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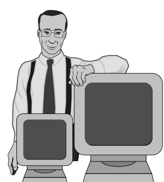

From The President's Desk

Ralph H. Phillips

From our family to yours, I would like to wish you a very happy, safe and blessed Holiday Season!

- **After nearly a year of work (and, many false starts) we are STILL in the process of updating our internet homepage. Please be patient with all of the "under construction" signs you see at www.kensingtonfinancial.com. A preliminary version should be up by January 31, 1999. Please feel free to let us know what you think about the new format.**
- **Huge congratulations go out to our friends Sean & Bonnie on the birth of their Son, Jesse Paul. He came into this world at a whopping 9 lb. and 20 ½"! Mother and Son are doing well.**
- **What a year in the Markets! We saw more volatility in 1998 than has been seen in many years. Causes? From my perspective, here are just a few of many: Who could have foreseen the Monica/Bill relationship? OR The Asian economic, currency and political crisis being allowed to fester for so long? OR The U.S. institutional lenders failing to properly manage their overseas exposure? That said, the United States STILL has the strongest economy in the World and as I write this, the DJIA is up 19% YTD and the S&P 500 is up nearly 20% YTD! I think we can all agree that the resiliency of the U.S. Markets' is truly amazing!**

So, my wish for you and for your families is for a Happy, Healthy,

Is Banking A Declining Industry?

Banks lost ground to other intermediaries in the share of assets under their control during the 1980s and 1990s. Indeed, the rapid growth of non-bank sources of credit and the increase in bank failures during the 1980s led many analysts to conclude that banking is a declining industry. Regulatory burdens and increasing competition have changed the business of banking over the past two decades. But is the banking industry in decline?

On the one hand, banks' assets make up about 25% of all assets held by financial institutions in 1995, down from 50% as recently as 1974. On the other hand, the ratio of bank assets to gross domestic product remained at about the same level in 1974 and 1994; these data do not suggest a decline in banking relative to the overall level of economic activity.

Another way to assess whether banking is a declining industry is to examine the trend in lending to non-financial businesses, the traditional activity of banks. It has been noted that over the period from 1979 to 1995, U.S. banks' share of real lending to non-farm, non-financial corporate business fell by one quarter from 20% to 15%, most of the decline occurring in the 1989- 1992 period. However, more than offsetting this fall in U.S. bank lending over the period was an increase in lending to U.S. corporations by foreign banks. Hence, taken together, U.S. and foreign banks' share of corporate lending shows no significant decline.

Banks have experienced strong competition in both their lending and deposit-taking activities in the 1980s and 1990s. On the lending side, the growth of the commercial paper market has made it possible for large, high quality corporate borrowers to raise more funds outside of bank loans. Additionally, finance companies can tap the commercial paper market for funds, then lend the proceeds to businesses and households. On the deposit side, banks face aggressive competition from money market mutual funds, which allow investors to write checks and pay higher rates of return than those typically offered on bank checking accounts.

(Continued on page 4)

How Much Risk Should You Tolerate In Your Portfolio?

Although all investments offer the potential for risk, you can take steps to understand and manage risk when building your own portfolio. Financial planners encourage their clients to evaluate their financial situations and their willingness to bear risk in determining whether an investment is appropriate.

In assessing the volatility of returns, financial planners recommend that you determine how far ahead your savings goal extends.

The longer your time horizon, the more you can focus on the growth potential of investments in stocks. Over the period from 1925 to 1994, one- year returns on stocks ranged between –43% and 54%, while 20- year returns ranged between 3% and 17%. For most people an important savings goal is retirement, and retirement savings make up a significant component of their wealth. If your retirement is many years away, you can take advantage of the opportunity for long-term gains offered by riskier investments such as common stock without much concern for short- term volatility in returns. Then as you approach retirement, you should adopt a more conservative strategy to reduce the risk of losing a substantial portion of your savings.

