

IAP FINANCIAL ADVISOR

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E-mails that tout stocks are costing investors big money. 3

The rich worry about inflation, adult child support, & more. 3

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Points of interest

- The first wave of baby boomers born between 1946 and 1964 are eligible for Social Security early retirement benefits in 2008.
- The richest boomers control the majority of the generation's wealth and will live off investment income.
- Younger foreign workers may step in to buy stocks from retired boomers.

THE BABY BOOM RETIREMENT WAVE
MAY NOT PUNISH THE STOCK MARKET

The largest generation in U.S. history is getting ready to retire, prompting dire predictions of a stock market bust.

Some market observers worry that baby boomers will sell off large amounts of financial assets to fund their retirements, while smaller generations that follow the boomers will not be able to purchase those assets.

The scariest predictions say the sell-off will result in a market meltdown that pushes down stock prices and reduces the rate of return on the stock market.

Don't sell your stocks yet, says the U.S. General Accounting Office. It studied the potential for a stock market bust when boomers retire and concluded it is not likely.

"Retiring boomers are not likely to sell financial assets in such a way as to cause a sharp and sudden decline in financial asset prices," the GAO said.

Who owns the stocks?
It is simplistic to think that boomers will have to sell all their investments in order to pay for retirement, the GAO said.

That's because most financial assets are held by the richest boomers, and they—like other rich retirees—will live mainly on the income from their investments.

The wealthiest 10% of boomers own more than two-thirds of the \$7.6 trillion held



Doom and gloomers predict a stock market crash caused by retiring baby boomers selling off their stocks to pay for retirement expenses.

by boomers in stocks, bonds, mutual funds, IRAs, and other retirement savings.

On average, the members of this group have \$1.2 million in financial assets and \$2 million in home equity and other investments.

"Research... indicates the wealthiest of these individuals tend to not sell their financial assets... instead, they choose to live from the income these assets generate," the GAO said.

Statistics on the wealthiest 10% of retirees from the generation preceding the boomers found that the majority actually had income

greater than they needed and that they tended to add to, rather than spend from, their investment portfolios.

Those retirees who do spend down investments in retirement tend to do so very slowly. That tendency, plus the extended 18-year range of initial retirement dates for the baby boomers, along with expected longer life expectancies in retirement, will mitigate against any sudden pressures on stocks.

Some predictions claim the boomers will drive down stock prices because they will sell off risky assets as they approach and enter retire-

FOREIGN STOCK BUYERS MAY STEP UP TO BUY BABY BOOMERS' STOCKS

ment and replace them with fixed income instruments.

Studies of current retiree behavior refutes that claim, the GAO says. Older retirees tend to hold onto their stock investments, it found.

Global economics

The dire predictions about U.S. boomer retirement also ignore the new globalism in financial markets. While there may be fewer U.S. workers to buy stocks from retired boomers, the growth in younger generations in the

rapidly modernizing Third World may provide a ready group of buyers, the GAO said.

Also, studies have shown demographic factors have little influence on stock markets. The real drivers of stock prices are macroeconomic and financial factors, the GAO said.

Finally, the GAO warned that baby boomers have more financial wealth at risk in real estate and that they should worry more about declines in housing prices affecting their



The global economy will mitigate the boomers' effect on stock prices.

retirements than about stock market declines.

WANT HIGH FUND RETURNS? CUT YOUR COSTS

Mutual fund investors can improve their returns by focusing on the costs of running individual funds, says former Vanguard Investments Chairman John C. Bogle.

"Costs clearly differentiate the superior performers from the inferior performers," he writes.

Bogle showed that costs matter in his newest book, "The Battle for the Soul of Capitalism" (Yale University Press, 2006).

He did a study of the gross and net returns of 942 funds that invested in U.S. stocks for the 10 years ended in February 2005.

The average cost of running the funds was 1.9%, a rate that included 1.2% in operating expenses and estimated portfolio transaction costs of 0.7%.

High cost = low return

Bogle found that the one-quarter of funds with the highest costs, averaging 3%, returned 9% a year on average to investors. However, the one-quarter of funds with the lowest cost, with expenses of

just 0.9%, returned 11.7% on average to investors.

"The low-cost funds enjoyed a premium of 30% per year in annual return over the high-cost funds, confirming the thesis that the higher the cost, the lower the total return," he wrote.

Higher risk as well

His study found that the highest-cost funds also assumed the most average risk.

"The high-cost quartile carried a risk that was an amazing 34% higher than the risk carried by the lowest-cost quartile," he wrote.

In addition, the high-cost funds had much higher turnover in their portfolios than did the low-cost funds, some 152% turnover per year vs. just 19% for the low-cost competitors.

This gave the low-cost investors an even bigger advantage in risk-adjusted returns, he wrote.

"The investor who simply sought out low-cost funds, then, enjoyed an amazing increase in annual risk-adjusted return from 8.1% to 11.9%, an enhancement of nearly 50% per year," he wrote.

Compounding the higher costs of the more expensive funds simply reduced their long-term returns, he notes.

