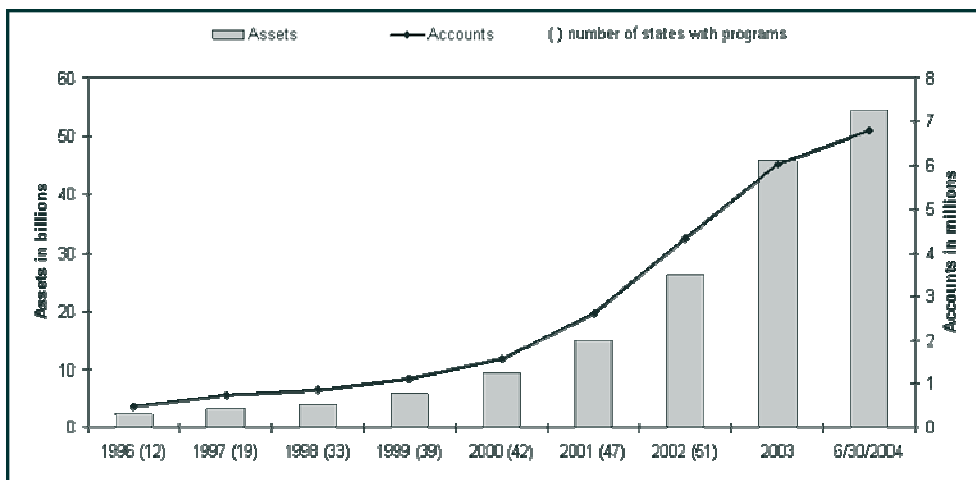




Canoe in the Rapids 1897, By Winslow Homer

## 529 College Savings Plans



Source: College Savings Plan Network

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## 529 College Savings Plans – The Good, the Bad, and the Ugly

529 College Savings Plans are a great place to start saving for your child or grandchild's education; however, research into the plan that you intend to invest is imperative. Fees can swamp investment returns, and up-front loads can be astronomical. Originally, Section 529 of the Internal Revenue Code was enacted to provide a savings vehicle for college similar to the 401(k) – uncomplicated and reasonably priced. However, many of the benefits of 529 Plans are being overshadowed by exorbitant fees and confusion on the multiple options available.

### The Good

529 Plans offer significant income tax advantages. The investment grows tax-free until the beneficiary attends college. Funds from the account can be withdrawn tax-free for the use of qualified college tuition, books, fees, and room and board. However, this tax benefit is set to expire in 2010 unless Congress renews it. For state income tax purposes, some states offer tax deductions to their residents. There are also gift and estate tax benefits to contributing to a 529 Plan. Currently, individuals can contribute up to \$55,000 per beneficiary into an account in a single year without being subject to gift tax (this assumes the account owner elects to have the \$55,000 treated as being made over a 5 year period and no other gifts are made to that beneficiary in the next 5 years). Therefore, a married couple can make contributions of \$110,000 in one year to a beneficiary. In addition, 529 Plans are not typically includable in an account owner's estate for federal estate tax purposes.



### The Bad

Nearly every state has its own plan, and some states even have multiple options (Nevada mar-

kets six). In all, there are over 70 different 529 Plans available in the United States, each with its own investment options and fees. Sorting through all of these plans can be overwhelming and time consuming. Often investors will not choose any plan for fear of making the wrong selection.

