WP&M

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Visit our Web site at www.wpam.com

Indianapolis
Telephone: 317-228-0800
Toll-free: 888-868-3855

New York
Telephone: 732-765-8387
Fax: 732-765-8279

E-mail
John Guy
john@wpam.com

Nancy Haddock
nancy@wpam.com

Renege

The call came at 11:59 p.m., exactly three days after acceptance: “The seller has taken a higher price,” said the realtor.

The seller had reneged on an accepted proposition. The seller took an opportunity, probably with satisfaction, perhaps joy, maybe a sense of good luck, or even a misplaced feeling of skillful manipulation.

“What can we do?” asked my daughter and son-in-law.

“Nothing,” said their agent. “The renege is illegal, but enforcement is impossible, requiring months in the courts.”

So began another sleepless night, with frustration and tears. They had looked for a new home almost two months, trying to settle in a new community, with new jobs and the uncertainties of unfamiliarity. They thought that the biggest piece of the puzzle, a place to live, had been found and placed. They began to imagine modifications to the home. They talked to their attorney and their mortgage and insurance agents. They imagined life in the new home. They were excited. Then, at midnight, an unethical seller smashed their dreams, causing them again to experience the anxieties of a new home search, the additional time with the realtor. After more than a month of trips in a realtor’s car, they had to start again, because an opportunistic seller had reneged. The seller received more money, but by breaking the deal, by ignoring the “handshake,” the seller caused chaos. If buyers or sellers reneged on only one percent of transactions, the result would be social and financial chaos. Fortunately, most Americans understand. Most Americans make good on their commitments.

Conrad Hilton told about his negotiations with Henry Crown, then owner of what now is known as the Chicago Hilton. The two men talked for hours and agreed on a price. They shook hands. No papers. No proposition. No written record or contract. A few days later, Henry Crown received a higher offer. Mr. Crown told the new potential buyer, “I have a handshake with Mr. Hilton. I must honor that handshake.” From this and other experiences, Mr. Hilton presented three principles of business. He said that the seller must have a profit, the buyer must have a bargain, and deals must be final.

Securities markets could not exist without firm and final oral contracts. In my 30 years as a stockbroker, no client attempted to change a transaction after a stock had risen above the sale price, or declined below the purchase price, but a colleague faced the first problem. The seller of a stock called a week after his order

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Changing Advisors

Down markets create personal stress. Some investors seek relief from stress by changing investment styles and/or advisors.[1] The change is not unlike putting on clean socks while hiking. The trip is the same, but it feels better, for a while.

When changing advisors or custodial representatives, investors should control two important factors. The first factor is expense. The second is diversification.

While no investor can control or affect the future course of investment values, investors can control expenses of investing. These expenses are commissions, fees, and taxes.

Investors save commissions by reducing the number of transactions and by gaining confidence, through study and experience, that securities acquired have superior prospects to securities sold.

Investors control fees by carefully reading prospectuses of packaged products, such as mutual funds. An especially burdensome fee obligation occurs when an investor switches from no-load or low-load mutual funds to mutual funds having high internal fees. Incurring such fees is not necessary, because any change of investment style, even a change to cash, can be accomplished within the family of funds offered by every no-load or low-load mutual fund organization. Especially frustrating to a knowledgeable observer is the investor who unintentionally incurs higher fees by changing advisors. This circumstance arises when an investor signs general transfer papers with a new advisor and then later learns that the new advisor cannot accept the no-load or low-load mutual funds held at the previous custodian. The choice then is either to sell the funds, and to acquire new assets at the new custodian, or to maintain the positions at the old custodian.

In every case, the investor is better off maintaining the old funds or switching to new funds in the same fund family. However, in most cases, the new relationship results in sale of the old funds and purchase of new funds in a new fund family.

Controlling the expense of taxes is to avoid ending a year with long-term realized capital gains.

