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Investors' Guide

PLANNING FOR THE NEXT ROUND OF **TAXES**

PENALTY-FREE **IRA** WITHDRAWALS

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CHOOSING THE RIGHT **LONG-TERM-CARE INSURANCE**

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HOW TO BUILD A WINNING **FUND PORTFOLIO**

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CREATE YOUR OWN **TROPICAL PARADISE**

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MONEY PHOTOGRAPH BY STEPHEN WEBSTER FOR FORBESS

Estate tax

McCain: $10 million exemption, 15% top rate.
Obama: $3.5 million exemption, 45% top rate.
Clinton: $3.5 million exemption, 45% top rate.

Ordinary income tax rates

McCain: top rate of 35%.
Obama: top rate of 39.6%.
Clinton: top rate of 39.6%.

Long-term capital gains and dividends

McCain: permanent rate of 15% for both.
Obama: around 25% for both gains and dividends.
Clinton: top rates of 20% for gains and 39.6% for dividends.

New tax cuts

McCain: Eliminate alternative minimum tax. Double personal exemption for dependents from $3,500 to $7,000. Cut corporate tax rate from 35% to 25%.
Obama: Give $500 per worker credit to offset payroll tax. Exempt from income tax seniors who make less than $50,000. Expand credits for college and retirement savings. Give 10% mortgage credit to nonitemizers.
Clinton: Expand credits for college and retirement savings. Expand earned income tax credit for big families. Add $3,000 tax credit for long-term care and caregivers.

SAUL LOEB / AFP / GETTY IMAGES; JEFF KOWALSKY / BLOOMBERG NEWS; JOSHUA ROBERTS / BLOOMBERG NEWS

higher rates. You put in aftertax dollars, the money grows untaxed and all withdrawals in retirement are tax free.

In contrast, with a traditional deductible IRA or 401(k), you put pretax dollars in and every dollar you take out in retirement is taxed as ordinary income—at what are likely to be higher rates than now.

With the Roth IRA, couples with adjusted gross income up to $159,000, and singles earning up to $101,000, can this year contribute $5,000 each ($6,000 for those 50 or older). Regardless of income, anyone whose employer offers it can use the newer Roth 401(k) option. For 2008 you can contribute up to $15,500 in after-tax salary ($20,500 if you're 50 or older).

A pretax 401(k) rather than a Roth still makes sense if your combined federal and local income tax rate is likely to fall. Candidates include New York City residents retiring to Florida and executives intending to quit to work for charity.

2) Do a Roth conversion. This strategy involves taking money out of a traditional IRA, declaring the taxable income and depositing it in a Roth, where all future growth is tax free. Only taxpayers with gross income below $100,000 are eligible, but that limit will end in 2010—unless Congress reneges.

Another rule that makes a conversion attractive for affluent families: With a pretax IRA you must take money out from age 70½; with the Roth you can let it ride and become a tax-free kitty for your kids.

3) Think twice about deferring pay. The prospect of higher rates, on top of a 2004 congressional crackdown on deferred-compensation plans, makes this perk less alluring. (Deferred comp grows tax deferred, and all income, including gains, is taxed as ordinary income when received.) It's hard to get at your money early if a big tax-rate hike looms or your company tanks, putting your deferred pot at risk, notes Mel Schwarz, Grant Thornton's director of tax legislative affairs. He adds that deferring comp still makes sense in some cases—say for someone who is in the top tax bracket now but likely won't be when he withdraws the cash.

4) Relocate assets. Investors may have been lulled into complacency over capital gains taxes in the three years through 2005 as their mutual funds used losses booked over the previous couple of years to offset gains. The holiday's over. Last year funds distributed $393 billion in long- and short-term gains to taxable shareholders, up 270% from 2005, estimates Thomas Roseen, a senior analyst at Lipper.

With the capital gains likely to keep on coming, you can minimize your tax bite by strategically deploying assets among taxable and tax-deferred accounts. Tax-efficient index funds, exchange-traded funds and "tax-managed" funds belong in taxable accounts. Small-cap growth funds, whose managers trade a lot, belong in tax-deferred accounts. Don't rush to sell, and thus realize costly gains, but use new money and any asset-reallocation moves to improve the location of holdings. Given the market's recent volatility, now may also be a good time to harvest losses that can be used to offset gains as you move assets around to strike a tax-efficient balance.

5) Track your cost basis. Keeping detailed records of your cost basis—that is, what you paid for each block of shares in a taxable account—is more crucial than ever. That's because Congress is likely to require that brokers and fund firms begin reporting your basis to the Internal Revenue Service. There's no guarantee they'll calculate your basis in a way that minimizes your tax bite. As is, unless you specify otherwise, when you sell a part of your shares, your fund will report the average cost for all of them. If instead you state beforehand which shares you're selling, you can minimize gains one year and recognize them later when you have offsetting losses.

6) Buy munis. If you're in a high tax bracket, tax-exempt municipal bonds are a buy, says Robert Gordon, president of Twenty-First Securities. While off their peak of this year, muni yields are still high relative to Treasurys, even at current tax rates *(see story, p. 14)*. Avoid private-purpose bonds—the kind whose income is taxable in the AMT. Vanguard, which offers some of the lowest-cost funds around, eliminated most of these bonds from its muni funds last year **F**

SHIFT THAT WEALTH NOW

Stock prices and interest rates are down and the estate tax is here to stay. Time to think about gifts and GRATs.

BY ASHLEA EBELING

JESSE LEFKOWITZ FOR FORBES

WHEN REPUBLICANS CONtrolled Congress, the estate tax seemed to be doomed to an early demise. Lawyers specializing in wealth transfer found their services a tough sell. Clients were reluctant to shell out fat fees and certainly didn't want schemes that involved paying gift taxes now in lieu of estate taxes later if there was a chance there wouldn't be an estate tax when the time came.

But busy days are here again for the lawyers, and not just because of the changed political outlook. Certain techniques that let you move big bucks to your kids while you're alive at reduced or no gift tax cost—for example, grantor retained annuity trusts—work best when both interest rates and asset values are depressed. "GRATs are smoking hot right now. Not only do we have low interest rates, but we have depressed real estate values," exults Jeffrey Baskies, a Boca Raton estate planning lawyer.

