

Sentinel

Personal Financial Management Ideas

Vol. 11, No. 1

Scarsdale, NY

October 2004

Former Hostage Surveys Today's Landscape

By Larry M. Elkin, CPA, CFP

Few Americans have more experience with militant Islam than Terry Anderson.

Anderson was chief Middle East correspondent for The Associated Press when he was abducted at gunpoint on a Beirut street in March 1985. His captors, the Iranian-backed Hezbollah militia, held him for nearly seven years — longer than any of the dozens of Westerners who were seized when civil war brought near-anarchy to Lebanon.

Anderson became an author and journalism professor after returning to the United States in December 1991. He settled in Ohio, won a lawsuit against the government of Iran, retired from teaching and built a ranch. His latest venture is into politics: Anderson is a Democratic candidate for the Ohio state Senate on next month's ballot.

With the human and financial costs of the U.S. invasion of Iraq mounting, and security issues at the top of voters' concerns in the presidential race, I wondered what Anderson might have to say on these subjects. I interviewed him by telephone in early September. Coincidentally, this was just a few days after hundreds of adults and children died in the disastrous end to a terrorist seizure of a school in Beslan, in the Russian republic of North Ossetia.

Sentinel: You were taken hostage in 1985, one of 18 Americans who were seized in Lebanon in that era. In your view, is there a thread that connects the Beirut hostage-takings of the 1980s with the terrorism that has followed in the two decades since?

Anderson: Yes, there's a thread: The use of Islam by some leaders, including religious leaders, to justify violence, which in my view it doesn't justify. These are people who teach hatred and claim to be following the Koran. I've read the Koran and that's not what it teaches.

There is a common thread in the Middle East in which the economic and political situation fosters this kind of radical fundamentalism. It is a place where all governments are authoritarian, where economic benefits are unequally distributed and where many people don't see a future for their children.

Certainly Iraq is very similar to Lebanon when these things were happening, in that the government has very little hold and does not have the power to stop the formation of these militias ... and does not seem to have the ability to stop kidnapping, whether it is for political purposes or economic purposes.

Sentinel: Do militants or the governments that have supported them engage in killings or kidnappings because they realistically can hope to benefit, either domestically or internationally? The Iranians, for example, received arms from the Reagan administration in exchange for help in winning the release of hostages, and Spain withdrew its forces from Iraq after the Madrid train bombings this year.

Anderson: [Trading arms to Iran in exchange for hostages' release] was a side issue. It was a mistake, obviously. Of course they expect to benefit in some fashion or they wouldn't be doing it. But benefit in their terms is not necessarily logical in our frame of reference.

Please Turn To Anderson, Page 5

Inside This Issue Of *Sentinel*

<i>Charitably Speaking: Drawing Kids To Art</i>	Page 2
<i>How Stable Are Your Stable Value Funds?</i>	Page 3
<i>Duly Noted</i>	Page 8

Art In Motion: Reaching Children Where They Live

By Shomari Hearn, CFP

Many public elementary and secondary school students returned to classes this year to find them a little less colorful — art had been eliminated. Over the last few years, budget cuts have forced officials to remove arts programs from school curriculums. While many charities have been created to fill the void, few are as unique and innovative as The Imagine Bus Project.

The Imagine Bus Project is an after-school program in San Francisco that focuses on providing arts education to inner-city children in pre-kindergarten through the 12th grade. “Our mission is to get kids off the street and to get them engaged, and we add to that by engaging them through art,” says Geoff Benjamin, CEO of The Imagine Bus Project.

What makes The Imagine Bus Project so different from other art-based charities is its method of delivery. The organization currently has two buses that have been converted into mobile art studios. A teacher, accompanied by a volunteer, drives each “art bus” into certain low-income neighborhoods in the San Francisco Bay area to teach art classes to underprivileged children. The buses travel to 16 sites in San Francisco and Sonoma County weekly.

Benjamin refers to the art buses as “the Good Humor trucks of after-school programs” because of their ability to draw in the most uninterested children in the neighborhoods the buses visit. “We have a knack for getting the most disengaged kids to participate in our activities. The kids that don’t sign up for after-school programs. The kids that hang out in front of the recreation center, but never go inside.”

