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Look Back—2nd Quarter 2013 & Bonds

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Just when we thought the stock and bond markets were destined to continue their relatively smooth upward trend – BAM – volatility returned in the second quarter 2013. Over the past few years, risk and rising markets have been predicated on the Federal Reserve continuing to pump an endless stream of money into the financial markets. On May 21, Federal Reserve Chairman Ben Bernanke said the central bank could start tapering bond purchases at the "next few meetings". Those few words sent stocks and bonds into convulsions creating a 5% June correction and downturn in the major U.S. markets. Realizing the torrent that he had unleashed, Bernanke blinked. He came back to explain that low interest rates would remain for quite some time and the bond-buying program would only gradually be removed. The stock market calmed to turn in a solid second quarter and also proved that the rising stock market of the last few years is being driven by Federal Reserve monetary policy and not by favorable business conditions. The bond markets did not fare as well; bonds will be discussed later in this article.

The second quarter 2013 scorecard saw both the DOW and S&P500 register +2.9% gains with the Russell 2000 slightly above that posting a +3.1% gain (Source: Wall Street Journal, 7-1-2013). The NASDAQ won second quarter honors with a highly respectable +4.15% return (Source: Dion's ETF Report, 2013, Volume 7). U.S. Stock Mutual Funds slightly underperformed the major market indexes with a +2.3% average return. The health/biotechnology mutual fund sector was the big winner with an average second quarter return of +5.00 and Gold oriented funds were the biggest losers with an average -35.0% downturn (Source: Wall Street Journal, 7-8-2013)

The headline story for the second quarter was actually in the bond markets. The Average Taxable Bond fund was down -2.2%. Ten separate bond categories make up this average in the Wall Street Journal. Municipal bond funds fared even worse than their taxable counterparts averaging -3.1% in losses. Four categories make up the Municipal component (Source: Wall Street Journal, 7-8-2013).

The second quarter downturn in bonds did not come without warning. In a rather unusual move on February 14, 2013, the Financial Industry Regulatory Authority (FINRA) issued an investor alert about the vulnerability of bonds and bond funds. FINRA stated, "Many economists believe that interest rates are not likely to get much lower and will eventually rise. If that is true, then outstanding bonds, particularly those with a low interest rate and high duration, may experience significant price drops as interest rates rise along the way." The downturn in bond prices did, in fact, happen and could continue to happen if/ when interest rates go up again.

Many investors have the misconception that bonds are risk free. That is not the case. Bonds are a security and usually display more stability than stocks; however, under the right conditions they too can go down. Bond prices are highly influenced by both interest rate risk and duration risk. When interest rates rise, bond prices fall and when interest rates fall, bond prices rise. This is the concept of interest rate risk. To understand this idea think of the teeter-totter you played on as a child. After you both got on, one side was always higher and the other lower depending on the momentum. That is what happens with bonds. Interest rate changes are the momentum that cause the up or down movement. Another major influence on bonds is duration risk. Duration risk is the sensitivity of a bond's price to a one percent change in interest rates. As an example, a client who invests $10,000 in a 10year U.S. Treasury note would see their principle fall by about $1,000 if rates rose by one percent.

There are differences in buying individual bonds and bond mutual funds. If you purchase an individual bond and hold it to maturity, you will receive interest payments along the way as well as the face value of the bond on the maturity date. The exception would be if there is a bankruptcy or default by the issuing company. Interest rate risk and duration risk are not an issue with individual bonds unless you sell the bond before the maturity date. Bond mutual funds, on the other hand, are sensitive to both interest rate and duration risk because the bonds held in these funds rarely ever mature. Deposits and redemptions take place in bond funds on a daily basis so there is a constant buying and selling of bonds in the account.

The details may be confusing but the lesson to remember is that losses are possible in both bonds and bond funds under certain conditions. The Money Management Program reviews all mutual fund bond positions on an ongoing basis and makes adjustments when needed. As an example, many bond funds being used in the Program were sold before the real downturn took place. If you have any questions on the investment strategies used in the Money Management Program please give me a call.

The guest article for this month is entitled, *Medicaid Myths: A Grain of Truth, but Mostly Myth*. It had been awhile since I attended an update session on Medicaid (not Medicare). Attorney Jack Bolling of Milford was offering a class through The Huron Valley Adult Ed program and I signed up for it. The class was very informative and Jack graciously gave me permission to publish one of the handouts. The information will be included in the next three newsletters. Take good care!!!

