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## Tune Up Your IRA, Tune Out the IRS

By Terry Price

In recent newspaper articles, questions have arisen about the improper handling by some custodians of Individual Retirement Account (IRA) distributions when such accounts are inherited by beneficiaries. When IRAs began years ago, they were generally small in size and the impact of their distributions was likewise quite small. However, today, with rollovers from profit sharing and 401(k) plans and a robust stock market, IRAs are often the largest asset owned by many individuals. IRAs often grow well into six and sometimes seven figure size.

Because of their long-term nature as investment vehicles for retirement, IRAs are often established, and then grow for years without further legal review. Over several decades, original beneficiary forms can potentially become lost or damaged. Or, through mergers and acquisitions of various custodial sponsors, it is sometimes possible for those forms to simply be mis-

(Continued on page 2)

## A Narrow Market

By David Andrew

The recent upward move of the Dow Jones Industrial Average (DJIA) to over 10,000 was the latest in a series of high points in the extended bull market. Indeed, since the market uptrend resumed in 1991, this index of only 30 companies has risen by over 250%. The larger Standard & Poor's 500 Index (S&P 500) is also up by about the same percentage. Although other major stock averages have also recently approached all-time highs, the bull market is no longer a tide that is lifting all boats.

While the DJIA, S&P 500 and NASDAQ have all been setting records, the majority of individual stocks in these indexes have moved well off their highs. Recently, more stocks have fallen than risen in price, which is indicative of the market's ongoing selectivity. Some feel that a handful of big-name, blue-chip companies are masking broad market weakness. It is true that the strong performance of

(Continued on page 3)



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### *In This Issue:*

Tune Up Your IRA, Tune Out the IRS	1
A Narrow Market	1
Acting Against Instinct	4

placed.

At the time of a person's death, a custodian without proper documentation often has no other choice than to fully distribute IRA assets. Such lump-sum distributions unfortunately create large income tax bills for the heir and a tax windfall for Uncle Sam. The preferred method is usually to retain the assets within the tax-deferred IRA structure, which is then inherited by the beneficiary. Distributions as well as income taxes are then paid out in the future in much smaller amounts, while retaining the powerful tax-deferred growth of the assets which an IRA provides.

Reflective of the benefits of an IRA's tax-free compounding of growth, consider this example. A 35 year old beneficiary receives a \$100,000 IRA which is kept intact. The IRA grows for 30 years tax free, compounding an average of 10% each year. When the beneficiary is then ready to retire at age 65, the IRA's value would have increased to about \$1.75 million.

On the other hand, had that same \$100,000 grown, but outside an IRA, the returns could be substantially less due to taxes on dividends and interest, as well as realized capital gains, during the thirty-year span. Reason-

ing that the fully-taxed portfolio might grow 9% a year, the portfolio would increase to only \$1.3 million. With only 8% growth, the value would rise to just over \$1 million. These are very large differences in favor of keeping the IRA intact.

To assure our clients that their beneficiary wishes are current and up to date, we have begun a process of reviewing all beneficiary forms for our managed IRA accounts. To confirm that proper documentation is in place and readily accessible, we are requesting a copy of the beneficiary statement currently on file with each custodian.

Those statements will be evaluated by our professional staff for any obvious circumstances that have changed since the documents were originally executed. Things we'll be looking for would normally include changes in our clients' personal circumstances. Those typically involve alterations to one's family such as births, deaths, or marital status. Should we discover any irregularities, or feel a discussion is warranted for clarification, we will consult our clients with specific details and recommendations. We hope this small exercise will help assure clients that their estate planning goals will become reality when they are eventually needed.



### *In Memoriam*

It is with sadness we report the passing of Gerald M. Burrill on March 18, 1999. "Jerry" was an investment counselor with Clifford Associates from 1987 until his retirement in December 1993. He served as a First Lieutenant in World War II and was awarded a Purple Heart and a Combat Infantryman's Badge. After graduating from the University of California at Berkeley in 1947, he began his career in the investment field in 1950. For many years, he was an active member of community organizations including the Rotary Club and the University Club. We at Clifford Associates appreciated his years of investment experience, as well as his long-standing relationships with many of our clients. He will be greatly missed.

("A Narrow Market," continued from page 1)

the major stock indexes has been driven by strong performance of the largest companies in these indexes. However, it is important to understand that these indexes are no more "top heavy" than they used to be. Also, one should not conclude that bigger is better.

