



# Wealth Architecture™ Digest

*Often people do not plan because they see only what is, and they do not have a vision of what can be. Something is always possible. We believe that, with vision, the possibilities are almost unlimited.*

## What Do Global Interest Rates Say?

As I wrote in the lead article, here in the US short term interest rates have been on the rise for the past two years. The Federal Reserve has raised short term interest rates, while long term rates are almost unchanged, making the yield curve virtually flat from six months to ten years. But what about other countries.

According to Bloomberg.com on January 26<sup>th</sup> both the United Kingdom and Australia had inverted yield curves. In Australia, their one-year government bonds were yielding 5.49%,

while the five-year bonds yielded 5.29%. The UK inversion was even more pronounced, with three-month paper being 4.45% and twenty-year bonds yielding 4.01%.

The most remarkable government obligations are in Japan. There, the three-month bill yields 1/10% – that’s right, almost ZERO. Even the five-year Japanese government bonds are yielding only 41/100%, less than 1/100<sup>th</sup> of US Treasury obligations. With Japan’s significant trade surplus with the US, it can borrow from the Japanese public,

and reinvest the money at 100 times the yield (before reducing returns slightly to hedge the currencies).

To me, global interest rates are not necessarily saying that there will be minimal inflation over the long term, although here in the US the Federal Reserve works hard to reduce inflationary pressures. Instead, the demand for our longer term treasuries is keeping a lid (for now), on their yield. While I make no predictions, I believe that there is significant risk in being long on the yield curve at a time when the

yields are still near historical lows.

The US Treasury statistics on the historical yields provides some food for thought. The average yield (calculated monthly) of the 10-year treasury over the past **52 years** is 6.53%, and even over the past 10 years it is 5.19%. The only 10-year period with lower average rates than today was the 1950s!

As an investor it is important that you understand the dynamics and risks in fixed income as well as stocks.

## Looking Back, Looking Forward

By Richard Haas

As we look back on 2005 and look forward to another election year it might be helpful to look at the significant events and changes that we have had to react to as we plan to maintain financial stability. While we read about the improving economy, there are continuing concerns that it is not making a difference for many workers, even though many corporations are experiencing record profits. But how are investors doing?

The answer is not as simple as one might think. Last year the Dow Jones Industrial Average was down for the first time since 2002, the S&P 500 was up 3%, and the NASDAQ Composite was up less than 2%. The Philadelphia Oil Service Index was up 45.89% and the Gold & Silver Index was up 25.17% (Source: NY Times 12/28/05). Each day The New York Times publishes a list of the twenty “favorite” stocks (held by the largest number of accounts at Merrill Lynch) and how they have performed. Through December 27<sup>th</sup> 16 of the 20 were down, and if an investor had bought an equal dollar amount of each at the beginning of the year, he/she would have be down 5.34% through the 27<sup>th</sup>.

There has been a great deal of talk about the improving economy and employment, but here too the results are mixed. As Paul Krugman wrote in The New York Times on December 5, 2005, “Even after adjusting for inflation, profits have risen more than fifty percent since the last quarter of 2001. But real wage and salary income is up less than seven percent.” He went on to point out that “average hourly earnings of nonsupervisory workers, adjusted for inflation, are lower now than when the recovery began.”

The year has been good to “savers,” but bad for borrowers, as short-term interest rates have dramatically increased. Six month T Bills have increased in yield from 2.6% to 4.34%, while the 10-year Treasury yield was virtually unchanged for the year.

On December 27<sup>th</sup> the US Treasury reported that the yield on the 6 month bill was 4.35%, while the 10 year treasury bond yield was 4.34% – a totally flat yield curve. This has caused the 5 year variable mortgages to rise from about 4.25% to near 6%, while the 30 year fixed rates hover around the same 6%, as they were early last year. *(continued on page 2)*

### Special Interest

“Would you rather scrub a bathroom than plan for retirement? If you answered “yes,” you are not alone: In a new survey, 31% of Americans gave the same response.... By the way... most participants in that survey said they’d pick lifetime health benefits over a pension.” (Source: Parade Magazine, San Jose Mercury 1/22/06)

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*Financial Catalyst Group was founded in 1977 to help successful people articulate their goals, and realize their dreams to protect and preserve their hard-earned wealth. At Financial Catalyst Group we provide unique Wealth Architecture™ services that result in the implementation of value-added plans for the responsible transfer of wealth through the generations. We specialize in working with families that desire to provide a legacy to their families and their communities, making gifts instead of paying transfer taxes. We work closely with these families and their advisors to form a strong, results-oriented team.*

## FCG NEWS

On January 1st we said, “good bye” to Carol Ford as she left Financial Catalyst Group to pursue other interests. We wish her well.

Richard Haas, President, Advisor  
JP Puette, LTC Specialist, Advisor  
Suzette Engdahl, Client Service Representative  
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## Looking Back Looking Forward (from front page)

Many people think that one of the primary reasons that long-term interest rates have remained stable, while short-term rates have risen, is that there has been significant *foreign* demand for our debt securities. America's balance of payments deficit continues at record levels. In 2004 the deficit was over \$650 *billion*, and in 2005 it will reach over 750 billion (Source: *Foreign Trade Division, US Census Bureau*)! For 2005 our trade deficit with China alone was almost \$200

billion. As a result of these continued deficits, Japan and China together hold almost **\$1 trillion** of our treasury securities. A need/desire of either country to repatriate a significant amount of that money would play real havoc with both the value of the dollar and interest rates.

It is difficult to understand what the longer term results will be of our exploding trade imbalance. In 1995 the total deficit was \$96.4 billion, about one-eighth this year's estimate.