(Continued on page 4)

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"The market is like a train sitting on the tracks. You can see the direction it's heading but you cannot dictate the time of departure. Those investors who put the market on a timetable not only become frustrated but end up making foolish moves. Instead, get on the train, sit back, and enjoy the scenery." —*Roger Engemann*

Redesign of the $50 and $20 Bills Their New Features

They're crisp, clean, and green. But for most, the Federal Reserve's redesigned bills are subjects of widespread curiosity. Apparently, some storeowners have been refusing to accept the new bills. Because they look so different from the old bills, they assumed the new notes were less than legitimate. Some have even been noted as describing the new bills as "unique," adding, "they look like fakes." But, actually, the new bills were created to prevent counterfeiting. Treasury Secretary Robert Rubin said, "Today we do have a secure currency, but we must stay ahead of the rush of technology."

From the time the Federal Reserve began shipping the new bills from its 37 offices and branches, they started appearing in some banks and other depository institutions. Since then, the notes have become widely available in the United States and abroad.

The security design features for the newly issued currency are due to increases in color copier technology. These new features appeared first in the $100 Federal Reserve Note and will be gradually phased in to additional denominations. Existing currency and the new series will co- circulate until existing currency is withdrawn at the Federal Reserve banks and branches. Withdrawal will be based on normal wear. The older bills are not being demonetized.

These new features include a clear, inscribed polyester thread that has been incorporated into the paper of genuine currency. The thread is embedded in the paper and runs vertically through the clear field to the left of the Federal Reserve Seal on all notes except the $1 denomination. Printed on the thread is a denomination identifier. On $20 denomination and lower, the security thread has "USA" followed by the written denomination. For example, "USA TWENTY USA TWENTY" is repeated along the entire length of the thread. The inscriptions are printed so that they can be read from either the face or the back of the note. The thread and the printing can only been seen by holding the note up to a source of light.

In addition to the security thread, a line of microprinting appears on the rim of the portrait on $50 denominations. The words "THE UNITED STATES

(Continued on page 3)

Determinants of Portfolio Choice The Need For Portfolio Allocation

The financial system offers savers an array of assets to choose from. Such assets are stores of value, that is, they can be sold when the investor needs the funds to spend on goods and services. The types of financial assets that savers have held, on average, included, in 1995, 4.7% of financial assets in checkable deposits, 13% in bank savings and time deposits, 7.4% in equity mutual funds, 21% in stocks directly held, 3.3% through life insurance reserves, and 34.9% through pension fund reserves. A generation ago, things were different. In 1970, households kept a larger share of their savings in bank checking and saving accounts and life insurance reserves and smaller share in mutual funds and pension reserves. Two generations ago, in 1950, households held most of their financial assets in bank accounts, government securities, and stocks; mutual funds and pension reserves were not major stores of household wealth.

This shows two patterns. The first pattern is that investors divide their assets among different financial assets, and the second pattern is that these allocations change over time. The decisions an individual investor makes have to do with deciding which assets to include in a portfolio, or collection of assets, and how much to devote to each asset in a portfolio. What influences your choice?

The concept of portfolio allocation answers questions about portfolio choice and how an investor distributes his or her savings across alternative investments. Accordingly, investors evaluate five criteria when deciding what investments to make and how much to invest in each alternative. These **determinants of portfolio choice are:**

- The investors wealth or total stock of saving to be allocated,
- The expected return from the investment as compared with the expected return from other investments,
- The degree of risk of the asset as compared to the risk of other assets,
- The liquidity of the asset as compared to other assets, and
- The cost of acquiring information about the asset as compared to gathering information about other assets.

In looking at portfolio allocation, the dispersal of savings to different assets over time, the popularity of some assets has increased among investors, whereas that of others has declined.

Another reason is the tax treatment of different assets. Investors compare expected returns on alternative assets when making decisions about portfolio allocation. One component of differences in expected returns is different tax treatment.

