children's education.