When it comes to school budget cuts, Benjamin understands why officials would not want to cut funding for reading or mathematics. However, he states, “by making that decision to cut art programs from the school curriculum, we are making the divide between rich and poor, kids that attend private versus public schools, that much greater.” Studies have shown that children exposed to the arts as part of their educations are much more likely to do well in other

PHILANTHROPY AT A GLANCE

Organization

The Imagine Bus Project

Address

608 Noe St.
San Francisco, CA 94114

Telephone

(415) 867-8740

Email

info@imaginebusproject.org

Internet

www.imaginebusproject.org

Fiscal Year

Dec. 31, 2003

Total Revenue*

\$308,597

Total Expenses*

\$241,286

Program Services*

69 percent

Management and General*

25 percent

Fund-raising*

6 percent

*This information was furnished by the charity. The organization's 2003 federal financial report was not yet available at press time.

Charitably Speaking

academic subjects (such as reading and math), achieve higher SAT scores, get into better colleges and have a much more positive attitude toward learning in general.

The Imagine Bus Project also runs two other programs that provide exposure to the arts. “The Art House,” formerly a police substation in San Francisco’s Potrero Hill neighborhood, serves as a drop-in center where children can do homework and create art. The Art House is open four afternoons a week. The third program is conducted at San Francisco Juvenile Hall, where a teacher from the organization teaches art classes four nights a week to children detained at the facility.

The Imagine Bus Project puts a lot of thought and effort into developing an art curriculum that will interest children of various ages. This is not easy, considering that the children taught on the art bus tend to range in age from 5 to 12, while the children who come to the drop-in center and those at the juvenile hall tend to be older. To address this issue, each program has a separate curriculum and is taught by an individual hired specifically for his or her skills and expertise with relation to the coursework.

Benjamin believes that The Imagine Bus Project’s programs are invaluable to the children who participate. “We’re helping kids feel more connected. Kids that don’t feel like they have a place in the world, we are helping them to understand their place in the world. Art can help them do that. Art can be this creative medium that allows the kids to express themselves and be heard.” In addition to teaching children about art as a form of self-expression, the charity also teaches them how to work well with others and to develop their interpersonal skills.

Other charitable organizations throughout the United States seem to agree with Benjamin. These organizations have contacted The Imagine Bus Project for guidance on how to

Please Turn To Children, Page 7

Sentinel

INVESTMENT FOCUS

Can You Rely On Stable Value Funds?

By Paul Jacobs

If you could purchase an intermediate-term bond fund with no risk of negative returns, wouldn't you be interested?

Stable value funds, also known as capital preservation, interest income or principal stability funds, seek to provide positive returns regardless of market conditions. However, the U.S. Securities and Exchange Commission has announced that it is investigating one type of stable value fund, leading some to conclude that stable value may end up extinct. While such conclusions are premature, investors should take a closer look at their stable value funds. There is no such thing as a truly guaranteed return, and investors who assume that their funds are infallible may be in for a few surprises.

Stable value funds generally invest in portfolios of high-credit-quality, short-term fixed-income securities and guaranteed-interest contracts (GICs) from banks or insurance companies. The funds are able to protect their portfolios against interest rate risk by purchasing insurance wrappers. If the market value of the fund portfolio drops below a certain level, the insurer steps in and pays the difference to keep the fund's net asset value (NAV) constant.

Stable value funds can be purchased only in tax-advantaged accounts such as 401(k)s, Section 529 Plan accounts and Individual Retirement Accounts (IRAs). According to the Stable Value Investment Association, \$321 billion of stable value assets are held in 401(k)s, compared with \$6 billion in IRAs. Similar to money market funds, stable value funds maintain fixed NAVs and make periodic dividend payments. However, stable value funds are able to purchase securities with longer durations and higher yields than money market funds,

which leads to a higher expected return with the same low volatility.

SEC Investigates Two Issues

The SEC is investigating only stable value mutual funds, which are generally available in IRAs. Stable value funds offered in employer-sponsored 401(k) plans are regulated by the Labor Department, and will not be affected by the SEC investigation. The SEC is looking into two issues with stable value mutual funds: the accounting methodology used and the possible lack of proper disclosure and investor familiarity with the product.

