

How to Invest During Times of Global Uncertainty

Q There is a lot of uncertainty in the world now, which makes me nervous about investing. What percentage of a 401(k) plan should be in stocks now, especially considering the war on terrorism, possible war in Iraq and the nuclear standoff with North Korea?

A "Investors always face uncertainty in the stock market," says Cheryl Holland, a financial planner in Columbia, S.C., "and it is difficult for anyone to know exactly what impact a war would have. Historically, any type of crisis tends to drive stock prices lower, but a rebound typically occurs within 12 months. Nevertheless, continued fear of terrorism and a prolonged war could have a negative impact on equities in the long term."

According to Ms. Holland, though, investors should avoid the temptation to time the market. As you can see by the accompanying table, if you had missed the best 40 days in the stock market over the past 12 years, your returns would have been eliminated. Therefore, you should maintain

S&P 500 ANNUAL RETURNS	
1/1/1990-6/30/2002	
	Annualized Return (percent)
3,157 Trading Days	11.05
Minus the 10 Best Days	7.30
Minus the 20 Best Days	4.44
Minus the 30 Best Days	2.09
Minus the 40 Best Days	0.02

Source: Abacus Planning Group

your stock market allocation, regardless of the headlines. How great should that allocation be? "That depends on your ability to ride out short-term volatility," says Ms. Holland. "The more aggressive you need to be to achieve your goals, the more stocks you should hold."

A "classic" asset allocation would hold 60-65 percent in equities; you might want to hold more or less, depending on your risk tolerance and your time horizon. One way to reduce your exposure to geopolitical events is to put some of your equity money into foreign stocks. "You can diversify among economies as well as companies," says Ms. Holland.

Moreover, if you are investing a certain amount of funds in your 401(k) each month, you are dollar-cost averaging. "This can benefit you in market downturns," says Ms. Holland. "You won't begin to second guess yourself."

Q My adviser is recommending I invest 10-15 percent of my portfolio in a "tax credit fund" that invests in low-income housing. A 10-12 percent tax credit may be claimed on my return for each of the first 10 years I invest in this limited partnership, and then it is hoped to achieve a capital gain or at least a return of the original principle after 15 years.

A "I would not advise setting up an offshore trust, especially given today's anti-tax-shelter climate," says Ed Slott, a CPA in Rockville Centre, N.Y., who publishes Ed Slott's IRA Advisor newsletter. "Instead, focus on keeping your old plan protected from creditors, at least until malpractice coverage is obtained."

Your state, California, provides limited creditor protection for IRAs, according to Mr. Slott. "Instead of rolling your old plan into an IRA," he says, "you might be better off setting up a qualified plan for your current clinic. Then you can roll the funds from your former plan to the new plan."

Possibilities for the new plan include a Keogh or a 401(k), both of which would offer creditor protection under Federal law. A defined benefit plan would allow you to make larger contributions while also providing asset protection. "What about your personal assets? Consider putting them in your spouse's name," says Mr. Slott. "Check the limits on your excess liability 'umbrella' insurance policy—you might want to raise them."

Perhaps most of all, do everything possible to obtain new malpractice insurance. "I don't think you can be in business without it today," says Mr. Slott. "Once that coverage is in place, creditor protection issues will not be as great a concern. Then you can roll your former plan money into an IRA, which offers better estate planning and distribution options."

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A "A 10-15 percent portfolio allocation seems quite high for an investment that is all but guaranteed not to produce any cash flow," says Randy Bruce Blaustein, who heads an accounting and auditing firm in New York City. "Moreover, no one can predict property values in 15 years. Depending on the size of your portfolio, I probably would limit such an investment to an allocation of less than 5 percent."

In reality, you might not be able to invest 10-15 percent of your portfolio in such a partnership, because there are limits to the use of these credits. (You must invest in low-income housing to get Federal housing credits.)

For many investors, the upper limit can be found by performing two calculations. Find out your likely tax obligation before any credits and also find out when you'd be exposed to the alternative minimum tax (AMT). These credits can't be used to offset the AMT. You can carry forward unused credits for 15 years but you probably won't want to wait that long for tax benefits.

Suppose your regular tax bill would be \$7,000. Working with your tax pro, you determine that you'd trigger the AMT if you reduced your tax bill below \$3,000.

This would indicate that you could use up to \$4,000 worth of these credits per year—the difference between \$7,000 and \$3,000. Assuming 10 percent tax credits per year, the maximum amount you can effectively invest would be \$40,000.

You can invest in several different years but the total investment shouldn't exceed the recommended maximum for your tax situation. You don't have to invest that much, of course. Generally, affordable housing partnerships have minimum investments of \$5,000.

Tax credits probably will provide the only returns to investors for 10 years or more. Investors are not likely to receive cash flow from rents, which are held below market levels for low-income tenants.

Eventually, though, investors may receive additional returns from the properties in the partnership under the following scenarios:

- ◆ The partnerships may be able to refinance some or most of their properties, paying out the borrowed funds as tax-free cash to investors.
- ◆ Nonprofit housing groups may purchase the properties in order to maintain affordable rent levels.
- ◆ Another alternative is a sale to a new group of investors who'll be able to receive a new stream of tax credits.

Even if the real estate is ultimately sold for only half of the original value, investors may earn a decent return from all sources. If the properties hold their value or appreciate, investors' returns will be higher. These credits are not "recaptured" (paid back to the IRS) at the end of the deal, so there are no nasty tax-return surprises.

If you're interested, be sure to invest with a proven sponsor who'll rent to eligible tenants and maintain property values. Before investing, ask to see the sponsor's reports to investors in previous programs to see if they contain good or bad news. Ask if you can talk with existing investors to find out if they've been pleased, and ask your adviser if the sponsor will help your tax preparer handle the necessary tax return schedules.

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