Over the past ten years our imports have almost doubled, while our exports have increased about 35%. With more competition (based on lower wages) from overseas causing problems for everything from technology to auto parts, it is hard to know which sectors and companies will prosper in the U.S. Since the beginning of the new millennium both GM and Cisco stock prices have dropped about 70%! Working in Silicon Valley

we regularly meet people who talk about the local companies "coming back," and from a profit standpoint many certainly have rebounded. Cisco's earnings for the year ending July, 2005 were a record \$5.7 billion, with earnings per share of \$.87, more than double the \$.36 per share for 2000 – the year the stock hit \$80.

*(continued on page 3)*

## Is Silence Golden?

Over the past 35 years I have met with hundreds of families who all faced the dilemma of what to do with their wealth, when to transfer their assets, and when and how to talk about it with the younger generation. In most cases the choice of the senior generation has been that it is better for the family dynamic if money is not discussed. But is this really the most effective paradigm for dealing with family wealth?

As I enter my own "older years" I feel that I would like my children to understand and hopefully share my values about such things as work ethic, economic self-reliance,

responsibility to others, and the place of "money" in one's life. I'd like them to know what they need to learn to handle money in a responsible fashion, how to evaluate alternatives, and what they might expect from an inheritance.

Many parents believe that "if the children know that they will receive a significant inheritance, they may lose their initiative." However, even though they refuse to talk openly about their wealth or their plans for it, the estate planning documents disgorge the entire estate in a lump sum if the children are at least 35 at the time of the parents' death. For some

children it's a bit like winning the lottery. Changes in lifestyle, changes in values, and changes in spouses occur all too often.

Why do so many people believe that if little is said, and if heirs are "older," it is better to say nothing than discussing it earlier? With many people living into their 90s, their children often will receive their inheritance *after* they have retired. If they never had significant wealth before, will they really know more about how to use it when they have spent a lifetime without facing the issues of wealth?

Of course this is relative, but where the older generation leaves even 1-2 million dollars to an adult child who has never had "excess" money, concern and confusion can be significant. There are emotional as well as financial concerns. Where there are assets to be divided amongst siblings, even more problems develop, most of which could be reduced or resolved with open discussion versus silence.

I believe that open communication is the most productive way to assure that family wealth, of whatever amount, unites rather than divides.

## Gifting Paradigms

Another area of estate planning that is often ill-used is that of making gifts to younger generations. There are serious emotional and philosophical issues that affect the timing and amount of gifts made to children and grand children. Tradition, trust, and fear all play parts in

the decision-making process.

As one would expect, there are a wide range of views regarding making gifts during one's lifetime. Obviously, no one should make gifts unless they are absolutely financially independent, having "more than enough" to live the way they desire,

without ever running short. But what then? We hear everything from the "when I was growing up," to "they'll just blow it." Dealing with money, like most aspects of dealing with life in general, comes with experience. If the individual has no money to save or invest, he/she will never learn how to

deal with it, as I discussed in the previous article. Giving children money, along with the requirement to deal with it responsibly and intelligently, provides a way to see, bit by bit, what kind of guidance is needed. These evidence-based data help provide insight into how wealth

## The IRS "Dirty Dozen"

Each year the Internal Revenue Service lists the top tax scams calling them the "Dirty Dozen." Last year's report (IR-2005-19) listed some items that I found amusing enough to share with you. Incredibly many of these tax evasion ideas have been around for many years. Among the listed schemes were:

- Frivolous arguments including such things as "being required to file a 1040 violates the Fifth Amendment right against self incrimination, or the Fourth Amendment right to privacy."
- "Claim of Rights" Doctrine scheme wherein "a taxpayer files a return and attempts to take a deduction equal to the

total amount of the wages. The taxpayer labels the deduction as a *necessary expense for the production of income.*"

- "No Gain Deduction" is another amusing scam. Here a taxpayer takes a miscellaneous itemized deduction equal to all of his AGI stating "No Gain Realized." Interesting idea.

There are other serious abuses including identity theft and the abuses of charitable organizations and charitable deduction. Most of the abuses mentioned above are promoted, for a fee, through seminars for people who frequently have relatively little income. Snake oil is still available for sale in the 21<sup>st</sup> century!

## Looking Back, Looking Forward (from page 2)

Obviously, the rising profits of Cisco have not translated into a recovering stock price, as it stood at just over \$17 at the end of 2005 (even though it rose to about \$19 by January 27<sup>th</sup>).

Being a market leader in a particular business does not necessarily translate into stellar stock performance, as over the past year while Cisco's net profits rose 25%, the stock was down about 10%. Even market-

leader Wal-Mart, with profits up 50% over five years finds its stock down 10% over the same period.

For some, history does not necessarily counsel caution. Since going public a little over a year ago Google has had a great run, and in early January was trading at over \$475/share. But with a P/E of 95 versus Yahoo's 38 and Microsoft's 22 it appears pricey. Even so, one

analyst has raised his estimate to \$600/share, while Morningstar (with no stocks to sell) sees Google's fair value at \$254/share! Who is the expert?

I find it interesting that on January 9, 2006 the Dow Jones Industrial Average reached 11,000, re-attaining its level of June 7, 2001 – a zero return over 4 ½ years. By January 25<sup>th</sup> it had backed off to 10,709.

So what does the data tell us? Readers who have followed my writings over the years will remember my mantra: stay diversified. Betting on one or two sectors is risky, and concentrating in a few stocks is downright gambling. Also, predicting the results for the year is as unreliable as predicting mountain weather, so "dressing in layers" can be as healthy for your portfolio as for your body.

The indices mentioned are unmanaged and cannot be directly invested into. Past performance does not guarantee future results.

The opinions expressed are those of the writer and are subject to change with economic and market conditions. They are not meant as investment advice. Market forecasts cannot be guaranteed and may not come to pass.