

For Clients and Friends of Financial Connections

The first quarter saw mostly red ink in the financial markets. It is somewhat unusual for both stocks and bonds to decline. The S&P 500 was down 2.2% the first three months, and intermediate bonds dropped 0.6%. Also unusual, mid-cap stocks (medium sized companies) outperformed both larger- and smaller-cap stocks. After years of being the best performer, small caps fared the worst, with the Russell 2000 dropping 5.3% through March while the S&P 400 (mid-cap index) was down only 0.4%. Among other asset classes, foreign bonds dropped almost 3% in the first quarter, due to the dollar retracing some of its losses. Still, commodity futures had another up quarter—the bright spot so far this year.

“Alternative Investments”

This phrase covers many styles of investing and is one of the buzz words experts often used to describe anything from hedge funds to pork bellies. Financial Connections uses the phrase to refer to investments that have a low correlation to the stock and bond markets.

But do you remember the saying that if you keep clothes long enough, they will come back in style again—bell bottoms, anyone? Sometimes the saying also applies to investments. For instance, Merger Fund has been part of many portfolios for over 10 years. It has a low correlation with the S&P 500. Today, Merger is considered to be in the hedge fund category and still has a low correlation with the S&P 500.

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**Quarterly Newsletter,
1st Quarter 2005,
4/18/2005**

SAN RAFAEL OFFICE

As most of you know, I (Jill) moved to San Rafael in 2001 from Mill Valley. After 12 years of commuting, I decided it was time to open a satellite office in Marin and, fortunately, found office space within walking distance from my home.

I plan to spend two days a week in San Rafael (Monday and Wednesday) and three days a week in Berkeley. Brian continues to work full time from Berkeley.

If any of you feel like coming to Marin and enjoying lunch over there before or after a meeting, please let me know. ☺

“The essence of investment management is the management of risks, not the management of returns.”

Benjamin Graham
The Intelligent Investor

CRUISING INSTEAD OF ASSISTED LIVING

The November 2004 issue of *The Journal of the American Geriatrics Society* wrote an article comparing the 20-year cost of living in an assisted living facility versus the 20-year cost of cruising on a ship.

It was almost the same. According to the article, on a typical cruise ship, the cost for a double-occupancy cabin over 20-years was \$230,497. The national average cost of living in an assisted living facility for the same time period was \$228,075 (higher in the Bay Area).

If you think about it, the amenities on a cruise ship are similar. Both offer meals (perhaps better on a cruise ship), medical facilities, housekeeping, laundry and social activities. Of course the ship can't provide help with toileting and other activities of daily living but it is an interesting idea, isn't it?

Source: *Journal of Financial Planning*, January 2005

FOR CLIENTS AND FRIENDS...

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We use several styles or types of alternative investments: Treasury Inflation Protected Securities (TIPS); funds whose holdings (stocks and bonds) are held in international currency (which performs better when the dollar declines); commodities (which perform better during inflationary times), real estate and funds with low volatility and correlation to the stock market.

We are studying funds that combine some of the above styles or types into a single fund. This may be a more efficient and less volatile approach than individual funds.

Quarterly reports

Enclosed are your reports for this quarter. Also included is our annual disclosure update (Form ADV) and our Privacy Statement.

Please give us a call if you would like to review your portfolio(s) or discuss your current financial situation, present and future.

FINANCIAL CONNECTIONS

This newsletter is written quarterly by Financial Connections. Please contact Financial Connections if there are any changes in your financial situation or investment objective(s). Remember, past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this newsletter, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Information herein should not be construed as legal advice.

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THE PROBLEM OF SOCIAL SECURITY

There is no shortage of opinions on how to deal with the possible shortfall in Social Security funding. We will try to articulate some of the issues and alternatives as objectively as possible.