How rich do you have to be to think about transferring wealth early? Not very, particularly if you live in certain states. Someone who dies this year can pass $2 million to nonspousal heirs free of federal estate tax. That rises to $3.5 million next year and is likely to settle there or higher *(see story, p. 5)*. But 23 states impose their own estate or inheritance taxes, some at far lower wealth levels; New Jersey and Rhode Island exempt only the first $675,000 going to nonspousal heirs. (You can transfer an unlimited amount to a spouse who is a U.S. citizen without federal or state gift or estate tax.)

The good news is that most affluent folks don't need to do fancy stuff; they can give away enough assets using the annual gift tax exclusion. Anyone can give $12,000 a year in cash, stock or property to any other person, without worrying about federal or state transfer taxes. A husband and wife can give their two grown children, and their kids' spouses, $96,000 a year. Cut in four grandchildren and $192,000 can be passed between generations every year. Noncash gifts—say, a family cruise—count against the $12,000. But if you pay someone's tuition or medical bills and send the check directly to the school or health provider, it doesn't eat into the $12,000 exclusion.

What if you want to transfer a bigger chunk at once? You also get a single lifetime gift tax exclusion of $1 million, which, when used, reduces dollar for dollar the amount you can pass to heirs free of federal estate tax.

Deciding which assets to give away can be tricky. You must consider both estate and capital gains taxes and make some educated guesses. Under current law—and likely in the future too—an asset passed on at your death gets a "step-up" in value to what it is worth at that time. So your heirs can sell it right away without owing capital gains tax. That means if your estate isn't likely to be taxed, you probably don't want to give away a highly appreciated asset. On the other hand, when you give an asset during your life, the recipient takes on your basis in it, or its current market value, whichever is *lower*. That means you can't transfer an unrealized loss and usually shouldn't be giving away property that's worth less than you paid for it. Sell it, book the loss yourself and give the cash.

What assets should you give away? If you have appreciated stock you want to sell now, you might do well giving it to an adult grandchild and letting him or her sell it. That's because folks at or below the 15% ordinary income tax bracket—for example, a single with $40,000 in gross income—qualify this year for a new 0% capital gains rate. (Caution: Full-time students don't qualify for the 0% rate unless they're married or 24 or older.)

What if your estate is likely to be taxable? Then you want to give assets with growth potential to get that growth out of your estate. Jonathan Forster, a tax lawyer with Greenberg Traurig in McLean, Va., reports that a client worth $80 million just put her shopping center interests into a family limited partnership and gave some shares in the partnership to her kids. "She wrote a check to the IRS for $200,000 in gift tax," he says. "She believes it's in her best interest to move assets, particularly at today's depressed values."

It's not just the sagging real estate market that made this transfer smart. Putting the real estate in the partnership reduced the appraised value of her gift; this "discount" is legit because the kids can't easily sell their minority partnerships or force Mom to sell the real estate and distribute cash.

Also, while estate and gift taxes carry the same nominal 45% tax rate, the gift tax works out to be cheaper. Why? If you give a $1 million gift to your daughter, you have to send a check for $450,000 in gift tax to the government. But if you leave that same $1.45 million in your estate, the 45% tax is levied on the whole amount. So the IRS gets $652,500 and your daughter only $797,500.

While the gift tax may be cheaper, most folks would still rather not pay it, which is why grantor retained annuity trusts are popular. You put assets like stocks, commercial real estate or shares of a family business in a trust that pays you a fixed annual annuity for a set number of years. At the end of that term what's left in the GRAT goes to your kids.

The State of The Estate Tax

Under the current wacky federal law, which will likely change before it takes effect, the estate tax disappears and then reappears.

YEAR	EXEMPTION AMOUNT ($MIL)	RATE
2008	$2.0	45%
2009	3.5	45
2010	0.0	0
2011	1.0	41 to 60

Source: CCH, a Wolters Kluwer business.

The key is this: The value of what's left for the kids, for gift tax purposes, is calculated by subtracting from the trust's value the discounted present value of your annuity. The discount rate (known as the Section 7520 rate) comes from a formula based on Treasury note yields. At the moment, Treasury yields are low, and Section 7520 spits out 3.2%. That makes the annuity look valuable and the remainder look small. If your assets earn more than 3.2%, you will have got a break on gift taxes.

Say you put $1 million of assets in a GRAT paying you an annuity of $355,000 a year for three years. As far as the IRS is concerned, you haven't given the kids anything at all, since that annuity will exhaust all the principal and earnings. Yet if the GRAT assets grow at 8% a year, there will be $110,000 left for your kids. By contrast, to set up a zero gift tax value GRAT in August 2007, when the 7520 rate was 6.2%, you would have had to pay yourself a $375,000 a year annuity, leaving only $42,000 for the kids, assuming the same 8% return. (One catch: You need to survive the term of the trust or else everything ends up back in your estate.)

"Capturing a change in the rates makes a difference, but the bigger play is by putting in assets where you expect a sudden spike in value," says Janine Racanelli, head of JPMorgan Private Bank's Advice Lab. Recently she's seen executives of financial firms whose stock has taken a drubbing funding GRATs with their company stock.

What if you bet wrong and the depressed assets you stick in a GRAT head further south? There will be nothing left for the kids and you'll be out the setup fees ($5,000 and up for a lawyer and $5,000 and up for an appraiser, if needed), plus annual accounting fees. "Some see GRATs as a lawyer/CPA/ appraiser annuity," concedes Baskies.

If you'd like to help charity as well as your kids (and your lawyers), there's another GRAT-like ploy that benefits from low interest rates: the charitable lead annuity trust. The annuity payments go to charity, instead of to you, and your kids get what's left. Vaughn W. Henry, a Springfield, Ill. charitable gift planner, recently helped a doctor set up a charitable lead trust holding $1.5 million in stock. The trust will pay $105,000 a year for 15 years to good causes. The doc's three kids get what's left. The low discounting rate tells the IRS that the doctor has given his kids the equivalent of only $264,000 in immediate cash. But if the portfolio earns 8% a year, they'll get $1.9 million, better than double what they would get if he were to hand over $264,000 and they invested it at 8%.

The tax treatment of this kind of charitable trust? The doctor doesn't get an immediate income tax deduction for the present value of the income stream given away or a deduction for the payments to charity over the years. Instead the trust declares capital gains and dividends as its own income, while claiming the $105,000 payments as charitable deductions. Usually, the trust winds up with little or no income tax due. **F**

THE BIG PICTURE

Don't let fads, fears and hot products distract you from the two most important things about constructing a portfolio: having a reasonable allocation of your assets and keeping your costs down.

