

Fall 2003



## Some Mutual Funds Rate Low on the Ethics Scale

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“Rule number one: don’t underestimate the other guy’s greed.” Al Pacino said this in Scarface. We thought these words of wisdom were intended for the world of drug trafficking. Unfortunately, today they seem to apply to the world of mutual funds.

In the 90s, the stock market served as an incubator for some positive ideas, such as call-ahead seating and effectively using the Internet for financial transactions. On the negative side, that climate fueled the greed of many. As a result, company employees from the CEO down to back-office operations managers were encouraged and rewarded for looking after their own interests first and foremost, sometimes to the detriment of their shareholders.

Mutual fund companies who don’t heed the advice of Oscar-winner Al Pacino may be hearing from New York Attorney General Eliot Spitzer. As many of you are probably aware, Spitzer recently made allegations of trading abuses against several major mutual fund companies including Janus, Strong, Bank of America and Banc One.

Two types of improprieties have been uncovered. One is improper behavior and the other illegal.

First, large investors were allowed to market time in and out of mutual funds. These investors were able to buy shares of a fund one day and sell them the next day. This gave a significant advantage to the short-term trader at the expense of the long-term shareholder.

Here is how the first scenario works. A short-term trader invests \$1 million in a \$9 million mutual fund, bringing the fund’s total assets to \$10 million. The mutual fund goes up 1 percent the next day and the short-term trader sells his shares immediately for a \$10,000 profit.

While this transaction benefits the short-term trader, long-term shareholders

could lose \$10,000 or more since the mutual fund was never able to invest the \$1 million. The potential to increase the fund by 1.1 percent (fully invested) was lost. Instead, there was only a 1 percent gain (large cash position).

This practice is not illegal. In fact, some mutual funds were created with the short-term trader in mind. Many fund companies, however, explicitly state that short-term trading is a violation, making those who practice it in violation of the rules of their prospectus, not to mention the trust of their clients.

The second type of impropriety is after-market trading, a practice allowing large investors to buy and sell shares of a mutual fund several hours after the market has closed. There are many occasions when late-breaking news can provide investors with more than an educated guess as to what the market will do the next day. Economic data, company earnings and even geopolitical events can turn the uncertainty of short-term stock market performance into a “sure thing.” Again, long-term investors are hurt, while late traders earn substantial returns with very little risk.

This practice is illegal and reprehensible.

As a major proponent of mutual funds, we are disappointed that some mutual fund companies have put their greed ahead of the interests of their shareholders.

If you own shares of mutual funds from any of these companies, what should you do? The best way to answer this question is to tell you what we will do. We will continue to keep our clients’ interests number one, investing in shares of mutual funds that benefit them. However, these transgressions will certainly play a “starring role” in guiding our thought process and ultimately our decision on what we feel is in our clients’ best interest. ♦

*Contact Bill Wendling if you have questions or would like additional information regarding this topic.*

# From Elaine As Seasons Change, So Do We

It's that season...the chill is in the air and the footballs are flying as the High Schools begin the State Tournament and the Indianapolis Colts begin the season's end run. Good luck to them all!

I just returned from my last Schwab Institutional Advisory Board meeting. My two-year term has given me an opportunity to provide our input concerning any new developments directly to the executive members of Schwab Institutional. Schwab Institutional, the division of Schwab that works with us and is responsible for the accounts we manage for you, works continuously to improve the technology and the services that we provide you. Here are two prime examples:



- **Power of One.** Under this program, we can make 30 trades within the first 30 days for any new assets (minimum of \$250,000) deposited in a new or existing account during the fourth quarter of this year, *with no transaction fee*. That means we can assist you in consolidating accounts and reallocating assets with little or no transaction costs. This is a great opportunity for you to sell small stock positions and to reinvest proceeds for

free. We are pleased to be able to offer this cost-saving program.

- **E-confirmations.** This program allows you to receive your transaction confirmations via e-mail rather than the regular mail. If you haven't already taken advantage of this paperless option, let us know so we can enroll you.

