BEDEL FINANCIAL
CONSULTING, INC.

Financial Planning and Investment Management

Spring 2002

Are You and Your Portfolio Marching in Sync?

"How long will my money last?" It is a seemingly simple question that can become very complicated, very quickly. And it is a question that we hear quite often. If you want to determine whether your lifetime and the lifetime of your portfolio are on the same time schedule, use this chart as a starting place for basic information. It can give you a "snapshot" look at your portfolio but is not designed to take into account individual variables.

As you review the chart, note the importance of your long-term investment return. A 1 percent difference can significantly impact the life of your portfolio. This is why we place so much importance on developing the appropriate asset allocation for your personal situation and assuring that the investment selection is effectively meeting your goals.

Annual withdrawal as a percentage of investment assets

Number of years until funds are depleted:

Investment return less 3% inflation	16%	15%	14%	13%	12%	11%	10%	9%	8%	7%	6%	5%
1%	7	7	8	8	9	10	12	14	16	20	26	37
2%	7	7	8	9	10	11	13	15	18	23	32	62
3%	7	8	8	9	10	12	14	17	21	28	49	•
4%	7	8	9	10	11	13	15	19	25	40	•	•
5%	8	8	9	10	12	14	17	22	33	•	•	•
6%	8	9	10	11	13	16	20	28	•	•	•	•
7%	8	9	10	12	14	18	25	•	•	•	•	•
8%	9	10	11	13	16	22	45	•	•	•	•	•

• Portfolio is expected to last indefinitely.

Chart courtesy of *Individual Investors Guide to the Top Mutual Funds*, 21st ed.

Charting Your Portfolio's Life Expectancy

Follow these steps to determine the life expectancy of your portfolio.

Estimate your annual withdrawal as a percentage of the total investment assets that will be used for this distribution by dividing the amount of the annual withdrawal by the total investment assets. For example, if you withdraw $60,000 per year from a portfolio worth $750,000, the percentage would be 8 percent ($60,000 / $750,000).

Determine your expected (but not guaranteed) rate of return. We prefer to use 6 percent for fixed income and 10 percent for equities, the long-term averages for each asset class. Depending upon your asset allocation, your expected return will fall between 6 and 10 percent. For example, a portfolio with an asset allocation of 50 percent fixed income and 50 percent equities would have an expected rate of return of 8 percent.

Determine your real rate of return by subtracting a 3 percent inflation rate from your expected rate of return. We use an average annual inflation rate of 3 percent because we anticipate low inflation rates — now a high priority for the Federal Reserve — to continue for the foreseeable future. In reality though, inflation numbers can vary widely. Remember when inflation was in the high teens in the early '80s? Workers whose pay increases fluctuate with changes in the cost of living are especially vulnerable to the highs and lows of inflation. And nothing is totally exempt. For example, in the early 1920s you could buy a White Castle hamburger for only a nickel. Now you'll pay nearly 50 cents — an average annual inflation rate of 2.8 percent!

The point where the percentage of your annual withdrawal (on the horizontal axis) and your real rate of return (on the vertical axis) intersect is the life expectancy, in years, of your investment portfolio. Using the chart to plot our scenario, a withdrawal rate of 8 percent, an expected rate of return on your assets of 8 percent, minus 3 percent for inflation shows that your portfolio would last for 33 years.

Comparing Life Expectancies

The next step is to compare your portfolio's life expectancy with your own. To be conservative, you should estimate your life expectancy and then add a few years to that figure.

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In This Issue

From Elaine

New Places — New Faces

I am writing this letter as I return from Tokyo where I represented the United States at the International Certified Financial Planner Council (CFP). The meeting was very productive and the hospitality of our Japanese hosts made the trip delightful.

Elaine Bedel

In February, I represented both the CFP Board and the state of Indiana as a delegate to *The 2002 National Summit on Retirement Savings* in Washington D. C. Two hundred delegates were asked to focus on one main issue: Americans are not saving adequately for retirement. President Bush's address to the group further emphasized the importance of retirement savings. Our feature article, "Are You and Your Portfolio Marching in Sync?," also addresses this issue. The delegation suggested policy changes for small business retirement plans and ways to minimize barriers to personal saving. My appreciation to Senators Lugar and Bayh and Congressman Burton for placing my name in nomination with Secretary of Labor, Elaine Choa.