### The Ugly

One of the main determinations in choosing a 529 Plan is fees. As mentioned above, there are 70 different plans to choose from

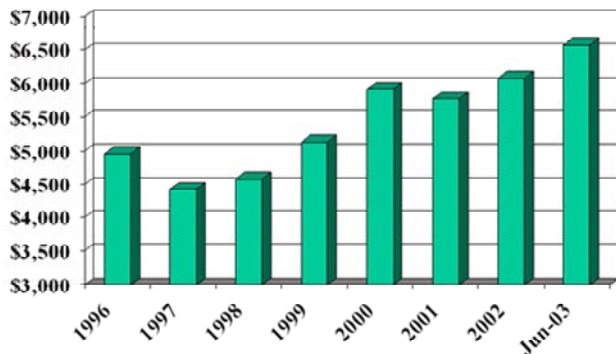


and nearly as many different levels of fees. As competition in 529 Plans has increased, states have looked to brokers to market their plans resulting in higher investor expenses. Sales loads on "advisor-sold" plans can be as high as 5.75% (as in Virginia's advisor-sold CollegeAmerica Plan), and annual expense ratios can be in excess of 2% (as in Wyoming's advisor-sold College Achievement Plan). In comparison, Utah's direct-sold plan has no sales-load and features low-cost Vanguard funds with expense ratios ranging from 0% (money-market fund) to 0.44% (age-based option). Excessive fees such as those found in many advisor-sold plans can often eliminate the benefit of the plan's tax deferral.

### The Solution

Thoroughly researching each state's plan is crucial before making a selection. For individuals living in a state with state income taxes, the first 529 plan that they should review is their own state's plan (if there is a corresponding state tax deduction available). For those individuals who do not have a state income tax or whose own state's plan is not appropriate, [www.SavingforCollege.com](http://www.SavingforCollege.com) is a great resource for information on all of the plans. As a benchmark for fees, consider funds with an expense ratio of no more than 1%. Three current low cost options with multiple investment choices are the plans in Iowa, Michigan, and Utah. Because of the myriad of choices available, clients have found it helpful to consult with us to help them make a more informed decision. ■

## Section 529 plan Average Account Size



Source: College Savings Plan Network

## College Cost Trends

- ◆ For the 2001-2002 academic year, tuition rates at public four-year institutions increased 7.7% and rates at private four-year colleges climbed 5.5%.
- ◆ Room and Board costs went up 6.6% at public four-year institutions.
- ◆ Since 1980, college costs have been rising at two to three times the rate on inflation.

Source: The College Board, 2002

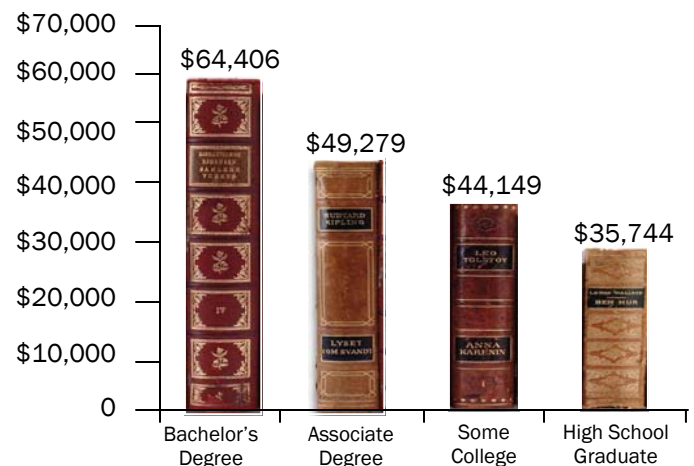
## College Planning

A study conducted in 2003 by the Investment Company Institute found some interesting facts concerning college savers surveyed:

- ◆ 31% were not aware of 529 Savings Plans
- ◆ 61% were aware of 529 Savings Plans but did not own one
- ◆ 8% owned a 529 Savings Plan

## Graduated Income

Studies show that college graduates earn nearly twice as much each year as those with only a high school education.



Source: The College Board, 2001

“An investment in knowledge always pays the best interest.”

- Benjamin Franklin

“Experience taught me a few things. One is to listen to your gut, no matter how good something sounds on paper. The second is that you’re generally better off sticking with what you know. And the third is that sometimes your best investments are the ones you don’t make.”