While my former responsibilities with the advisory board often took me out of state, I've continued to be closely involved with the local community. *Inside Indiana Business* with Gerry Dick is a weekend news program about Indiana business that you won't want to miss. I have had the pleasure of appearing on the show periodically to discuss relevant financial planning topics. Their Web site,

[www.IndianaBusiness.com](http://www.IndianaBusiness.com), provides information on the show times as well as an opportunity to sign up for The Inside Edge, their complimentary daily e-newsletter. My weekly article appears on their site each Monday. For past articles, go to the contributor archive section. The year-end planning article enclosed in this newsletter was published there on October 20.

In each of our last two newsletters, we have introduced new members to our

firm. This one is no exception. We are pleased to have Julie Gilliam join us. She is supporting our financial planning staff as a financial planning specialist. Julie graduated from Texas Tech University in May with an undergraduate degree in Financial Planning. It is very impressive to note that she also passed the CFP® certification exam in July—no small accomplishment!

We have received positive comments from many of you about our newsletter. Some believe it so good that we must use professional writers! Well we do, but the professionals are all members of our staff! In response to your comments, we have added a byline for each article, which will allow you to follow up directly with the appropriate staff member if you have any questions.

Thanks to all who received and completed the client survey in November. This information is very helpful in allowing us to serve you better. We do listen and react—the last survey created this newsletter!

Best wishes for the upcoming holiday season.

Sincerely,

Elaine E. Bedel, CFP®

Charitable giving can either be encouraged or discouraged by the way the Internal Revenue Service (IRS) tax code is structured. This year both the Senate and the House have proposed legislation that will impact charitable giving. It remains to be seen which of the two plans will prevail. While both plans offer improved incentives over the present system, there are important differences.

Currently, only those who itemize their deductions on their federal tax returns can receive a tax benefit for their gifts. According to IRS data, only one-third of Americans utilize the Schedule A for itemized deductions on their tax returns. Those who do itemize, often

find that only a portion of their charitable giving is tax deductible due to the reduction on Schedule A based on their adjusted gross income.

This practice discourages charitable giving for many taxpayers: the two-thirds who do not itemize and a segment of the one-third who do itemize, but can only realize a deduction for a portion of their giving.

Both the Senate and the House plans will potentially increase the likelihood of charitable giving and impact charitable giving plans. The most significant feature in both proposed plans is to allow individuals to donate all or a portion of their retirement assets

## Industry Proposed Legislation Will

(Traditional and Roth IRAs) to charity during their lifetime, without recognizing the distribution as taxable income and without claiming a charitable deduction. This helps both “non-itemizers” and “itemizers.”

The Charity Aid, Recovery and Empowerment (CARE) Act passed by the Senate in April 2003, creates numerous incentives to encourage Americans to give to charities, including:

- the IRA charitable rollover that allows donors to directly transfer funds from their Traditional or Roth IRAs to a charitable organization;

# Client Dream — Client Reality

## Make Your IRA a Combo With a Roth on the Side!

Multiple IRAs, numerous custodians, different beneficiaries and distribution wishes—does this scenario, or a variation of it, sound familiar to you? If so, you probably find it difficult to keep everything straight, much less track the performance of your investments.

Having several IRAs does not allow you to invest more money. Your maximum annual contribution through tax year 2004 cannot exceed \$3,000 (\$3,500 if you are over age 50) no matter how many IRAs (traditional or Roth) you have.

Combining your IRAs can simplify your life and maybe even save you some money. All deductible and non-deductible traditional IRAs can be combined. The exception is Roth IRAs. They cannot be combined with traditional IRAs.

Changes in the tax rules in years 2001 and 2002 make it easier to combine traditional IRAs. In the past, it was necessary to create multiple IRAs prior to age 70 1/2, if you had multiple beneficiaries and wanted to provide greater flexibility for beneficiary distributions. Thanks to the provision

changes, your IRA can be divided into separate accounts, one for each of your named beneficiaries, after your death.

Minimum distributions must be taken from your traditional IRA accounts beginning in the year you become 70 1/2 years of age. (Minimum distributions are not required from Roth IRAs.) Combining IRA accounts will make the calculation and the distribution of the minimum amount much easier.