BY MICHAEL MAIELLO

THE DOLLAR IS LOWER THAN EVER against the euro, gas prices are higher than ever, Egyptians are rioting over food shortages and Sam's Club is rationing rice. Such upheaval aside, it's business as usual on Wall Street: Small investors are repeating past mistakes by focusing on the market's short-term troubles rather than on their own long-term objectives.

Instead of diving into tech stocks or housing near the peak, the masses are this time pouring into Treasurys and commodities, says Christine Benz, personal finance director at Morningstar in Chicago. Small investors pumped $10.4 billion into mutual funds and exchange-traded funds specializing in Treasury Inflation-Protected Securities over the last year, driving up the price of TIPS and thereby lowering future returns. Buy one now, at least in a taxable account, and you are just about guaranteed to be a loser.

In January the government issued a ten-year TIPS at $99.14 per $100 with an afterinflation yield of 1.7%. It now sells for $101.05, and the yield is down to 1.5%. The bond protects you against inflation, but still, this is a very bad deal. If the cost of living goes up 3%, the bond gives you a total return of 4.5%, and all of that return is taxable immediately. If your tax bracket is 35%, you lose more than 1.5 percentage points to taxes. Subtract inflation and your real, aftertax return is negative.

That's not all. If you buy the Treasury through a fund, you'll be even worse off because funds have overhead.

Putting the TIPS in a 401(k) postpones, but does not eliminate, the tax punishment. When the money comes out, it will be subject to post-2009 federal tax rates (all but certain to be higher than today's) and, somewhat surprisingly, state income tax as well.

Why are retail investors falling all over themselves to buy TIPS? Because they are in a panic. The price of gasoline is going up, and TIPS have the specious appeal of beating the cost of living. They are missing the big picture.

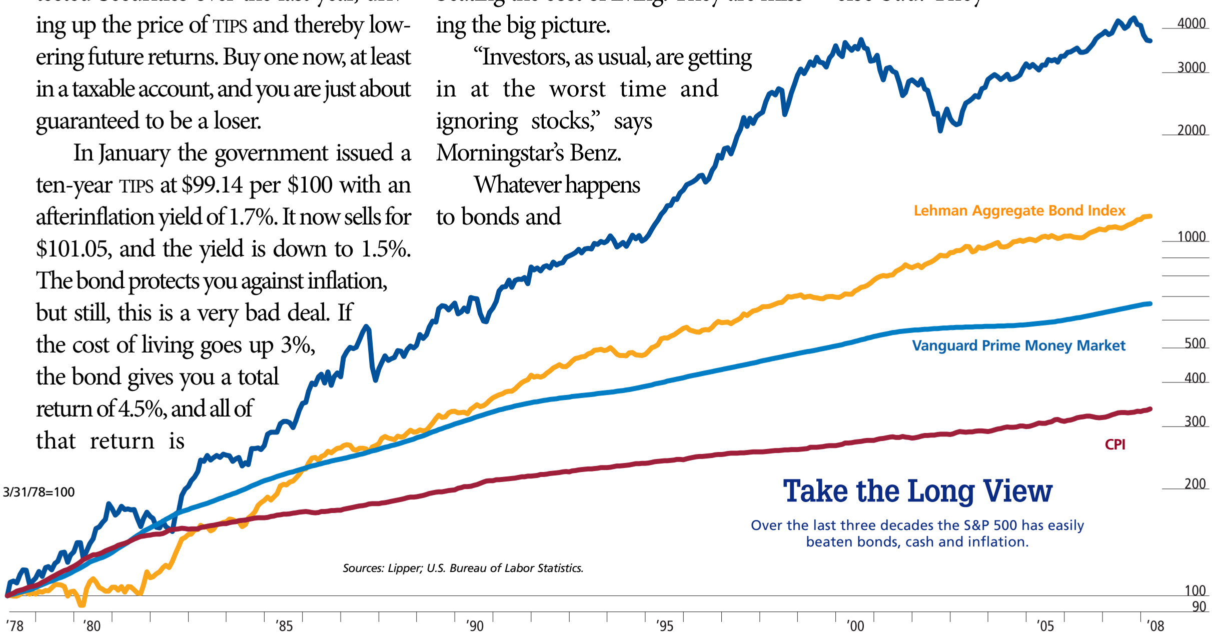
"Investors, as usual, are getting in at the worst time and ignoring stocks," says Morningstar's Benz.

Whatever happens to bonds and commodities from here, the rush from one hot sector to another is usually far more profitable to the brokers clipping commissions off each buy-and-sell order than to people aiming to pay for college and retirement.

What investors should be doing when panic is in the air is tuning out the market's day-to-day distractions and focusing on multidecade goals. That means sticking to two basics: deciding what asset categories to own and finding ways to own them cheaply. We'll restate this simple philosophy as four rules.

Think About Allocation. Most people don't give any thought at all to how they allocate between stocks, bonds, cash and commodities. They just buy what's worked lately.

What Wall Street refers to as a "flight to quality" amid short-term troubles often turns out to be a flight to mediocrity over the long haul. Lately that flight has been a stampede into bonds, especially Treasurys, for their safe-haven status. True, they don't default. But they do something else bad. They



Take the Long View

Over the last three decades the S&P 500 has easily beaten bonds, cash and inflation.

Best of the Bunch

Only 29% of actively managed funds have beaten Vanguard's S&P 500 Index since it was offered to small investors in 1976. These ten have performed best. All have below-average fees.

FUND	TOTAL RETURN YEAR–TO-DATE	5-YEAR	ANNUALIZED 8/31/97–4/30/08	ANNUAL EXPENSES PER $100
FIDELITY MAGELLAN	–6.7%	10.1%	17.8%	$0.54
CGM CAPITAL DEVELOPMENT	–0.4	24.2	16.8	1.09[1]
COLUMBIA ACORN-Z	–4.6	17.3	16.6	0.74
SEQUOIA	–1.4	9.0	16.2	1.00
AMERICAN GROWTH OF AMERICA-A	–3.2	13.9	15.8	0.62[2]
DAVIS NEW YORK VENTURE-A	–3.8	13.2	15.8	0.85[3]
MUTUAL SHARES-Z	–6.1	12.0	15.2	0.74[1]
HARTFORD GROWTH OPPORTUNITIES-L	–10.2	18.1	15.2	1.04[3]
ROYCE PENNSYLVANIA MUTUAL-INV	–2.9	16.3	15.1	0.89
AMERICAN CENTURY GROWTH-INV	–4.8	10.8	15.1	1.00
S&P 500	**–5.0**	**10.6**	**12.0**	

Performance through Apr. 30. [1]Closed to new investors. [2]Fund may impose sales charge of up to 5.75%. [3]Fund may impose sales charge of up to 4.75%. *Source: Lipper.*

eat away your purchasing power.