- Donald Trump

## Financial Markets Perspective

Hal Peterson—Chief Investment Officer  
 Matt Jachimiak—Portfolio Manager

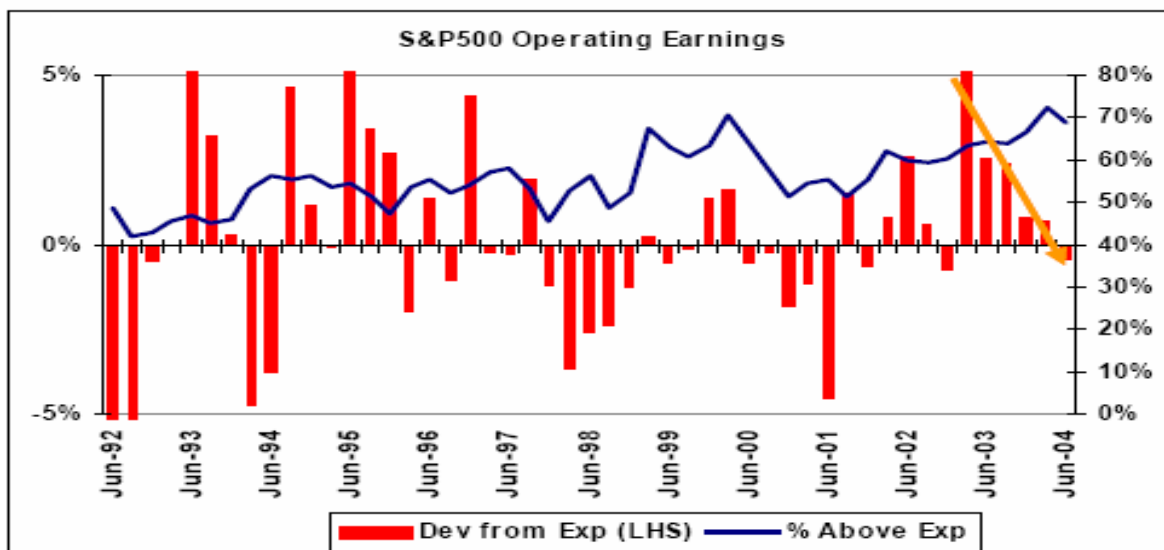
Most agree it has been a frustrating year in the stock market for the investors trying to squeeze out profits in a trendless market and for the many waiting it out on the sidelines and dying of boredom. Terrorist threats, the disappointing Iraqi peace and the confusing oil situation have not exactly instilled a sense of confidence. Likely the bigger problem for investors was their lack of belief in what have been positive underlying fundamentals. Early in the year when the economy was in a long stretch of 5%-plus economic growth, investors were more afraid of rising inflation and the start of aggressive Fed tightening. When the Fed did start to raise rates, investors at first did not believe it would stay on the promised measured pace. When investors were finally convinced the Fed would take a slow approach to tightening, they believed the worst about the economy when it took a temporary breather from its year-long rapid growth path. They refused to believe the Fed’s explanation that the soft patch was only temporary. Inflation is still very low, long-term interest rates remain historically low, and third quarter earnings will come in with a respectable 14%-15% gain. In short, it has been the year of the unbeliever, as far as the fundamentals are concerned. On the

terrorist front, early in the quarter investors appeared convinced that terrorists would make a big strike at the Democratic Convention, the Olympics and the Republican Convention in that order. As with all their economics fears, none of this actually occurred.

### Second Quarter Update

In our 2<sup>nd</sup> Quarter Newsletter we talked about how we felt corporate tax rates were at historic lows and that corporations would not see any earnings benefit from tax rates being lowered any further. We have continued our research into our thesis of slowing corporate profits and we continue to see evidence of this throughout the US market. The chart below shows the percentage of S&P 500 companies that have exceeded their earnings estimates which is represented by the blue line. The red bars indicate the average by which these companies have exceeded their estimates. The chart clearly shows that we have hit a peak with over 70% of S&P 500 companies exceeding estimates but we also see that the percentage by which these companies are beating expectations has dropped from 5% in 1<sup>st</sup> Quarter '03 to turning negative in the 2<sup>nd</sup> Quarter '04. It is not our belief that corporate earnings are being affected by historically low corporate tax rates but there is evidence showing that companies are having difficulty beating estimates and they will not get any benefit from lower tax rates in the future.