Combining IRAs makes sense from both a financial and record-keeping standpoint. If you have multiple IRAs at various custodians, you may be charged an annual fee by each one, especially if you do not meet certain minimum balances. By combining your IRAs, you may be able to avoid all fees since you now have one account with a larger balance. And consolidating your paperwork, makes your “investment and minimum distribution life” more manageable!

So, the question is, “Why haven’t you combined your IRAs?”•

Contact Shelly Willingham if you have questions or would like additional information regarding this topic.

### IRA Facts

According to Investment Company Institute data from June 2003:

- More than 41 percent of U.S. households, an estimated 45.2 million families, now own IRAs of some type. This is a 2 million increase over 2002 figures.
- Sixteen million households now own Roth IRAs, a 21 percent increase over 2002.

## Your Questions

### Inheritance Funds Advice

*Q: I just inherited a significant amount of money and wonder what things I need to consider?*

**A:** First, you should update your personal balance sheet to determine your financial position after receipt of these funds. Next, you should review your goals to determine if this inheritance will have a long-range impact on your objectives. If you have been anticipating this inheritance in your plans, now is the right time to find out how the actual amount will affect your goals. Finally, develop alternative uses for the funds in light of your updated financial position.

Listed below are some specific strategies to consider after receiving an inheritance:

- Consider reducing your personal debt.
- Evaluate and update your investment plan. An inheritance may have a significant affect on the asset allocation of your existing portfolio. Will the future income from these additional funds put you in a higher income tax bracket?
- Review and update your life insurance coverage.
- Update your estate plan.
- Consider allocating funds to a charitable organization. •

Contact Bill Howell if you have questions or would like additional information regarding these topics.

## y News

### Impact Charitable Giving

- the “non-itemizer” deduction that gives donors who do not itemize their taxes the opportunity to take a limited charitable deduction; and
  - enhanced incentives for gifts of food, books, computers and scientific property.
- In September 2003, the House passed its version—The Charitable Giving Act. This act contains a number of similar fundraising provisions such as the IRA Rollover provision and the “non-itemizer” deduction. However, there are key structural differences between the House and Senate versions of the bill, including:
- **Age restrictions.** The House version sets the age for a donor to transfer funds from an IRA to a charity at 70 1/2; the Senate version sets the age at 59 1/2.
  - **Gift type restrictions.** The House version provides income tax exclusions for amounts donors transfer from their IRA to charity, but only for an immediate or direct gift; the Senate version provides exclusions for either a direct gift or a deferred gift. With a deferred gift, the charity does not receive the funds until some time in the future, e.g., charitable remainder trust.

What happens from here? The important differences between these two bills will be reconciled during a conference committee led by Senate Finance Committee Chairman Charles Grassley (R-IA) and the House Ways and Means Chairman Bill Thomas (R-CA).

Bedel Financial Consulting supports the Senate version of the bill that gives donors more flexibility in their charitable-giving plans. We will keep you informed of the status of this landmark charitable-giving legislation. •

Contact Dawn Morley if you have questions or would like additional information regarding this topic.

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## Congratulations to

Bill Wendling, one of our investment managers. In September, the Association for Investment Management and Research (AIMR) awarded Bill the Chartered Financial Analyst (CFA) designation. The CFA designation is a globally recognized standard for measuring the competence and integrity of financial analysts. It is awarded only after the candidate successfully passes three rigorous exams and accumulates sufficient work experience in the field. WE ARE PROUD OF BILL'S ACCOMPLISHMENT. ●

## Corporate Calendar

Bedel Financial Consulting will  
be closed for business on the  
following days:

### Year 2003

**Thanksgiving** - November 28  
**Day after Thanksgiving** - November 29  
**Christmas Day** - December 25  
**Day After Christmas** - December 26

### Year 2004

**New Year's Day** - January 1  
**Day After New Year's Day** - January 2

## Thank you!

Thank you for your patience in waiting with us for SBC to correct their snafu and list us in the Business Section of the White Pages. We finally made it!

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