The SEC has questioned why stable value mutual funds are able to reflect static NAVs, even though the value of their underlying portfolios changes each day. While the mutual fund companies say that the insurance wrapper justifies the fixed NAV, the SEC is looking into the accounting methods the fund companies use to value their wrappers.

Because stable value funds have been in existence only during a period of falling interest rates, insurers have rarely had to step in to maintain fixed NAVs. Because insurers believed the probability of having to meet an obligation to a stable value fund was low, they charged very low premiums. Critics maintain that insurers have underestimated the potential liabilities on their balance sheets. The SEC seeks through its investigation to better understand the accounting methods the insurers use.

Many investors are not aware of the risks involved with their stable value funds. The first lesson that any investor

There is no such thing as
a truly guaranteed return,
and investors who
assume that their funds
are infallible may be in
for a few surprises.

...Funds

should understand is that only the insurer guarantees the fund's NAV. It is not guaranteed by the fund company, the federal government or any other entity. If a fund buys insurance from a fly-by-night insurer, and the insurer is unable to fulfill its obligation when called upon, the investor will suffer a loss of principal. A second consideration is that some insurance wrappers do not protect against the default of a fixed-income security in the fund portfolio. Investors should be skeptical of a stable value fund that offers a higher yield than its peer group. The fund may be buying bonds from issuers with low credit ratings. This could lead to defaults that the insurer may not cover.

The main issue, which should concern both the SEC and individual investors, is the potential consequences of rising interest rates. A disturbing scenario could unfold: As interest rates increase, the values of bonds fall and debt issuers become more likely to default. The mutual fund companies call upon insurers to step in and maintain a fixed net asset value. Investors in stable value funds that have not purchased proper insurance coverage lose substantial amounts. In addition, insurance premiums for stable value fund insurance wrappers could become prohibitively expensive, leading to either reduced investment returns or the conversion of stable value funds to more traditional fixed-income funds. Two mutual fund companies (Principal Financial Group and PBHG Funds) have already converted their stable value mutual funds into traditional fixed-income funds, citing as a major factor concerns about rising insurance premiums.

Should The SEC Eliminate Stable Value?

Stable value funds are attractive as long as they are able to fulfill their promises to investors. To protect yourself, we recommend taking a closer look at any stable value funds in your portfolio. It is important to evaluate the stability and number of insurance providers that the fund is using. It is also important to evaluate the creditworthiness and fair market value of the fund's portfolio. If the fair market value of the fund's portfolio is lower than the insurance wrapper amount, you stand to lose principal if the SEC revokes wrappers. Finally, be aware of movements in interest rates

and the bond markets, and how they may potentially affect your stable value fund.

Investors who own stable value funds only in their 401(k)s also should monitor these funds, as well as the SEC investigation. While the SEC does not regulate investments held in 401(k)s, its findings on stable value funds could have a long-term effect on this asset class. Fund companies with stable value products available only in 401(k)s could also choose to

adhere to any new rules or regulations for stable value mutual funds.

The diversification and risk/return characteristics of a properly operated stable value fund are attractive, and there is a place for stable value in some investors' portfolios.

Palisades Hudson Asset Management, Inc., has used only one stable value mutual fund, the Scudder PreservationPlus Income Fund, for its clients. The fund purchases insurance wrappers from seven different insurers, all with financial strength ratings of AA+ or AAA, and the average credit quality of the fund's portfolio is AAA. In addition, according to Scudder, the fair market value of the fund's portfolio is greater than the insurance wrapper amount, meaning that the fund's NAV (currently fixed at \$10.00 per

share) would actually increase if wrappers were revoked.

While some believe that the SEC will put an end to the funds, others have recommended more regulation. A reasonable approach may be to regulate stable value mutual funds in a similar way to money market funds, which are required to construct portfolios according to certain quality, maturity and diversification standards. No such rules currently exist for stable value mutual funds. For the funds to continue, the SEC may impose similar standards, as well as standards for the insurance wrappers that the funds purchase.

The diversification and risk/return characteristics of a properly operated stable value fund are attractive, and there is a place for stable value in some investors' portfolios. These funds will be particularly appealing to the coming wave of retirees, who may have an aversion to risk but also will be looking for high yields on their investments. However, all investors should recognize the risks involved, and monitor their stable value investments as they would any other investment.