MEDICAID MYTHS;

A Grain of Truth, but Mostly Myth

Many people want to know when Medicaid will cover nursing home costs, which can easily run $96,000 a year or more! Not many people can pay those costs out of their regular income, so it doesn't take long to deplete your life savings. While long-term care insurance remains the best planning option for long-term care needs because of the freedom of choice and flexibility it offers, unfortunately many people are not insurable or the insurance is too expensive due to health, age, or fixed budgets. As a result, many people rely on advice from friends or relatives about how to get Medicaid to pay the cost for nursing home care. No two situations or fact patterns are alike. What worked for one family is not likely to work for you or your family and the law changes frequently.

Unfortunately, few lawyers know this area of the law; it is a complicated area and should only be handled by an attorney who practices primarily or exclusively in the area of Medicaid law. Consult an elder law attorney about your individual situation.
What follows are some common "myths" that if relied upon without seeking professional advice, can lead to erroneous decision making and may bring serious or even disastrous consequences. Often, these "myths" are partially correct, and are supplied by well meaning friends, relatives, or acquaintances but, usually they are just plain wrong!

1.Myth: "I am not going to even apply for Medicaid because it is only for people that have no money or any other way to pay for nursing home care. We have considerable savings, and a house, and cars, and other things of value, so we won't be eligible."
FACT: Don't be so sure! Many of the assets named above may not count against you for Medicaid qualification. Before you make the decision on your own or after hearing from a friend or relative that you can't even apply for Medicaid because you own "too much", it is always a good idea to consult an attorney. As a rule most attorneys will offer their initial consultation at no charge anyway. Ultimately, you may be correct in your assessment of your inability to qualify for benefits, but what if you are wrong and you spend or give away your assets and you didn't have to? Often times, mot, if not all, assets can be saved with proper planning!

2.Myth: "I have to give away everything (own to get Medicaid."
FACT: Basically, a person is permitted to own some property, and still be eligible for Medicaid. The trick comes in knowing what is "countable" and what is "non-countable" under the Medicaid rules. For example, an individual's homestead and automobile are exempt and not countable for Medicaid qualification purposes. In addition, certain types of prepaid burial contracts are non-countable. There are many other types of "non-countable property." The bottom line is, you don't need to be completely without assets to be Medicaid eligible.

3. Myth: "I can't give anything away and get Medicaid."
FACT: The Medicaid rules provide that a person can be disqualified for giving away property in some cases. But, a lot depends on what is given away, to whom, and when; it's complicated! Some asset transfers are not penalized under the Medicaid rules. Consult with an elder law lawyer who knows the Medicaid rules and the law..

4. Myth: "I have to wait 5 years after giving anything away to get Medicaid."
FACT: The disqualification period isn't always for 5 years and sometimes there is no disqualification at all. True, there is as-year "lookback" for some asset transfers under the Medicaid rules. This means that the Medicaid agency will look back at all transfers of property, including sales for less than market value. However, the rules penalizing transfers do not apply to all transfers. See #2 above. A change made by the Deficit Reduction Act of 2006, applies penalties going forward from the date of application when a person is otherwise eligible for benefits. This new rule is much more severe and can result in much longer penalty periods. If you are contemplating making transfers, seek professional legal assistance beforehand!

5. Myth: "I can keep all our marital property and my inherited property when my spouse gets Medicaid."
FACT: When a married person applies for Medicaid, assets in either or both spouse's names are considered by the Medicaid agency, even if a pre or post-nuptial agreement is in place. However, some assets won't be "countable" and you may keep a sizable portion, usually all of them, as an asset allowance if your spouse enters a nursing home. See #1 above. *The non-nursing home spouse will not become destitute in order to provide the proper care for their laved one!*

6. Myth: "If I put my property into my spouse's name, I will be eligible for Medicaid."
FACT: Assets are counted, regardless of which spouse's name they are in. However, the healthy spouse will be given several months to re-title assets from the name of the spouse that is in the nursing home, into the name of the healthy non-nursing home spouse.

7. Myth: "Medicare will cover my nursing home bill."
FACT: Medicare only covers a small amount of the nursing home care provided in this country. Many older people are surprised to learn this. In general, there are 20 days of full coverage if you go into the nursing home after at least three days in the hospital, and you are getting skilled care (not intermediate level care). Then, if you still need skilled care, you can get up to 80 days of partial coverage from Medicare. After that, you will either pay out-of-pocket, or you will need to qualify and get Medicaid, unless you have private long term care insurance.

Part I: 1 - 7 —— Part II & Part III (To follow in August & September Newsletters)

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