We can't prove it, but we suspect that most of the people buying ten-year Treasurys today aren't buying because they expect terrific returns over the next decade. They are buying because they witnessed great returns over the past year (great compared to stocks, at any rate). As investors bid up bonds over the last year, Vanguard's Intermediate-Term Treasury Fund posted a 10.5% total return. Meanwhile, its yield has fallen to 3.1%. That's a pretty good forecast of what you'll get owning this fund for the next decade.

That's a terrible return. It's highly likely to be negative after inflation and taxes. See the arithmetic above, where we showed how a 4.5% yield is likely to net a negative real return, too. You have to expect extraordinarily good things on the inflation front to like a 3.3% return. Indeed, our 3% assumption for inflation is pretty conservative. In the past year the cost of living went up 4%.

Could stocks do worse than 3.3%? Sure. They are, after all, risky. But what is likely?

During one-year periods over the past two centuries stocks have outperformed government and corporate bonds 60% of the time, according to an updated edition of *Stocks for the Long Run*, by Wharton finance professor Jeremy Siegel. Stretch the time frame to five-year periods and stocks excel 70% of the time, with their wining percentage rising to 95% for periods longer than 20 years.

The moral of this story is that investors who can sleep through the bumps should weight their holdings heavily toward stocks, argues Edmund (Ned) Notzon, chairman of the asset allocation committee for fund vendor T. Rowe Price. Under his direction, T. Rowe's target-date retirement and college savings funds are the most equities-laden in the business.

Investors in their 20s and 30s should hold at least 90% of assets in stocks and cut that only to 55% at age 65, he recommends. Given inflation's corrosive effects, even octogenarians should hold 40% of their stash in stocks, throttling back to 20% at age 95, and then only if they don't much care about what's left for their heirs, he says.

If you're working with a blank slate, or tax-deferred account, the simplest way to diversify is through a single fund that covers the earth and relieves you of the temptation to load up on hot regions or sectors or abandon out-of-favor ones. Vanguard launched a Global Stock Index Fund and ETF last month that tracks the FTSE All-World Index of 2,800 companies and includes a 55% weighting outside the U.S. At 0.25% a year in fees, it's the cheapest global index around.

A second way to own the world is to buy country- or sector-specific mutual funds or ETFs. Then when one gets beaten up, harvest the losses to offset gains elsewhere when you rebalance. The key is reinvesting by the original plan, regardless of the market's swings.

Beware of overlap, too. Gazprom, for example, is the top holding in Fidelity's Emerging Markets and Aggressive International funds. Similarly, before buying an energy fund, note that energy stocks already compose 13% of the market-cap-weighted S&P 500. Many fund Web sites update holdings monthly, versus semiannually in Securities & Exchange Commission filings.

Be a Cheapskate. As Vanguard founder John C. Bogle put it, investing is one business where you get what you *don't* pay for. Pony up the average 1.5% of assets that U.S. equity no-load funds charge and over time you're likely to lag the market by about that much.

More, actually, according to Madrid's Universidad Carlos III professors Javier Gil-Bazo and Pablo Ruiz-Verdú. That's because managers keep fees high in precisely those funds whose investors are inattentive, they concluded after studying actively managed funds in business for at least two years. "A significant fraction of investors responds at best sluggishly to differences in afterfee performance," the professors wrote in a working paper. "Funds exploit that fact and charge high fees."

The flip side is that sophisticated investors care dearly about performance, and therefore fees, so the best managers keep them low. Postscript: The ten cheapest actively managed funds are all from Vanguard.

What about all those broker-sold load funds? They're hardly ever worth the money. On average they clip 5.5% off savings before they go to work and charge 1.3% in management fees versus 1% for no-load equity funds. If you really need hand-holding, consider using a financial planner who charges a flat fee or 1% or so of assets a year to put you into low-cost mutual funds or ETFs.

One cost not captured in most fee tables is the brokerage commissions funds run up buying and selling. Where the fees do turn up is in reduced performance. The best way to minimize them is to buy ETFs, index funds or others with low turnover ratios. You can also gauge the net effects of brokerage costs by reviewing FORBES' fund tables, which include them in fees. We don't, however, include the effect of bid-ask spreads, which are significant but hard to quantify. Our advice on this score is to be leery of high-turnover funds.

Think About Risk. We're not averse to taking risks, or we wouldn't be saying kind things about the stock market. But we do think you should be contemplating it before putting your money down. If you don't, you might react badly to a market spill. You might, in short, buy high and sell low. That's what befell a lot of the investors who stampeded into tech funds in 1999 and 2000.

One way to measure risk for a stock fund is to evaluate its performance separately in bull and bear markets. FORBES does that for you with its fund grading system, available at www.forbes.com/finance/funds. Risky funds tend to get As and Bs in bull markets and Ds and Fs in bear markets. Example: Fidelity Select Electronics. Conservative funds have the reverse profile, like Fidelity Select Insurance.

Another measure, available for any investment with a performance history, is how widely the returns have strayed from their long-term average. For example, you look at how monthly returns over the past three or five years have danced around the monthly average. The analysis is usually presented as an annualized standard deviation. For the Vanguard S&P 500 Index Fund, the standard deviation over five years is 8.9%. Pimco's Commodities Real Return Strategies Fund far outperformed the Vanguard index fund over that period but took big chances; its annualized standard deviation was 17.8%. You can find standard deviation figures on Morningstar's Web site.

Don't Buy Past Performance. At any given moment there will be funds that have done well in the past five or ten years and trumpet their results in ads. Don't buy thinking that future returns will be as good as past ones. You should, to be sure, buy a fund with a good history rather than a bad one, but past performance is a pretty weak indicator.

In 1976 Vanguard's S&P 500 Index offered retail investors their first chance to passively track stocks. At the time there were 308 U.S. stock funds big enough to be listed in the FORBES Mutual Fund Survey. Over the succeeding 32 years 89 of these funds, or 29%, have beaten the Vanguard index fund. This is a decent measure of how likely it is that a managed fund will beat the index over such spans.