...Anderson

I think [the Madrid bombers] were less interested in the presence or absence of Spanish troops [in Iraq] than they were in simply showing their power. When the Spanish government gave in to their demands, it was simply a bonus.

There are a lot of groups in Iraq trying to jockey for power. They're sitting on a trillion dollars' worth of oil. Somebody's got to come out on top.

Take [Iraqi Shiite insurgent leader Muqtada] al-Sadr. His people and those groups that are more or less under his control actually did release many of their hostages ... because al-Sadr does not want to be seen as a terrorist. He wants to be seen as a legitimate power ... so he was relatively, and I emphasize the term relatively, restrained. He's primarily interested in the use of military power and force in the pursuit of political aims in Iraq. Some of the other groups picked up hostages, made ridiculous demands and promptly cut off their heads.

Obviously not interested in political demands ... much more purely terrorism. You see chaos there, where all sorts of groups can flourish.

There's very little that we can do about it. You can't use regular troops, no matter how well trained or motivated, to stop a war of terror. The Israelis have been trying to do it for 50 years and they haven't succeeded.

Sentinel: You sued the Iranian government for sponsoring your abductors. You won a default judgment when Iran refused to defend itself in U.S. courts. Other hostages did the same. Do you see any signs that these types of financial penalties are helping to reduce state sponsorship of terrorism?

Anderson: The Iranians have sure gotten a little calmer about it, haven't they? I assume there's more than one reason for it ... but it certainly doesn't hurt to make it more expensive for them. States sponsor terrorism because it's a cheap way to wage war. If you make it much more expensive for them, they're going to be that much less likely to do it.



AP/Wide World Photos

Terry Anderson, with his daughter Sulome, waves as they leave the U.S. Ambassador's residence in Damascus following his release by Hezbollah militants in Beirut in December 1991. Anderson is now the Democratic candidate in the Ohio Senate's 20th District.

Sentinel: Do you think President Bush was right to order the U.S. invasion of Iraq? And, if not, was it a mistake of policy, of execution, or of both?

Anderson: I would hesitate to say he was right. I have serious doubts about the wisdom of that decision. Saddam Hussein and his people, there's no question they were very bad people ... I worked in Iraq in 1984 and 1985 for AP. I know who those people were, and I have no brief for them. However, the justification for the war was patently mistaken at a minimum, and I would be inclined to say it was deliberately misleading...

It is clear today that we went into this war with too few troops to accomplish the job. They weren't well equipped, and the people who were running it had no idea what to do once they won the battle. They had no plans. They had an unrealistic and foolish expectation that the Iraqis would open their arms wide and become democratic.

Please Turn To Anderson, Page 6

...Anderson

Sentinel: Israel preemptively bombed Iraq's Osirak nuclear reactor in 1981. This may have prevented Saddam Hussein from being able to threaten or use nuclear weapons in his wars with Iran and, later, the American-led coalition that liberated Kuwait. Now there are fears that Iran is seeking nuclear weapons. How should America and the West respond — if the Israelis don't get there first?

Anderson: To have the Israelis bomb Iran would be a serious, serious mistake. The reaction would be pretty awful.

I think we're doing the right thing ... in trying to persuade Iran that it isn't in its best interests to have nuclear weapons.

Iran is not the source of the [present-day] terror that we're talking about. Don't confuse the two. In the first 10 or 20 years of its [Islamic republic] it funded and encouraged terrorists. Whether or not it is still doing so is in question. The only way to handle Iran is to encourage it to become a member of the community of nations.

Sentinel: In the wake of the Beslan tragedy, Russian officials are enunciating a doctrine of preemption against terrorism, mirroring the policies announced by President Bush after 9/11. In your view, does preemption stand to bring benefits that are worth the costs in lost goodwill or, as apparently happened in Iraq, of making decisions based on faulty information?

Anderson: Preemption may have to be done at one time or another if there is a clear and present threat.

Sentinel: You had 2,454 days to get to know the people who held you. What motivated them? And do you think similar motivations apply to other militants, including al-Qaida today?

Anderson: Their immediate motivation was to use me and others to free their compatriots who were in prison in Kuwait. One of [the Kuwaiti prisoners] happened to be the brother-in-law of the man who was primarily responsible for [my] kidnapping. He happened to be head of security

for Hezbollah. Other groups became involved over the years, and they had different motivations.