Accordingly, we can explain trends in the way in which investors allocate their funds among different assets by the concept of portfolio choice. As the wealth of the population grows, investors are more likely to substitute luxury assets. Investments that reduce risk and information costs and increase liquidity become popular vehicles for investors who seek high expected returns. Shifts in taxation or

Roth IRA Technical Corrections

Earlier this year, the U.S. House of Representatives and Senate passed and President Clinton signed into law, the IRS Restructuring and Reform Act of 1998. What follows is an update of the highlights from H.R. 2676 that pertains to the Roth IRA.

- Only one five year holding period is required for any Roth IRA. The period begins with the date of the first contribution or conversion added to an account.
- Withdrawals taken from a conversion Roth IRA before the five year period has ended will be subject to a 10% penalty tax.
- A taxpayer may decide not to spread over four years the amount includable in income due to a conversion of a traditional IRA to a Roth IRA, and instead pay all taxes up front. (Note: The ability to spread the tax liability on the conversion amount over a four year period is only applicable to conversions done in 1998.)
- When a taxpayer that made a conversion dies during the above four year period, the taxable amount of the conversion not previously reported will be includable as income in the deceased's final tax return. An exception is made if the Roth IRA is inherited by a spouse. In this case, the spouse must include the outstanding conversion amount as part of his or her income over the remainder of the four year period.
- Individuals who wish to convert their traditional IRA to a Roth IRA can do so only in a year during which their adjusted gross income (AGI) does not exceed $100,000. The $100,000 AGI is calculated without including the amount of the conversion. A deductible regular IRA contribution can't be used to reduce an individual's AGI.
- The Roth distribution order has been set so that the first money coming out consists of annual contributions. This is followed by converted amounts on a first in / first out basis, after tax basis on the converted amount, and then the income/appreciation on any annual contributions or conversion amounts.
- Effective January 1, 2005, required minimum

(Continued on page 4)

Market Uncertainty

Market uncertainty is a continual dilemma that tends to lead the majority of investors into a lack of certainty about their investment choices. Due to ones preference of less risk to more risk, it is implied that people must be paid to take risk because investors require a higher interest rate on a more risky asset to induce him or her to hold it. Though this market strategy is understood, it should be recognized that volatility and uncertainty are necessary when dealing with investments. Although nothing can eliminate all risk, the effects can be combated through the steadfastness of long- term investing.

As a result of sharp market declines and fear of greater losses, it can be very tempting to redeem shares and even abandon long- term investment plans altogether. That is why investors are offered two key points to remain focused. First, declines of market cycles are natural and necessary. Second, unknown to many investors, losses aren't caused by the stock market; losses are caused by early distributions on ones retirement. Whenever investors do not take heed to these points, their real return is affected and real return depends on two things: the price on the day they invest and the value on the day they sell. Through research of average annual compound return over the past ten years, it shows a mean of 18.6%, and this only occurred four times since 1928. Because investors can set expectations too high, those in it for the long- term should set their realistic average return at about 10%. This will allow for fluctuations in the market but not lead to a lot of surprises for investors.

Several solutions are available to reduce choice and market uncertainty when choosing to invest. Global research is the first key. Know what's happening in other countries because this provides a foundation for evaluating investments in the United States. Additionally, keep your expectations under control, as well as, pick and choose an investment manager with a long- term focus. Also, diversify among different assets, different sizes and types of companies, and different geographic regions. Likewise, be aware risks such as currency inflation, political instability, different securities regulations and period of illiquidity can result from global

"November: This is one of the peculiarly dangerous months to speculate in stocks. The others are July, January, September, April, October, May, March, June, December, August, and February."
—Mark Twain

(Continued from "The Redesign of $50 and $20 Bill" on page 2)

OF AMERICA" are repeated along the sides of the portrait. As with the new security thread, the microprinting will also be gradually phased in on all denominations. To the naked eye, the microprinting appears as little more than a solid line and can only be read by using magnification. Neither of the new security features can be accurately reproduced by an office machine copier.

Also, there is the enlarged portrait. This feature spaces the portrait off center, making it harder to counterfeit. Next is the color shifting ink, which changes color when the bill is tilted in the light. Likewise, there is the watermark of the portrait, which appears holographically.