Over the years a lot of the stinker funds have been merged out of existence. Only 205 of the 308 at the starting line are still in the race. Were you foolish enough to use 205 as your denominator, you would erroneously conclude that 43% of actively managed funds beat the passive one.

Among the ten best-performing actively managed funds *(see table, below)* that beat Vanguard's index over 32 years, seven are no-loads and all have below-average fees. (Loads aren't figured into our performance numbers; expenses are.) Only one top-ten fund is a small-cap, although small stocks supposedly outperform large ones over time. Topping the list: Fidelity's recently reopened Magellan, with a 17.8% annual return to the Vanguard index's 12%. That includes market-beating results for 9 years when Magellan was closed.

Bottom line: Getting a hot fund may win a sprint or two, but nothing trumps a diverse portfolio and steady hand over time. **F**

Research by John Chamberlain.

The World for Pennies a Day

These index funds and ETFs are the cheapest in their sectors. They're also a good bet to beat most actively managed funds.

FUND | CATEGORY	TOTAL RETURN YEAR-TO-DATE	TOTAL RETURN 3-YEAR ANNUALIZED	ASSETS 3/31/08 ($MIL)	ANNUAL EXPENSES PER $100
VANGUARD LARGE-CAP INDEX-ETF | U.S. Equity	–4.9%	8.9%	$2,164	$0.07
E-TRADE INTERNATIONAL INDEX | International	–3.9	16.0	169	0.09
VANGUARD EUROPEAN STOCK INDEX-INV | Europe	–4.5	17.2	33,930	0.22
VANGUARD PACIFIC STOCK INDEX-INV | Asia	–1.5	13.7	15,399	0.22
ISHARES MSCI KOKUSAI INDEX | Global	–4.4	NA	9	0.25
BLDRS EMERGING MARKETS 50 ADR INDEX | Emerging Markets	–1.1	41.9	779	0.30

Performance through Apr. 30. NA: Not available. *Source: Lipper.*

INSIDE TRACK

Executives trading their company's stock don't always have the right answers. But you should think twice before betting against them.

BY MEGHA BAHREE

BENJAMIN SILVERMAN, THE head of research at InsiderScore, doesn't break out in a cold sweat at every headline reporting another writedown or missed quarterly earnings forecast. Not that he doesn't take the investment temperature of the economy; he just takes his readings from the people in the know: the ones running the companies whose stock prices flick across our screens, the insiders.

When executives and directors of companies and those who own 10% or more of a stock buy or sell their shares in the company or any of their options or restricted stock awards, the Securities & Exchange Commission requires that they disclose the transaction within 48 hours. Mandatory disclosure was put in place after the Enron meltdown. "A CEO can no longer tell investors that the company is doing great and continue to dump his stock quietly on the side," says Silverman.

Between January 2006 and April 2008 there were 1.2 million such transactions, in which 18.5 billion shares were bought and 16.2 billion shares sold across 9,300 firms. InsiderScore has formulas to assess each trade. It takes into account the position of the insider, the number of shares, the price paid, how the buy (or sell) changed the executive's overall holding and how the stock performed in the previous week, month and year. By looking for patterns specific to an insider and also for those that range across a company, an industry or the entire market, InsiderScore divines if a trade is a buy or sell signal.

"Insiders' behavior is predictive," says Nejat Seyhun, a finance professor at the University of Michigan and author of *Investment Intelligence From Insider Trading*. When the equities market started dipping last August on subprime woes, insiders became bullish, he says. Silverman agrees: "Insiders were buying at a level we had not seen in close to a decade." True to the two men's expectations, the market rallied; the S&P 500 rose from 1,406 to 1,554 by mid-October.

Benjamin Silverman: opening the doors to insiders' outlooks.

EVAN KAFKA FOR FORBES

The index has since slipped back to its August 2007 level. And how are the insiders reacting now? Just as bullishly as they did then, according to Silverman.

For investors who like the insider play but want to avoid the slog of keeping track of the transactions, Claymore Securities offers the Claymore/Sabrient Insider exchange-traded fund. This tracks the Sabrient Insider Sentiment Index developed by Sabrient Systems, an equity research firm in Santa Barbara, Calif. The index comprises 100 stocks in which there has been a trend of insider buying plus recent earnings estimate increases by Wall Street analysts. Since being launched in September 2006, the index has shown a cumulative gain of 9.45%, outstripping its

Leading Indicators

Five companies where insiders are buying, and five where they are off-loading.

COMPANY	RECENT PRICE	P/E	NET SHARES PAST 3 MONTHS (THOU)
INSIDER BUYS			
AMREP	$54.80	18	81[1]
CHESAPEAKE ENERGY	56.12	32	1,583
COACH	35.11	18	47
MCMORAN EXPLORATION	30.51	NA	506
NORTEL NETWORKS	8.31	NA	946
INSIDER SELLS			
BLACKROCK	212.15	27	–136
FLEXTRONICS INTERNATIONAL	10.58	NA	–2,483
GOLDMAN SACHS GROUP	189.76	9	–47
HESS	112.79	16	–177
VORNADO REALTY TRUST	94.46	20	–240

Price as of May 7. [1]Six-month figure. NA: Not applicable. *Sources: FT Interactive Data, Lion-Shares and Reuters Fundamentals via FactSet Research Systems; Bloomberg Financial Markets.*

benchmark, the S&P MidCap 400, by 2.8 percentage points.

In its current basket of 100 stocks, computer stocks account for 18.2% of the total (versus 16.7% of the S&P 500), financials 17.1% (versus 17.6%), industrials 16.4% (versus 11.5%) and consumer discretionary 14.8% (versus 8.5%).

The last may come as a surprise, given the daily announcements of sluggish consumer sales. Is this another case of insiders knowing better? "Some of these industries are cyclical, and people working in those industries understand that more so than the average investor," says Christian Magoon, Claymore's president. "They've seen there are times you buy in the downturn." Moreover, the holding time for insiders is a lot longer than for the average investor. "Insiders aren't trailing indicators, they are leading indicators," says Magoon. "They get in before things get good."

The top five positions in the Claymore/Sabrient Insider ETF are in SunPower, First Solar, Anthracite Capital, Redwood Trust and Cash America International, with weightings in the portfolio ranging from 1.2% to 1.3%. The ETF was launched along with the index in September 2006 at $25 a share and now has $29 million of managed assets. It was recently trading at $27.61, a three-cent premium to its net asset value.