Is there a parallel between that and Iraq? Not really. There is a parallel in the conditions: Chaos and lack of central authority. There is a parallel in terms of broad motivations: they are Islamic fundamentalists; they don't like us. They are capable of rationalizing the most awful acts by their particular interpretation of Islam.

•Violent fundamentalists
have been able to draw
support by characterizing
America as the enemy,
and we are the enemy
because we support Israel.•

Sentinel: Can the threat of Islamic militancy be dispelled without a true settlement of the Israeli-Palestinian conflict? Would such a settlement, remote as it seems today, even be enough?

Anderson: It would certainly be a major factor. One of our problems is that the violent fundamentalists have been able to draw support by characterizing America as the enemy, and we are the enemy because we support Israel. There is no question that U.S. policy is heavily biased toward Israel,

and has been since 1948. [Settlement of the conflict] would remove a major irritant. It would be more difficult for them to paint us as the enemy. That doesn't mean they won't continue to do it.

Sentinel: You are a nationally known figure. Your journalism career put you in the hottest of the world's hot spots. Yet today you are running for the quintessential entry-level political office, a seat in the Ohio state Senate — and if you win, you'll be part of a party that currently is outnumbered 22-11 in that chamber. Why do you want this job?

Anderson: I live in southeast Ohio, Appalachian Ohio. It's the poorest part of the state, one of the poorest parts of the country. It's absolutely beautiful. The people here are among the nicest I know. They need help.

Sentinel: What can a state senator realistically do to produce private-sector jobs in your area? Or do you think it is not necessarily important whether the jobs are in the private sector, as long as there are new jobs?

Anderson: I do think it's important to develop the private

Please Turn To Anderson, Page 7

...Children

replicate its work. As a result, Benjamin intends to develop a manual for other charities that will explain how to run an Imagine Bus Project and create an art bus. The manual will also include a year's worth of art curriculum.

To reward the children for their dedication, The Imagine Bus Project runs an "Artist of the Week" program. Each week, the teachers designate a child who has been well behaved, engaged and committed to the artistic process, and who has worked well with the other children. One of the child's art pieces is framed and placed in an art show. The teachers also contact the child's parents to inform them of their child's achievement. According to Benjamin, in some cases, this may be the only positive feedback that the parents are receiving about their children, which helps the parents better understand the value of the program.

Benjamin says the annual budget to run The Imagine Bus Project currently is \$200,000. The organization employs five part-time workers and typically has 10 to 15 volunteers, who teach 500 to 600 children each week. The Imagine Bus Project was incorporated in 2001, and as a

young, small charity, much of its funding is via grants from large, well-established private foundations. The tax-exempt organization does not receive any government funding. However, contributions from individuals are more than welcome as the charity continues to grow. In addition to cash gifts, the charity requests that contributors consider donating non-cash gifts such as art supplies, digital cameras to catalog the children's work and create a virtual art gallery on the Web, and tires for the art buses. Benjamin also is working with the charity's board of directors to acquire an additional bus.

Palisades Hudson Charitable Portfolio, Inc. (PHCP), has selected The Imagine Bus Project as one of the prospective charities to include in its Arts & Culture Fund, as part of the fund's priority objective to provide children in underserved communities with opportunities to experience and participate in the creative and performing arts. You can read more about PHCP at www.palisadeshudson.com and about the Arts & Culture Fund in the *2003-2004 Charitable Giving Program*, also available at our Web site.

...Anderson

sector. One of my emphases is to develop tourism and recreation. We're losing our factories. We have to set off in a different direction. If we can develop the infrastructure and the plans and proposals, we can make this area something it hasn't been, which is a place for people to come to enjoy themselves ... Can one state senator do that? No, but certainly I can have a voice.

Sentinel: Coal has historically been important in your area, though the mines have declined in recent decades. Lately, the Bush administration has favored expansion of the use of coal, and has supported changes in clean air regulations that are seen as friendly to the coal industry. That said, why do you think a Kerry administration would be better for your region of Ohio?

Anderson: The coal we have here is dirty coal. That's why our coal mines closed. Coal users can get better coal cheaper out West. If we could develop the technologies that could allow us to use our coal and still maintain environmental standards, that would be a good thing for this region.