If a new advisor sells or recommends sale of appreciated securities, the capital gain consequences can be large. Investors should be aware of this possibility as well as of opportunities to avoid gains, such as by realizing offsetting losses, by contributing appreciated securities to charity, or by delaying sale.

Maintaining valid diversification is another important goal for investors who change advisors, especially for investors having multiple investment advisor relationships. When making a change, the investor must be certain that total net worth is spread among different investment styles, and among at least ten industries in equity portfolios. This seems simple. It is not. The reason for the difficulty is that names of mutual funds often do not reflect the style or content of the funds. Also, investors usually do not comprehensively review multiple custodial statements received from different custodians. This effort requires examining all statements side by side, or producing a consolidated report. Without consolidated reporting, observing the level of diversification is between difficult and impossible.

The most personally daunting aspect of changing advisors is informing the old advisor. To avoid personal embarrassment and awkwardness, most investors do not inform the old advisor prior to making a change. Instead, investors fill out transfer papers at the offices of the new advisor. Then, the old advisor hears about the change indirectly, without explanation. By avoiding a personal conversation with the old advisor, the investor suffers two consequences. The important and most measurable consequence is incurrence of unnecessary expense that could be avoided by talking openly with the old advisor. Any professional, whether doctor, lawyer, accountant, or investment advisor, understands that some clients will leave. Though it is personally frustrating, the professional knows that change happens. Once a change is announced and explained, the best advice for reducing costs of the change will be rendered by the old advisor, because he or she best understands the nature of assets presently held. The other consequence of not informing the old advisor in advance is unnecessary creation of permanent personal resentment.

[1] Changing advisors inherently results in a change of investment style, because each investment advisor has a unique world view.

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The Bear Market

The magnitude of our bear market, and the pain it has inflicted, are shown in *The New York Times'* daily list of "The Favorites."

"The Favorites" are twenty stocks held by the largest number of accounts at Merrill Lynch.

They are big names, familiar to all, powerful and enduring companies that lead business and provide valuable, necessary services. The list includes Exxon, GE, Wal-Mart, and Merck.

As of October 2, not one of the twenty companies had increased in price since January 1.

The company with the least decline was Johnson & Johnson, down 4.7 %. The greatest decline was Lucent, down over 85 %. Most showed declines between 40 % and 60 %.

We believe that no investor has made money the last two years. While some specialized accounts have shown profit (such as a few hedge funds), no individual, properly diversified among many asset classes, has experienced an increase in personal net worth. A few investors, imprudently nondiversified and/or using speculative techniques such as margin, probably are at the precipice.

The positive side of this negative news is that we all are in it together. We rise and fall together, and when the tide turns, we will float higher, together. Only those among us who jump ship, or who change from a familiar vessel to an unknown ship (see story on changing advisors), will miss the next opportunity. To encourage investors to be calm and patient, Wealth Planning&Management includes the following paragraph in client policy letters:

Some argue that decline is around the corner. My response is that WP&M does not time the market. We do not attempt to predict prices in the short run. Portfolios are fully invested at all times on the belief that if we sell at the wrong time, we might miss the next upward move. Furthermore, we purchase shares of quality enterprises that are likely to be in business many years. On the other hand, we believe that downward market adjustments are normal. We just do not know when they will occur. The best we can say is that if you and I do business twenty years, we are likely to experience at least three periods of negative returns. At least one of those periods will be a major adjustment that tests our emotions and our patience.

Predicting the Market

The desire to predict, or to hear a prediction, is profound. We want to know the future. But, we cannot. A not-uncommon conversation between WP&M and a client goes like this:

"What do you think of the market?" asks the client.

"We do not predict," says John or Nancy.

"OK. I understand. We will buy and hold. By the way, what do you think of the economy?"

"We do not predict the economy."

"Yes, true. That is difficult. Maybe impossible. Did you notice the unemployment figures last week? Do you have an idea what will happen to total employment?"