Since its inception the ETF has had an annualized return of 7.25%, to the market's 5.43%. "We're trying to invest like the people who know the most about the company," says Magoon. The return is net of expenses—fairly high as ETFs of U.S. stocks go, at 0.6% a year.

If you'd prefer to pick off individual stocks, consider these: One company that saw insiders scooping up more equity was Chesapeake Energy. Chief Executive Aubrey McClendon bought $70 million in stock in the first three months of this year (and another $22.9 million since the beginning of April). That is more than he bought in all of 2007.

At McMoran Exploration, Robert Day, a director and the founder of Trust Co. of the West, bought $23.4 million of stock. In 2007 he bought $57 million of stock of its former sister company, Freeport-McMoran, in the range of $53 to $63 per share. Today that one is trading at $114. "He knows cyclical industries," says Silverman. "His grandfather was the founder of Superior Oil. He's got some oil in his veins. He's the kind of insider you look to follow."

Another industry that has seen active insider buying is home building. Hovnanian Enterprises is up 107% since its founder upped his stake from 27.2% to 29.2% in January. Real estate development firm Amrep is up 87% since its vice chairman and majority shareholder upped his stake from 58% to 60% in December. Insiders are stirring in telecoms, too. In May Richard Lynch, Verizon's chief technology officer, boosted his stake to 26,000 shares from 6,000 shares, even though the company's earnings had taken a hit from its $18 billion investment in a new fiber network. This was the largest insider buy by an executive in a large telecom company in the past five years.

There have been insider sales, too. John Hess, chief executive of oil producer and refiner Hess Corp., sold $173 million worth of stock in March. Maybe he's been around long enough to know that commodity price spikes don't last more than a few years. At Goldman Sachs the vice chairman and the president sold stock worth a combined 14 million in January and March. At Vornado Realty Trust $30 million of smart money has left in the past month. Think twice before you buy any of these. **F**

SUPERCHARGED MUNIS

Conventional wisdom says buy muni bonds in cautiously staggered maturities. Jimmy Klotz says put everything into long bonds—and get an extra point of yield.

BY BERNARD CONDON

POPULAR TACTIC WITH BROKERS selling municipal bonds: ladder your portfolio. You buy a bond due in a year, another due in three, then six and end with one due in nine years. As each matures, you put the principal into a nine-year bond. The rolling redemptions provide some protection against rising interest rates, which of course kill the market value of bonds. As bonds are redeemed, you redeploy the money at the new higher rates.

This is Wall Street propaganda, says James A. Klotz, 60, the president of brokers FMSbonds of Boca Raton, Fla. Reason: Your yield will be less than it could be. Better to put all your money in long bonds, he says, and take your chances on interest rates.

"Everyone wants to tell you how they're so sophisticated," says Klotz. "But bonds don't need to be managed. Just buy and hold."

As a 35-year veteran of the bond business, Klotz knows all the tricks. Brokers love laddering for two reasons, he says: It gives them a lot of work scaring up medium-term bonds every two years; and it protects *them*—against angry phone calls. If interest rates shoot up, people holding long-maturity bonds can see 20% or even 40% losses in market value. Indeed, Klotz remembers the bond collapse of the early 1980s, when munis from some solid issuers traded at 50 cents on the dollar.

CHRIS GASH FOR FORBES

What makes him so sure that won't happen again? The interest rate spike of a generation ago, he says, was due to the Fed's desperate battle against inflation. Next time it will tame inflation early, Klotz figures.

The problem with a ladder that reaches out only nine years is its skimpy yield. A California general-obligation muni due in 2017 yields 4%, versus 5.1% on a GO due in 30 years. (Both of these get A+ ratings from Standard and Poor's—good, but not great.) If you won't need the money until 2038—if you are 40 and investing for retirement, or 65 and planning bequests—you and/or your heirs can afford a stretch of high interest rates. Provided the agency borrowing the money doesn't default, the full principal will come back in 2038, even if it has had a bumpy ride in the meantime.

"If you're going to panic when you see the monthly statement, you shouldn't buy munis," Klotz says. "Buy a money market fund."

Klotz says laddering might make sense with U.S. Treasurys: These (taxable) bonds have a flatter yield curve, so you don't give up as much by going short. The muni yield curve is steeper. Time diversity costs real money there. Klotz does, to be sure, advocate diversifying across issuers by putting, say, $100,000 into four different tax-free bonds.

What if inflation creeps up and muni interest rates climb by two points? That would take the market value of a $100,000 bond due in 2038 down to $78,000. You could sell and take a $22,000 long-term capital loss, usable against any amount of capital gains and against up to $3,000 a year of salary and other income. (Unused losses carry forward.) But do get back into the market for the new 7% rate.

There are two ways to do that. Put your $78,000 into newly issued 7% bonds at 100 cents on the dollar. They would return only $78,000 of principal at maturity but pay $5,460 a year, instead of $5,000. Or you could, with the same $78,000, buy $100,000 (par value) of a 5% bond trading at 78 cents on the dollar. These would pay $5,000 a year but repay $100,000 in principal in 2038.

The risk with the former strategy is that the new, high-coupon bonds could get called. That is, if rates fall again to 5%, the sewer authority that has your $78,000 could force an early redemption and end your $5,460 income stream. You can prevent that by putting cash from a tax-loss sale into discounted bonds.

That's what Klotz and his partner, Paul Finesilver, did for clients when the Fed was working its magic in 1982. They sold 6% bonds trading at 50 cents on the dollar and reinvested in different 6% bonds trading at 50 cents. Their clients came out even, earning over time the

Going Long

Veteran trader Klotz says buy long-term munis from solid issuers like these, and forget about the short stuff. If interest rates rise, you can use the extra income you'll be earning to buy new bonds at higher yields.

NAME	RATING	PRICE	COUPON	MATURITY	YIELD[1]
CALIFORNIA	A+	$98.78	5.0%	2038	5.1%
ILLINOIS FINANCE AUTHORITY EDWARD HOSPITAL	AAA	102.77	5.5	2040	5.1
LONG BEACH, CALIF. BUILDING FINANCE AUTHORITY	AAA	99.85	5.0	2035	5.0
METROPOLITAN TRANSPORTATION AUTHORITY (NY)	A	100.34	5.0	2035	4.9
NEW YORK CITY HOUSING DEVELOPMENT CORP.	AA	100.00	5.0	2033	5.0
NEW YORK THRUWAY AUTHORITY	AA–	101.08	5.0	2037	4.9

[1]To maturity or, if lower, to first call. *Sources: Bloomberg; Standard & Poor's.*

same 6% they had bargained for. Had they switched into new bonds paying more like 12%, those bonds would have been called away as interest rates subsided in the late 1980s, and the investors would have suffered a permanent erosion of capital.