We've made huge strides in this country on the environment

in the last 50 years ... It doesn't seem to me a good thing to go backwards in the name of economic development.

Sentinel: Ohio is one of the most important swing states in this year's presidential election. Right now, polls have the Bush-Kerry race very close. If we can ask you to dust off your pundit hat for a moment, how do you think Ohio will go in November, and what is likely to be the deciding factor?

Anderson: I'm a Kerry supporter, so I'm biased. I really think Kerry is going to take the state. It's been hurt too bad by the loss of jobs. Our school funding system is a mess. Like everywhere else, health care is spotty and way too expensive. It's ripe to go to Kerry.

Send *Sentinel* To A Friend

You can email this edition of *Sentinel* to a friend. Simply log on to our Web site at www.palisadeshudson.com and click on the *Sentinel* link in the lefthand column. Then download the Adobe Postscript *Sentinel* file and attach it to an email.

Duly Noted

Family Partnership Assets Included In Estate. Assets transferred to two family partnerships by a 95-year-old man who died two years later must be included in the decedent's taxable estate, a Philadelphia federal appeals court ruled. Theodore Thompson transferred nearly all his wealth to the partnerships with an "implied agreement" that he would be the principal beneficiary of that wealth while he lived, the Pennsylvania court ruled in upholding a decision by the Tax Court. The court found that under Section 2036(a) of the tax code, the assets must be included in the estate without the 40 percent discount for lack of marketability and control that the estate claimed for Thompson's partnership interests. In another case earlier this year, the Texas-based 5th U.S. Circuit Court of Appeals found that Sec. 2036(a) did not apply in similar circumstances because of an exception for a "bona fide sale" of the decedent's assets to the partnership. The 3rd Circuit panel declined to follow that precedent, setting up a possible showdown in the Supreme Court to resolve the conflict between the circuits. *Estate of Thompson v. Commissioner*, 2004 TNT 171-8.

Court Strikes Down Ohio Investment Credit. Ohio's corporate income tax credit for in-state investments in machinery and equipment poses an unconstitutional burden on interstate commerce, a federal appeals court ruled. The 6th U.S. Circuit Court of Appeals upheld an abatement of state and local property taxes that the city of Toledo granted to entice DaimlerChrysler to build a new auto assembly plant. But the court found that by granting a credit against Ohio's income-based franchise tax only for in-state investment, the state ran afoul of the Commerce Clause of the U.S. Constitution. *Cuno et. al. v. DaimlerChrysler, Inc.*, 2004 TNT 174-13.

Oops! I Said It Again. A California mother who financed her daughter's pop star aspirations was not lucky in front of Tax Court Judge James Halpern. The IRS disallowed losses Vanessa Bernardo claimed for the record company she started in partnership with her daughter, Melissa O'Donnell, because the Service determined that Bernardo did not seek to make a profit in the music business. Bernardo, a clothing store manager, told Halpern that from the time her daughter was 10 years old, they agreed that mother and daughter would share her music earnings 50-50, but only until Mom recouped her expenses. The judge, perhaps believing the taxpayer was not that innocent, pressed her about whether she expected to share in any profits at all from her daughter's career. That would be subject to future negotiation, Bernardo replied. The judge then ruled in favor of the IRS. *Bernardo v. Commissioner*, T.C. Memo 2004-199.

Sentinel

Sentinel is published four times annually by Palisades Hudson Financial Group LLC, 2 Overhill Road, Suite 100, Scarsdale, NY 10583. Phone (914) 723-5000. You can also reach *Sentinel* via electronic mail at Sentinel@palisadeshudson.com. Subscription: one year \$25; two years \$45. All material copyright 2004 by Palisades Hudson Financial Group LLC. No portion may be reproduced except by written permission. This publication is intended to provide accurate and authoritative information regarding the subject matter covered, but should not be used in place of specific legal, accounting or other professional advice. If legal advice or other expert assistance is required, the services of a competent professional should be sought.

Sentinel

2 Overhill Road, Suite 100
Scarsdale, NY 10583

PRESORTED
STANDARD
U.S. POSTAGE
PAID
KALISPELL, MT
PERMIT NO. 87