Also in February, I was a guest speaker at the 24th annual consumer Money Show in Orlando, Florida. This show attracts several thousand participants and, to my delight, four Bedel Financial clients were in the audience!

In March, I spoke at a similar consumer show sponsored by the *Boston Globe*, again on the topic of financial planning. Some of you may know that my oldest son is a senior at Boston College, so a trip to Bean Town is always welcome! During this particular trip, I was a special guest on Bob Glovsky's call-in radio show. Bob Glovsky is a very highly respected Financial Planner in the Boston Area. This was a treat for me because I always enjoy discussing financial planning and answering questions from listeners! The hot topics this time were investment diversification and Enron.

On the home front, we welcomed a new member to our staff during the first quarter. Brianne Campbell is our new Administrative Assistant/Receptionist. You may have already met or spoken with her. She replaced Tanya Richter, who has taken on the responsibilities of the Operations Coordinator from Tim Zimmerman. Tim left to follow his career aspirations as a member of the Franklin Township Fire Department. We welcome Brianne, congratulate Tanya on her promotion and wish Tim the best as he pursues his new career.

If you have any questions as you review the articles on retirement portfolios, qualified personal residence trusts or hedge funds, please call or e-mail us.

Sincerely,

Elaine

Elaine E. Bedel, CFP™

Industry News

Hedge Funds: Risky Business or Savvy Strategy?

There has been a lot of talk over the past year or so about the use of hedge funds in personal investment portfolios. Many people think a hedge fund is similar to a regular mutual fund, but nothing could be further from the truth.

A hedge fund is actually a small business unit, often organized as a limited partnership or limited liability company. Generally it is not registered with the Securities and Exchange Commission. A management company or promoter operates it and, in turn, hires a manager to invest the funds using a specific investment strategy.

It works like this. Promoters invite a limited number of investors to join the fund, as limited partners or members, and own a piece of the business. Investors are generally shielded from personal liability, but their original investment capital remains totally at risk. The stability of their investment depends solely upon the performance of the fund.

Almost all hedge funds are offered only to "accredited investors" — people who have at least $1 million in investment assets or who earn more than $200,000 annually. Minimum investment requirements of typically $500,000 or more from each individual investor, ensure that these funds are reserved for investors with a very high net worth or large institutions, such as pension or endowment funds.

Growing popularity among investors has prompted the organization of a new type of hedge fund — "fund of funds" — in which the promoter selects several hedge fund managers to invest portions of the fund. The theory: The risk is spread out among several different investment managers and/or strategies. Even though the minimum investment amount is often less than $100,000 for these "fund of funds," the investor is still required to be "accredited."

Hedge funds choose investment managers whose expertise is in selecting securities that are under- or over-priced in the marketplace at any given time. To reduce risks, the investment manager may purchase securities deemed to be under-valued in the short run, while simultaneously selling borrowed securities that are overpriced.

If the manager bets correctly, the hedge fund will make money as the value of one stock goes up and the other goes down. Most funds use sophisticated computer software to identify these pricing anomalies. Since these pricing opportunities tend to be very small and last for only short periods of time, the hedge fund will often borrow funds to increase profits on successful trades.

The major investment risks for hedge funds stem from taking positions in securities based upon the *anticipated* moves in those securities in a relatively short window of time…and then having the securities not perform as expected. If borrowed funds (leverage) were used to increase investment returns, the

Client Dream — Client Reality

Qualified Personal Residence Trusts

Do you have a primary residence, second home or family vacation home that you would like to pass on to your children? If your answer is "yes," then a Qualified Personal Residence Trust (QPRT) is an option to consider. The QPRT offers you the advantage of saving money on estate taxes by gifting the property at a discounted value. To do this, however, you must turn over your assets to your children prior to your death.

For example, if you are 70 years old and want to transfer a $1 million house to your children, you would transfer ownership of the house to a QPRT, but retain the right to live in the house. At the time you make the transfer, a gift value is determined. The longer the term of the trust, the greater the discount that is used to determine the gift value of the house.

At the end of the specified time, *i.e.* the trust term, your children, who are the beneficiaries of the trust, become the owners. If you die before the trust term, the house is returned to your estate at the full fair-market value. If you live beyond the trust term, the entire asset value is removed from your estate.