Background

Social Security is a pay-as-you-go system. Your payroll taxes pay for current beneficiaries of Social Security. The excess collected from payroll taxes goes into a trust fund that invests in U.S. Treasury bonds. The government has taken excess cash from previous years and spent it as part of the federal budget—replacing the funds it used with IOUs.

In 2018 the outflows for benefits are scheduled to exceed the inflows received from payroll taxes. Two questions stand out: How long will Social Security be able to pay full benefits, and when will the government have to start repaying the IOUs?

Payment into Social Security

- ◆ In 1935, 42 workers contributed to Social Security for each recipient.
- ◆ In 1950, 16 workers contributed to the system for each recipient.
- ◆ Currently, 3 workers contribute for each recipient.
- ◆ By 2050, only 2 workers will contribute for each recipient.

Payment out of Social Security

When the government has to repay the IOUs, its options are to

- ◆ Raise payroll tax by increasing the cap on contributions
- ◆ Reduce benefits
- ◆ Borrow more
- ◆ All of the above

Other issues discussed are

- ◆ Using private accounts
- ◆ Changing the calculation of Social Security benefits. Currently, the increase is based on the rate of wage growth. An alternative plan is to use the Consumer Price Index instead. The change would reduce benefits, since wage growth is about 1.1% more than the CPI.
- ◆ Reducing spousal benefits

Little Known Facts of Interest

Of businesses founded in 1994, 5% survived to 2004. (Family Firm Institute)

One-third of American adults state they are not living the American Dream. (National League of Cities)

4.9% is the estimated annual rate of investment return over the next 5 years for people with \$1-\$5 million of investable assets. (Boston Consulting Group)

In 1571, Elizabeth I wore what is recorded as the first “armlet of gold, all fairly encrusted with rubies and diamonds having the closing thereof a small clock.”

The first wristwatch recorded was in 1790 in Geneva, Switzerland (but should we give some credit to Elizabeth’s goldsmiths?)

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LESSONS FROM TERRY SCHIAVO

Whether or not we want to be kept alive with a feeding tube, none of us want to participate in the drama we saw Terry and her family experience.

It reinforces one lesson: we need to state our wishes, in advance and in writing, while we are still able. If you who do not have a written Advance Directive, we urge you to execute one immediately. Or if you have one that is a few years old, you should make a new one; privacy rules have been updated. We also recommend you discuss your wishes with children and other loved ones; they and the person you designate to carry out your wishes need to hear you say what you want at the end of life.

For couples who are not married, it is critical that you update forms and carry them with you at all times. We are not always in our home territory when illness befalls us.

Methods to complete Advance Directives:

- ◆ Contact your estate attorney or your medical carrier
- ◆ Go to the California Medical Association web site: <http://www.cmanet.org/>
- ◆ Ask Financial Connections to forward a PDF file (we are not providing legal advice but providing a place to start considering the issues)

Don't wait. This is important to you and your loved ones.

Jill D. Hollander

FEWER EMPLOYEES OFFERED HEALTH BENEFITS BY THEIR COMPANIES

The Employee Benefit Research Institute studied the latest data from the Census Bureau and the Department of Health and Human Services of employer sponsored health insurance. They estimate 29% of early retirees (those retiring before they are eligible for Medicare) had employer sponsored health insurance, down from 39% in 1997. The trend is expected to continue.

While the rise of health-care costs and the aging population partly explain the decline, the institute's report singled out a 1990 Federal Accounting Standard Board rule that forced firms to show retiree health-benefits as a liability on their financial statements.

James Klein, president of the American Benefits Council said employees should lower their expectation of employer based health coverage and save more on their own for future health care expenses.

THE PROBLEM OF SOCIAL SECURITY *continued from inside page*

This subject is too complex for the space available here. What is best for you depends on your age and your investments, and on whether you have a company-sponsored pension plan or Social Security alone to live on in retirement. And we haven't even discussed the financial difficulties of Medicare! Some people suggest both systems need an overhaul at the same time.

Brian Pon