Each of these designations is printed in specific locations on the note. During manufacturing, the Bureau of Engraving and Printing uses these designations to identify the plate, which printed a specific note.

More than 13 million pieces of literature alerting consumers about the new bills have been printed in 20 languages, including Spanish, Chinese, Japanese, French and several Eastern European languages.

Redesigned versions of even smaller denominations -- $10, $5, and $1 – will be introduced into

(Continued from "How Much Risk" on page 1)

Finally, in assessing the volatility of returns, you should consider the effects of inflation and taxes. Your investment returns are (generally) subject to taxation, and your real returns to inflation. With these considerations in mind, over the period mentioned, "safe" government bonds would have brought you a less- than-volatile average annual yield of 4.7% before taxes and inflation but only 0.2% after taxes and inflation. Common stocks, however, yielded 10.2% before taxes and inflation and 3.9% after taxes and inflation.

(Continued from "Roth IRA Technical Corrections" on page 3)

distribution amounts are excluded from adjusted gross income for eligibility purposes under a conversion Roth.

- If a traditional IRA to Roth IRA conversion is made in 1998, for example, and the individual discovers early in 1999 the he is not eligible to fund a Roth IRA, a transfer back to the traditional IRA is permitted without penalty. However, the transfer back must be completed by the due date of the taxpayer's return for the year of the distribution.
- The tax on any withdrawal from a conversion Roth IRA, before all income taxes have been paid under a four year spread, becomes payable immediately in addition to the tax due under the four year period. For example, an investor who converts $28,000 in 1998 can spread the tax liability of that conversion amount over four years: let us say, $7,000 each year in 1998, 1999, 2000, and 2001. However, if a portion of that conversion amount is withdrawn in 1999, say, $13,000, the investor must pay taxes on the following amounts: $7,000 in 1998; $20,000 in 1999 ($7,000 for the 1999 tax year and a $13,000 express payment for the withdrawal amount); and $1,000 in the year 2000. The total taxable amount is not to exceed the conversion amount.

Kensington Financial Services, Inc. does not provide tax or legal advice. Alternative minimum tax rules may apply. The information provided here is in summary form. Please contact your Certified

TELL US WHAT YOU THINK!!

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Seminar: Financial Planning for Your Business

Kensington Financial Services, Inc., in conjunction with the StrongLand Chamber of Commerce presented the first of a four- part series of investment seminars in September of 1998. The seminar, entitled "Financial Planning for Your Business," attempted to educate employers about the various employee retirement accounts available, as well as, providing some insight into what type of retirement plan may be best suited for their business needs.

The speaker, Renee LeVeque, Vice President of Kensington Financial Services, Inc., offered a thorough and detailed presentation on such plans as Simplified Employee Pension Programs (SEP IRA), Savings Incentive Match Plan for Employees (SIMPLE IRA), Traditional 401(K) Pension Programs, and SIMPLE 401 (K)s. Along with providing a simplified definition of each plan, her presentation also included an outline of key points about each and what type of business each plan is tailored towards. Additionally, she provided the key benefits of each program and provided a booklet that answered common questions that one may have about the programs.

Her presentation went on to cover such topics as the advantages of long-term investing, as well as, market risks that individuals face when choosing to invest. This seminar was indeed a success and those interested in attending future programs are strongly encouraged to come out and learn about the benefits of retirement planning and market investing. Anyone interested in receiving Ms. LeVeque's booklet should call us at (724) 334- 1950 and request

(Continued from "Is Banking A Declining Industry?" on page 1)

Focusing just on traditional lending and deposit-taking activities probably understates banks' importance relative to non-bank competitors. The growth of off-balance- sheet- activities the biggest change in banks' business in the past two decades has helped banks to unbundle information and monitoring services from lending activities.

How important are these new activities? Between 1980 and 1995, banks' non-interest income almost doubled from 19% of total bank income to about 35%. Hence, while banks' direct lending role declined relative to other financial institutions, their indirect role expanded and viewed from the period since the 1950s, banks' share of intermediated assets has been fairly stable. It can be

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