Alas, the tax-loss game has got a little trickier because of a law change. Now if you buy a "tax-exempt" muni at a discount the capital gain realized at maturity is taxed as ordinary interest income. (It's not fair, but that's how the tax laws work.) Switching to higher-coupon bonds finesses this problem but at the risk that rates subside and you get whipsawed by a bond call. Klotz's advice: Don't take that tax loss unless it's really big and you can make use of it. Otherwise sit tight.

If you don't need the coupon payments to live, reinvest income from going long in new 30-year bonds, Klotz advises. Make sure you have 10-year call protection and consider possible tax changes. Don't buy double-tax-free bonds if you plan a move across state lines.

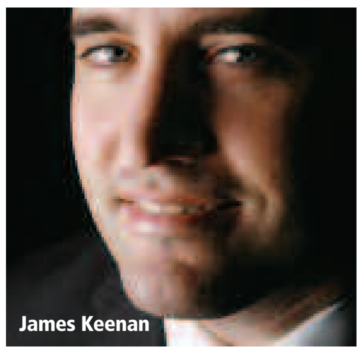
Before buying, it also pays to check price quotes against the securities industry Web site, www.investinginbonds.com, to avoid getting gouged by brokers. Or buy newly issued bonds. The table on page 114 displays a sampling of high-quality munis that Klotz likes.

If you have less than $100,000 to invest, or need liquidity, you're better off in a muni bond fund. **F**

HIGH YIELD HIGH RISK

Junk bonds are perilous in the best of times, which these are not. Funds like BlackRock offer those with the stomach for it at least a chance of survival.

BY ROBERT LENZNER



James Keenan

PETER ROSS FOR FORBES

JAMES KEENAN, COMANAGER OF the BlackRock High Yield Bond fund, loves disarray in the markets. "It's a risky time, but I'm getting paid for it," says the Notre Dame graduate and son of an FBI agent.

In January Keenan shied off investing in the $29.7 billion buyout of Harrah's Entertainment by private equity giants TPG and Apollo Management, even though $13\frac{3}{8}$% debentures were on offer and he reckoned that Harrah's could weather a prolonged recession without defaulting on its paper. Almost immediately, with the subprime mortgage crisis swirling and lots of leveraged buyout debt overhanging balance sheets, the bonds fell precipitously. Keenan bought the bonds at around 85 cents on the dollar, for a yield to maturity of 15%. He'll buy more if the price falls further. "Debt is more attractive than equity right now," he says. "I like bonds. They are senior in the capital structure and are trading at a significant discount to parity."

Keenan, 31, and his associates have their $1.7 billion fund deep into junk territory. The portfolio is 35% in BB-rated issues, 35% in Bs, 15% in CCCs and 10% in bank debt. The fund's yield of 9%, which is net of expenses and the dilution caused by uninvested cash, implies that Keenan's junk is yielding more than 10%. That's almost seven percentage points above the yield on ten-year Treasurys. Since its inception in 1998, the fund's investor share class has returned a compound 5.7%, versus 5.9% for its benchmark, Lehman Brothers' U.S. Corporate High-Yield Index. The case for buying junk now: Lenders are frightened and junk is cheap.

Many bonds in the BlackRock fund are the by-product of leveraged buyouts. This makes High Yield a way for low-budget investors to invest alongside private equity and hedge funds without the usual rapacious fees of those categories. The BlackRock fund has an expense ratio of 1% and an upfront load of up to 4%.

Like equity analysts, Keenan's staff of 24 do bottom-up research, monitoring and modeling free cash flow estimates to create their own credit ratings for borrowers. They need to be sure that the cash an issuer has left after covering its capital expenditures can comfortably cover the interest bills and, it's hoped, retire some of the principal. Keenan scrutinizes the expense accounts of his analysts "to make sure they're on the road visiting companies."

After a leveraged buyout a borrower will typically have debt (bonds plus bank debt) equal to four to seven times operating profit (in the sense of earnings before interest, taxes and depreciation). That ratio of debt to profit doesn't look too scary. But two cautions are in order. One is that a certain level of capital expenditures is necessary just to stay in business—cement kilns and airplanes and printing presses have to be replaced. The other is that when the denominator collapses, as it has a habit of doing in recessions, the ratio goes skyward.

A recent mistake BlackRock made was to buy bonds used to finance a buyout of Yellow Pages publisher R.H. Donnelley. That seemingly stable advertising business has taken a blow from the Internet. The bonds were issued at par value. At the time, the ratio of debt to Ebitda was seven times. Keenan bought some bonds at 100 cents on the dollar. The debt ratio is still seven, and the bonds are trading at 70 cents on the dollar.

Keenan's portfolio leans toward sectors that he thinks will outperform the economy as a whole. It's 5.0% in metal miners and processors, versus 3.8% for the Lehman junk index; 6.1% in wireless phone companies versus 1.7% for the index. He is avoiding food and beverage producers and retailers. "The consumer is weak. I see a slowdown in consumer spending coming, so I'm underweight retail," Keenan explains.

He likes the Freeport-McMoran Copper & Gold 8⅜% bond due in 2017, trading at 110 for a 6.5% yield. With copper pushing close to $4 a pound, Freeport has been able to pay down faster than expected the $11.5 billion it borrowed to acquire Phelps Dodge. Freeport's ratio of debt to Ebitda has dropped from 4 to 0.5. If metal prices hold up, Keenan says, Freeport will enjoy $5 billion a year in profits before taxes and depreciation but after interest and cap-ex.

Since many of the fund's holdings are the result of private equity LBOs, Keenan often finds himself in tricky negotiations with the likes of Blackstone and Apollo. He prefers not to buy securities unless BlackRock is covered by covenants that protect its position in the debt structure.

Keenan has set himself two guidelines: The issuer can't take its money out in a cash dividend or add debt senior to BlackRock's, without permission from the bondholders. Those provisos protected him from the worst of two troubled Apollo LBOs, Linens 'n Things and Claire's Stores.