Each dollar invested in a high-cost fund grew to \$2.18 over the 10-year period. Meanwhile, each dollar invested in a low-cost fund grew to an average \$3.07. "Fund investors would have improved their 10-year profit by 75%, simply by doing their fishing in the low-cost pond," he wrote.



Mutual fund managers who acted like Scrooges returned higher net profits to their investors.

The low-cost funds enjoyed a premium of 30% per year in annual return over the high-cost funds."

INVESTORS PAY DEARLY WHEN ACTING ON E-MAILS THAT TOUT HOT STOCKS

"Hot stock alert. This one is still climbing the stock charts."

"Watch it soar on Monday as shorts buy back!"

"The company is growing up fast. Invest now and you will not regret it."

It is a rare Internet user who doesn't find his or her e-mail basket filled with stock tout messages like these.

A new study of spam e-mails that tout unlisted stocks estimates that they account for as much as 10% of all e-mail traffic, with as many as 100 million junk messages sent each week.

What is more amazing, according to two university researchers, is that some recipients are acting on the "advice" given in these e-mails and are buying the stocks.

Tipsters are selling

Even worse, they do so despite disclaimers given in fine print at the end of most of these messages that say the senders plan to sell the very stocks they are recom-

mending.

The evidence is contained in a paper by Laura L. Frieder of Purdue and Jonathan L. Zittrain of Oxford.

They surveyed millions of e-mails received from 2004 through mid-2005 by an Internet group that monitors spam.

The e-mails recommended 300 so-called "Pink Sheet" stocks that are not traded on major stock exchanges.

Big price spikes

The study found a "significantly positive return" on the day most spam was received and on the day before. Within a day of that price spike, the average price of the stocks fell sharply, presumably because the spammers sold their shares at a profit.

The professors said it was surprising that the spam worked so well, since so much of the Internet public usually says it wants to avoid



Spammers are pocketing big money by pushing low-price stocks on the Internet.

spam.

"At least some part of the Internet public appears to be hungry for investing advice" and willing to follow advice that is "flatly against interest," they wrote.

It also calls into question the ease with which investors can act upon bad advice.

The Internet offers "one-click investing by amateurs who previously would have had brokers or other intermediaries to temper actions arising from their susceptibility to scams," they wrote.

"Within a day of that price spike, the average price of the stocks fell sharply, presumably because the spammers sold their shares at a profit."

THE RICH WORRY, CHILD SUPPORT, & MORE

They may have millions of dollars, but the rich aren't very confident these days.

A survey by the Spectrem Group found that millionaires are neutral about the economy after having been optimistic over the last year, it said.

The big worry is inflation, which was the top concern noted by participants in the survey.

Millionaires said inflation threatened their financial security more than the economy, unemployment, or high



energy prices, Spectrem said.

Still supporting kids

When do you stop supporting your children? Apparently never, found a survey of people aged 62 to 75 by Financial Freedom Senior Funding Corp. in California. It found that about half of survey participants were providing some assistance to children.

Many provided babysitting services, but 13% also said they provided some financial support to their kids.

Even worse, another 11%

said they still had an adult child living at home.

Meanwhile, almost 80% said they did not expect to be financial burdens to their children.

Rich people's burden

The wealthiest 1% of Americans controlled 33.4% of the nation's wealth in 2004. Their share grew from 32.7% three years earlier.

And if you want to find a millionaire, go to California, according to the Internal Revenue Service. That state held 572,000 millionaires out of 3.5 million in the United States.



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A LEGENDARY MANAGER OF HEDGE FUNDS WARNS INVESTORS AWAY

When Michael Steinhardt tells you not to invest in hedge funds, you had better take notice.

Steinhardt left the hedge fund business in 1995 after running one of the most successful funds ever.

He wrote a recent guest editorial in *The New York Times* excoriating the industry's marketing and warning most investors to avoid such funds.

"As recent history shows, the outsized expectations attached to the hedge fund mystique cannot be matched by performance across the board," he wrote.

Steinhardt said hedge funds remain appropriate for wealthy investors who can afford to gamble with small amounts of their net worth.

But the risky funds are dangerous and should be



Hedge funds are shaking down ordinary investors for high fees.

avoided by ordinary investors.

The industry has grown to \$1.5 trillion in assets mainly because it is a lucrative pursuit for managers.

"Realistically, there are a limited number of truly superior fund managers," he wrote. "Yet legions of managers earn extraordinary compensation for what, as the indices reveal, has been ordinary performance."

Hedge fund performance is dismal these days, he said.

Since the stock market bottom in 2002, a major index of hedge fund performance was beaten by the U.S. stock market in two out of three years.

From 1993 through 2005, the same index matched the total return of the Standard & Poors 500 Stocks index. This is a far cry from the traditional goal of hedge funds, which was to beat the market, he noted.

With so many competing funds, it is impossible for investors to identify the few who will beat the market, he said.

"Even the most sophisticated investors will be challenged, confirming once again that hedge funds are not designed for the masses," Steinhardt concluded.