Steven G. Blum and Associates LLC

Guiding Families Through Every Aspect of Their Financial Lives

October 2005

What Is An ETF?

There has been a lot of hoopla in the financial press lately about ETFs and so this seems a good time to examine exactly what they are. ETF stands for Exchange Traded Fund. In essence, ETFs are index mutual funds that can be traded throughout the day on exchanges as if they were individual stocks.

The rise of ETFs represents significant new competition in the index mutual fund business and that has been good for investors. A number of companies have created these investment vehicles and some of them are operated at very low cost. For example, the iShares S&P 500 Index (trading symbol IVV) has internal fund operating fees of 0.09% - less than 1/10 of one percent. This has tended to drive down prices across the board for index mutual funds. By way of comparison, Vanguard's 500 Index Fund has operating fees of 0.18% and Fidelity recently cut operating fees on its S & P 500 index fund to 0.1%. (Compare this to a typical mutual fund which might have charges of 1 and ½% - 15 times as high). Overall, competition and lower costs for this important category of investments is a good thing.

The other major benefit of ETFs is that they can be traded whenever the stock market is open. In contrast to this, traditional open-end index mutual funds can only be bought or sold at one price each day. Thus, an investor has a theoretical opportunity to take advantage of a big rise or fall in the middle of the trading day that may not remain in place by the closing bell. This is touted as a big advantage – but it really isn't. If the stock market is falling sharply at mid-day, who among us can know that somehow it is going to recover by the end of that trading session? The truth is that the ability to trade intraday is only an advantage for speculators and, as we have said on a number of occasions, short term speculation in stocks is nothing more than gambling.

In summary, then, we conclude that ETFs are a useful investment tool. Like index mutual funds, they afford us very highly diversified, low cost investment options that make a whole lot of sense for rational investors. They have helped to drive down costs and that puts more money into our pockets. All-in-all, we are glad they have been created and are easily available to us. As for all the hype, though, about how this new vehicle has "changed how we invest" let me suggest this: put your thumb and forefinger about a ¼ inch apart. Take a look. That is how much of an improvement ETFs represent over the low cost index funds we have been using with clients for many years.

ASK MARY

What is the best way to save for my child's college education?

There are three investment strategies to save for college: custodial accounts; Coverdell Education Accounts; and Qualified Tuition Programs. The most popular of the three options is a Qualified Tuition Program, often called a "529"plan, (so named for its place in the tax code).

529 plans have been established by most states and can make all investment income on qualified college savings free from federal (and, in some cases, state) taxation. There is no income limit for participation and no cap on annual contributions (but talk to a professional before putting in more than $11,000 in a calendar year). Furthermore, you

Steven G. Blum and Associates LLC
801 Yale Ave, Suite 1212 / Swarthmore, PA 19081
Phone: 877-ASK-BLUM (1-877-275-2586) Fax: 801-437-3391
Website: www.stevengblum.com Email: stevenblum@stevengblum.com

do not even have to live in the state in whose plan you invest.

There are many things to consider before investing in a 529 plan. Although income on 529 plans is tax-free for college costs, there are major taxes and penalties if the money is not used for the purpose of education. For this reason, it's better to save for the tuition costs at the least expensive school you'd consider and have access to other funds that can be used for college (but could also be spent elsewhere) to provide the balance. Also, make sure you have fully invested in your retirement before saving in a 529 plan – “No one is going to give you financial aid to retire.”

For financial aid purposes, only 529 college savings plans that are owned by the parent or student are reported as assets and, as such, 5% to 6% of the money is assessed as part of the effective family contribution. One way to get around this is to have a grandparent, or someone other than the parent, be the account owner of the 529 plan. They can contribute up to $11,000 per year - $22,000 for married couples without any tax consequences.

Not all 529 plans are alike. Some carry much higher fees and have more limited investment options than others. Thus, it is important to do your homework when selecting the right plan for your family.