One measure of a company's size is market capitalization, or market cap. The market capitalization of a company is determined by the total market value of its outstanding shares. In 1998, the percentage of S&P 500 market capitalization claimed by large companies was only modestly higher than in 1988 and, by some measures, is actually lower than in 1978 (see Table 1).

Companies	1978	1988	1998
10 largest	27.0%	18.4%	20.7%
25 largest	40.6%	31.4%	38.1%
50 largest	53.5%	46.0%	54.9%

Source: Standard and Poor's and PaineWebber.

Although the S&P 500 is *not* notably more "top heavy" than normal, it is true that the largest capitalization companies have performed better than the Index as a whole. As Table 2 indicates, in each of the past four years, the top 50 companies in terms of market capitalization have generated more than their share of the overall appreciation of the S&P 500. Moreover, this was particularly true in 1998, when the top 50 companies accounted for about half of the S&P 500's market capitalization but contributed more than two thirds of its appreciation.

There are several reasons suggested for the exceptionally strong performance of the largest capitalization companies and the

	Share of market cap	Share of S&P 500 performance
1995	47.8%	53.7%
1996	47.9%	59.3%
1997	49.7%	55.0%
1998	54.9%	68.7%

Source: FactSet and PaineWebber.

"narrowness" of the overall market. However, one of the best explanations for this narrowness is that the S&P 500 is increasingly being lead by fast-growing companies that dominate their industries, are gaining market share, and are growing despite or perhaps even because of their large size. This is supported by a comparison of the top 10 companies in the S&P 500 in 1978, 1988 and 1998. The average expected earnings growth rates of the top 10 companies in 1998 is more than double that of the average company in the index. In 1978 and 1988, there was little difference between the earning growth rate of the top 10 companies and that of the average company in the Index. In short, large capitalization companies are leading the market partly because they are both *large* and are *growing rapidly*.

Despite the phenomenal success enjoyed by a select group companies, much of their growth in market capitalization is also due to a dramatic expansion of their price-to-earnings (PE) multiples. For example, while the PE multiple for the S&P 500 Index is now at a *record* high, the multiple for the 50 largest companies is about *twice* that of the Index! As we have seen in the past, there are limits to certain investment trends, no matter how long they have enjoyed success.



**Principals:**

Maye Albanez, CFA

David Andrew

Peter Boyle, CFA

Ken Dike, Esq., CPA

Jim Fox

Terry Price

Bill Varney

Ralph Weil, CFA

Bruce White

**Offices:**

Pasadena,  
California  
(626) 792-2228

Westlake Village,  
California  
(805) 381-2228

Huntington Beach,  
California  
(714) 846-2851

Denver,  
Colorado  
(303) 623-2228

## Acting Against Instinct

*By Jim Fox*

From time to time, we share with our clients elements of our process or professional activity that might be of interest. The intent is to offer insight which in turn creates understanding and confidence. For this article, we are focusing on a practice that sometimes confuses our clients.

The confusion that arises results from the fact that we often act in a counter-intuitive manner. In other words, we buy or sell a stock at a time when emotion might suggest the opposite action. This practice is possible only because we are empowered to act on behalf of clients without the obligation to make a persuasive sales presentation. In some ways, this operating characteristic enhances the counselors' ability to provide superior results.

The effort we want to describe is best introduced by the old Wall Street saying: "By the time the smoke has lifted, the train has left the station." Prices are cheapest when demand is low and prices are dear when supply is low. This financial fact applies to all manner of investment goods from oil to common stocks. The French have a similar statement. Roughly translated, "Buy on the cannons (during the struggle) and sell on the trumpets (triumphant celebration)." Following this axiom of successful investing is a practice which

demands unemotional judgment. A detached decision can pay enormous rewards. Buying stocks after the huge October 1987 market decline, when the outlook was bleak, has proven to be a sound decision. We now see an opportunity in Japan, even though the press delights in emphasizing new economic pain. The same is true of sectors of today's market that have not participated in the recent run-up of the Dow Jones Industrial Average.

Many investors let their cost in a stock affect their decision on when to buy or sell. The University of California at Davis studied 10,000 individual investors and found that they were much more likely to sell a stock and realize a gain than to sell and realize a loss. The reason, of course, is psychological. Most investors are reluctant to admit a mistake by taking a loss. Successful investors, on the other hand, act contrary to emotion and let the fundamentals of the company determine an appropriate time to buy or sell.

While we are not always perfect in timing or judgment, we consciously act in an unemotional manner, following sound investment principles. As investment counselors, independent of transactional or product sales quotas, we view this as one of our greatest strengths.