Therefore, determining the appropriate term for the trust is very important. The longer the trust term, the lower the gift value, but you also increase the odds that you will not outlive the trust.

…determining the appropriate term for the trust is very important.

If you live beyond the trust term, your children own the home. In order for you to continue to live in the home, you must begin paying rent to your children. The rent that you pay is additional funds moved from your estate to your children.

The provisions of the QPRT allow the house to be sold during the period of the trust. A replacement house can be purchased or the funds can be invested with the income being paid to you for the remaining duration of the trust.

This strategy can allow you to transfer the residence to your children, reduce your estate value for tax purposes and allow you to continue to enjoy the benefits of the property for your lifetime.•

ADV Form Request

As a client, you have the opportunity to request the latest update of Bedel Financial Consulting, Inc.'s ADV Form Part II, as required by the Security and Exchange Commission. Please let us know if you would like to receive the latest version.

fund's equity may not be adequate to cover the outstanding loans if the trades don't proceed as planned. This could result in bankruptcy.

Other hedge fund characteristics also need to be taken into consideration by potential investors:

- Fees associated with hedge funds are higher than other passive investments since managers often receive incentive fees of up to 25 percent of the profits in addition to the normal administrative fees of 1 or 2 percent.
- Investor funds are subject to withdrawal restrictions, often requiring 60 days prior notice, quarterly or semi-annually.
- Hedge funds are not currently regulated by the Securities and Exchange Commission, therefore minimal disclosures are made to investors. It is not unusual for the investments within the hedge fund to be undisclosed to the investor. Minimal disclosures can also mean that investors may not be informed of management issues — the risk undertaken, and/or how closely the manager is adhering to the fund's investment policy.

That said, why are hedge funds so popular? Superior investment talent, for one. The higher incentive fee charged by most hedge fund agreements gives the investment manager the money to hire some of the best talent in the marketplace. Secondly, most hedge funds try to target risk and volatility at a lower level than the equity markets by combining different investment strategies that make a profit regardless of which direction the markets go in the short run. According to Alliance Capital Management, Inc. and based upon the current investment climate, an investor should look for annual compounded returns of 8 –12 percent with volatility lower than that of the stock market.

Bedel Financial Consulting, Inc., is reviewing several hedge fund strategies, as well as performance of funds under different investment managers. We will keep you apprised of our activities in this area.•

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If your portfolio's life expectancy does not match your own, play with the numbers to see what scenario brings them into alignment. For example, if you based your annual withdrawal on 8 percent and came up short of funds, try using 7 percent. You might be surprised at the difference one percent can make — it can add many more years to your portfolio and may be an easy adjustment for you to make.

Staying on top of changes

At Bedel Financial, we provide an answer to this question during your initial financial planning session. However we suggest that, at the very least, you do a periodic portfolio check-up to make sure you are still on track. Any unexpected results should be an indicator that you need to take a more detailed look into your portfolio. A revision to your investment strategy may also be in order. If you'd like a more detailed analysis geared to your individual portfolio or your retirement strategy, contact either Elaine Bedel or Shelly Willingham.•

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Financial Planning and Investment Management

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Your Questions

Average Budget Information

Q: *How does my spending compare with the national average?*

A: Everyone's budget varies according to personal circumstances, preferences, priorities and needs. However, it sometimes helps to see how your spending compares with the national average. The chart below, which reflects the national average, should give you some guidance.

According to a 1997 Bureau of Labor Statistics survey, Americans spend this percentage of their income on the following items each year.

Housing & Furnishings	30.44%	Other Transportation	3.99%
Taxes	9.47%	Other Expenditures	3.96%
Pension & Social Security	6.84%	Apparel & Services	3.81%
Transportation – Vehicles	6.70%	Cash Contributions	2.95%
Food at home	6.33%	Gasoline & Oil	2.51%
Health Care & Insurance	5.68%	Personal Care Products	1.28%
Utilities	5.44%	Life & Other Personal Insurance	1.10%
Food away from home	4.80%		
Entertainment & Travel	4.70%	TOTAL	100.00%

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If you know someone who might like to receive this newsletter, please let us know and we will add them to our list. Our newsletters are also available on our Web site at **www.BedelFinancial.com**.

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