Catholic financier answers questions on personal finance, 'bailout'

WASHINGTON – Given the continuing churning in U.S. financial markets and the resultant worry by many Americans, Catholic News Service asked Frank Rauscher, senior principal at Aquinas Associates in Plano, Texas, a Dallas suburb, questions about personal finance and the recently enacted federal "bailout" or "rescue" bill.

Question: Where's the safest place now to keep money?

Answer: "Safest" means the least amount of potential loss of face value. Risk is commensurate with return so expect to get the lowest returns for the most "safety." Place it in:

– Any FDIC-insured bank subject to the insurance coverage limits (do not chase long-term rates right now).

– Any money market fund that is covered by FDIC insurance.

– Any short-term Treasury bill. You can purchase 90-day Treasury bills that automatically renew from the Federal Reserve.

Be aware the interest rate may not cover the effect of inflation if the money is left in short-term accounts very long. While it is "safe" the purchasing power may be eroding.

Q: Where are the wisest choices to invest money?

A: You start with a written plan by identifying specific objectives.

For example, how stable is your job and how many months of living expenses do you need to have in reserve in the event of a layoff? How much debt needs to be repaid (you can earn 18-plus percent on your money today by paying off credit-card debt), children's college plans, major purchase plans in the near future (house, car, etc.), retirement goals, etc. These seem basic but most people never write these down and it is the process of putting them into writing that is the magic.

Then visit a financial professional (you may need to visit with several to find one with whom you are comfortable). The time horizon for your plans and your risk tolerance will help develop the “wisest” investment choices. And the true financial professional will help you develop your “risk tolerance.” Risk tolerance means the probability that your investments will go up or down by a certain percent (perhaps up or down 15 percent) seven out of 10 times in a 10-year period. The technical term is one standard deviation for the asset class in which you are invested. Professionals can provide you with that information. Risk tolerance includes that feeling in your stomach when you read that your investments have decreased in value. How much can you take?

Q: What would have to happen before my nest egg becomes imperiled?

It becomes imperiled when you do not have a good plan and stick to it in up-and-down markets.

A: If your nest egg is invested in the stock or bond markets, anyone can look smart in an up market. It is the down markets that try our souls. Again, ask a professional to show you a chart of the stock and bond markets for the last 80 years, including the 1929 Depression, to allow you to visualize the ups and downs.

Q: Should I get out of the stock market?

A: If the stock investments were part of an original plan, then only take out some if your written plan says that an event is approaching (within a few years) which requires cash such as college tuition, car purchase, etc.

There are other places to invest money but they are usually less liquid and usually not conducive to small amounts of continuous investment. Some people look at gold or gold coins, which have done well over the past few years, but gold has done poorly over longer periods of time.

One of the world’s richest people, Warren Buffett, appears to like the market at these prices as he is buying into some major companies whose prices have dropped.

He got rich by buying low and selling high and by being patient with compound interest on bonds.

Q: What's the closest thing in history that compares to this?

A: Oct. 9 marked the one-year anniversary of the S&P 500's all-time closing high of 1565. The low close for the index over the past year took place on Oct. 3, when the S&P 500 dropped to 1099, off 29.8 percent from its peak. The S&P 500 is an unmanaged index of 500 widely-held stocks that is generally considered representative of the U.S. stock market (source: BTN Research). This does not include the Oct. 7 drop.

In the nine bear markets for the S&P 500 since 1957 (not counting the current downturn), the average decline from the stock index's peak close to its bear-market low close was 31.5 percent. The average length of time from the stock index's peak close to its bear-market low close has been 12.3 months (source: BTN Research).

The S&P 500 lost 8.9 percent (total return) in September 2008, its worst monthly performance since the stock index fell 10.9 percent in September 2002. The 2000-02 bear market lasted 30 months and suffered through a 49- percent drop but the bear market ended nine days after the September 2002 double-digit loss (source: BTN Research).

If by "closest thing" you mean an event that has required federal intervention, then I must defer as I am not a great historian on this. I would guess the bank holidays of the 1930s, but this time it is not the small banks that are in the most trouble; it is part of the top 50. (Editor's Note: The government declared "bank holidays" limiting the right of depositors to make withdrawals.)

Q: What are the strong points and flaws in the federal "bailout"/"rescue" plan?

A: Congress has chosen to act on the (Treasury Secretary Henry) Paulson plan. We are going to have to live with it, as is any new president. I think it best to give it time without diverting confidence from it and we should give it a real chance. Confidence in the financial system is crucial to making it work. Currently, banks and investors with money are not confident about which shoe (bank failure) will drop next and have been reluctant to provide any funding beyond a few days to other banks or commercial-paper borrowers.

More important will be subsequent regulations to come as a result of this mess, regulations that should provide sunlight on all that is being done. I liken it to pro football. Most games are won by execution of plays that everyone knows exist. Pro teams that rely on gadget plays may score one touchdown but you do not win most games that way.

You usually win by execution. Banks do not need to have secret methods of making money. It is right to keep customers' names secret, but there is no need to have secret products. This mess has proven that those products were bad for everyone.

Years ago I belonged to a special group of bank credit administrators that met every six months to discuss what we were doing with bank credit products and to discuss results. It was 12 of the biggest banks in the country and we were objectively honest in providing constructive criticism of each other because it was good for the industry. We were transparent and it helped keep each other out of trouble. The advantage of a new product was the time lag that it took for another to imitate it if it was a good idea. There was no value in trying to keep it secret if another entered the market in a stupid way. An example of entering a market in a stupid way was when Citibank mass-issued credit cards without the customer even applying for it. It resulted in massive bankruptcies, Congress outlawed the practice – regulation – and then Citibank lobbied to tighten the bankruptcy laws because of its losses. Citibank was not part of our group.

I hope this gives you some food for thought.