Sources: Barrington Research, Bloomberg L.P.



Sources: Thompson, Bloomberg, Julius Baer Investment Management

Below are relevant market indices for the quarter ended September 30, 2004:

Market Indices	3 <sup>rd</sup> Qtr	Y-T-D	1 Year	3 Year	5 Year	10 Year
LB Credit Bond Index	3.20%	3.35%	3.68%	5.88%	7.48%	7.66%
Dow Jones World Index	-0.82%	3.60%	18.25%	8.03%	-0.11%	6.83%
S&P 500 Index	-1.87%	1.50%	13.86%	4.04%	-1.31%	11.08%
Russell 2000 Index	-2.85%	3.71%	18.77%	13.71%	7.41%	9.86%
NASDAQ Composite Index	-7.37%	-5.32%	6.15%	8.18%	-7.13%	9.78%
MSCI EAFE Index	-0.23%	4.62%	22.52%	9.52%	-0.51%	4.34%
MSCI Emerging Markets Index	8.26%	7.41%	26.53%	25.94%	6.04%	0.10%
NAREIT Equity REIT Index (real estate)	8.23%	14.19%	25.51%	19.47%	18.28%	13.19%



The chart below provides the gross returns as of September 30, 2004 for structured model portfolios that we use as benchmarks for client portfolios. The model portfolio illustration below provides recent history as to how diversified portfolios perform. When comparing the indices above to the model portfolios below, one can quickly see the value of diversification. The goal at SCA is to implement portfolios for our clients with lower volatility, which over time provides enhanced returns. The model portfolios below are rebalanced monthly and do not take into account transaction fees, which differs from actual portfolio activity.

Diversified Portfolios	3 <sup>rd</sup> Qtr	Y-T-D	1 Year	3 Year	5 Year	10 Year
Fixed Income (0% equity, 100% fixed)	1.84%	1.59%	1.35%	3.99%	5.09%	6.00%
Income (20% equity, 80% fixed)	1.65%	2.77%	5.65%	6.62%	6.14%	7.23%
Income & Growth (40% equity, 60% fixed)	1.47%	3.96%	10.10%	9.20%	7.10%	8.39%
Growth & Income (60% equity, 40% fixed)	1.27%	5.12%	14.64%	11.75%	7.98%	9.47%
Growth (80% equity, 20% fixed)	1.06%	6.29%	19.32%	14.22%	8.76%	10.47%
Equity (100% equity, 0% fixed)	0.84%	7.44%	24.12%	16.64%	9.44%	11.39%

The model portfolios above are rebalanced monthly and do not take into account transaction fees, which differs from actual portfolio activity. Past performance cannot guarantee future results.

Source: Dimensional Advisors

## Practice News

### WE'RE MOVING...



*TO THE 16TH FLOOR*

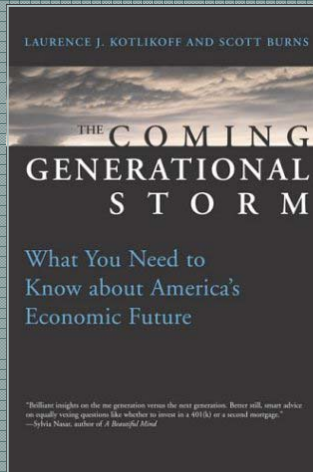
*FROM THE 9TH FLOOR*



**OUR MOVE IS SCHEDULED FOR THE WEEKEND OF  
NOVEMBER 13TH!**

### Suggested Reading:

**The Coming Generational  
Storm: What You Need to  
Know about America's  
Economic Future**



By Laurence J. Kotlikoff and Scott Burns

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