And so on, with each new sentence forming another attempt to obtain a prediction.

An outstanding investment newsletter, "The Babson Staff Letter," dealt with this problem in August of this year. It listed the following as "The Perennial Unpredictables:"

1. What stock prices will do next week, month, or year.

2. When the economy will change direction and for how long.

3. Which way political winds will blow.

4. Where the course of international developments will lead.

However, all is not lost, because the letter provided this list of predictables:

1. The population and labor forces will continue to grow.

2. More people will need more goods and services.

3. Research will develop new products and new techniques, creating more jobs, greater productivity, and higher demand.

4. The dollar's buying power will keep shrinking.

5. Well-managed companies with favorable long-term characteristics will continue to make above-average progress in earnings and dividends.

And the letter concluded:

"Prudent, successful investors accept that there are limits to the information they can know with certainty. They expect the unexpected but don't try to predict it. They diversify their portfolios so as to limit its impact, and they use time and compounding to minimize the financial disruptions of near-term market vagaries."[2]

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[2] "The Babson Staff Letter," David L. Babson & Company, Inc., One Memorial Drive, Cambridge, Massachusetts 02142, Friday, August 30, 2002, issue written by Edwin D. Everett.

Renege,

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to sell to claim that he had not placed the sell order, that he was entitled to the subsequent higher price. The result of this false claim was hours and hours of pain and expense for both my colleague and the firm. The broker, the manager, the regional manager, the firm's attorneys, the client's attorneys, all engaged in fruitless discussions before the client met his responsibility. The cost of these discussions was staggering and pointless. Our system survives because reneges are aberrations.

All of us face the problem—daily. What do we do when the soup we purchased today at Kroger is at a lower price tomorrow at A&P? Do we return the one and buy the other? What about the consumer who purchases the wrong product? Does he return the product a week later, having removed it from the package, having attempted to install the product? (At a Car Quest in Newport, a handwritten sign says: "If you purchased the wrong part, you have a spare part.")

While the morality of business is sometimes murky, and the definition of a handshake is not always clear, all parties to a business transaction must keep commitments. Without adherence to this principle, business is impossible, social strife inevitable, and freedom is threatened.

A Tax Revolt

(We should pay more?)

Investor Warren Buffett does not mind sending checks to Uncle Sam. "This is the price of liberty," he said. Taxes also are the price of valuable services.

The United States Weather Bureau is worth every tax dollar we pay, and probably more. During the hurricane season of 2001, we observed its phenomenal accuracy in predicting the course of hurricane Michelle, allowing us (John and Chichi) to plan to protect ourselves. At the same time, and much more important, tens of thousands of people in Cuba were warned to defend themselves against this onslaught. This year, the forecasts for hurricane Isidore and hurricane Lilli saved many lives and gave people the opportunity to protect their property. The bureau also accurately predicted residual effects of these storms as far north as Maine.

In Indianapolis in October of this year, the weather bureau was instrumental in saving lives before a freak line of tornadoes crossed the city. By using warning sirens and media broadcasts, hundreds of children were led to take protective actions in their schools.

On another night this year, the bureau told us that high winds, building to 50 knots, would start at 10 p.m. and ease off by 11 a.m. the next morning. We secured the deck, closed the hatches, and watched as the bureau's prediction played out right on schedule.

In cooperation with Internet providers (especially universities), cell phone and satellite phone technology, radio facsimile services, global positioning satellite services, and the builders and managers of both weather data satellites and satellites that project photographs, every person can access weather data that is relevant to their location.

For sailors, farmers, snow removal planners, organizers of outdoor sports, persons planning vacations, aviators, fishermen, sponsors of outdoor entertainment, providers and consumers of energy, and hundreds more, the historic data maintained by the bureau, and its daily forecasts, make our lives more manageable, and more safe. Its services are worth the taxes we pay.

Good night, Dorothy. You done good.

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