Keenan isn't sure we've seen the bottom of the credit bubble. He has an 8% cash cushion to take advantage of what he calls "a default environment." If U.S. earnings weaken, he says, "Equities will trade down, and the spread [of junk yields] over Treasurys will widen."

If you have at least $5 million to put into junk debt, you could buy individual bonds. With less, you probably shouldn't: You'll get killed either by bid/ask spreads or a lack of diversification. To smaller investors we recommend buying no-load funds with reasonable expense ratios. The table shows eight. **F**

Junk Sale

To avoid a load like BlackRock's, consider these eight junk funds, which FORBES rates as Best Buys. All have an average credit quality of B, except Vanguard's BB.

FUND	5-YEAR AVERAGE TOTAL RETURN	YIELD	ANNUAL EXPENSES PER $100
FEDERATED HIGH-YIELD TRUST	8.0%	7.7%	$0.99
FIDELITY CAPITAL & INCOME	10.0	6.5	0.76
FIDELITY HIGH INCOME	8.3	7.6	0.75
NORTHERN HIGH YIELD FIXED INCOME	6.4	7.8	0.90
PAYDEN HIGH INCOME	6.6	7.7	0.61
T ROWE PRICE HIGH-YIELD	7.6	7.9	0.77
USAA HIGH-YIELD OPPORTUNITIES	7.6	7.8	0.90
VANGUARD HIGH-YIELD CORP-INV	6.2	7.7	0.26

Performance through Apr. 30. *Sources: Forbes; Lipper; Morningstar.*


Deepwater expertise: drilling the Jack 2 well in the Gulf of Mexico.

KJETIL ALSVIK FOR STATOILHYDRO

THE GOVERNMENT OIL PLAY

National governments are hogging 70% of the world's most accessible petroleum. You can get a piece of the action by buying shares of companies like Statoil.

BY CHRISTOPHER HELMAN WITH EMILY SCHMALL

THE JACK 2 WELL DRILLED IN THE deep waters of the Gulf of Mexico in 2006 was heralded as opening up 15 billion barrels of untouched oil reserves. Do you want a piece of it? You could buy into Chevron or Devon Energy, partners in the project. Or you could buy shares in a mostly government-owned oil company that is also participating, the Norwegian firm StatoilHydro.

Øivind Reinertsen, who runs operations in the gulf for StatoilHydro, hastens to dampen expectations. "There's a lot of oil there, but nobody talks about the cost. If we started today without developing new technology, the economics would not be robust even at today's oil prices," he says. Even so, StatoilHydro looks intriguing. It's making good money off oil projects that are already pumping: $8.7 billion last year, or $2.70 per ADR. Of that, $5.3 billion was paid out in dividends, for a 4.5% yield on the recent $39 share price.

It costs $200 million to drill and complete a single well at Jack's 30,000-foot depths. But StatoilHydro is dedicated to the gulf. It has invested $8.5 billion there over six years. Reinertsen expects to drill 25 new wells by 2012.

StatoilHydro was formed last October in the merger of Norway's biggest company, Statoil, with the oil and gas operations of Norsk Hydro. Norway's $400 billion state pension fund owns 63% of the company's shares. With $102 billion in combined annual sales, StatoilHydro is among the world's ten largest publicly traded oil companies.

National oil companies hold more than 70% of the world's easily recovered oil and natural gas. But you can't buy shares in 100% state-owned giants like Saudi Aramco, Petróleos Mexicanos (Pemex), or Petróleos de Venezuela. StatoilHydro is one of a handful of hybrid state-controlled oil companies *(see table, p. 18)* in which you can.

Oil the World's a Stage

These seven state-controlled sisters have access to massive, low-cost reserves of oil and gas at home and handy political connections to help expand abroad.

COMPANY	% STATE-OWNED	P/E	5-YEAR ANNUALIZED TOTAL RETURN	MARKET VALUE ($BIL)	RESERVES[1]
CNOOC	65%	18	52.5%	$81	2.6
ENI	30	8	27.3	154	6.4
GAZPROM	50	12	56.3	312	120.0
OMV GROUP	32	9	47.6	22	1.2
PETROBRAS	32	21	75.9	243	13.8
PETROCHINA	86	11	54.4	427	19.6
STATOILHYDRO	63	13	39.1	114	6.0

Return and market value as of May 6. All companies trade in the U.S. as American Depositary Receipts. All figures in U.S. dollars. [1]Billions of barrels of oil equivalents. *Sources: FT Interactive Data, LionShares and Worldscope via FactSet Research Systems; Bloomberg Financial Markets.*

These hybrids are decent investments for outsiders. They enjoy preferential access to large, low-cost reserves at home. By dint of being listed on international exchanges, they have some motivation to be transparent to outside shareholders. That said, "Gazprom is a direct instrument of Russian state policy, while the Chinese [PetroChina and Cnooc] are just a shambles, with the government telling them what to do," says Charles Maxwell, oil analyst with Weeden & Co. Still, Maxwell believes that over time access to resources will compensate investors throwing in with autocrats.

StatoilHydro's political risk is low. Unlike the backlash that China's Cnooc got in 2005 when it attempted to buy the California firm Unocal, the Norwegians haven't elicited a peep from U.S. politicians for their viking thrust into the Gulf of Mexico. "I don't think Congress would have been upset if it was Statoil that bought Unocal," says Reinertsen.

The company gets 80% of its 1.9 million barrels of daily production from home waters. The rest comes from spots like Azerbaijan, Angola, Algeria and Iran, where it weathered a bribery scandal in 2004 and is developing the giant South Pars gas field. Next year it will drill for oil in Cuba, 50 miles from Key West, with Spain's Repsol and India's 74%-state-owned Oil & Natural Gas Co.

U.S. oil companies aren't allowed to operate in Cuba or Iran and have had a hard time cracking Russia, too. But earlier this year Gazprom finalized a deal with StatoilHydro and France's Total to develop the Shtokman field's 130 trillion cubic feet of gas under the icy Barents Sea. "We have a very close relationship with national oil companies around the world," says StatoilHydro Chief Executive Helge Lund. In Venezuela, where ExxonMobil is deep in a legal fight over confiscated projects, Lund reportedly negotiated $230 million in compensation for an expropriated field and signed a new development deal.

Charles Ober, manager of the T. Rowe Price New Era Fund, likes StatoilHydro—and also Petróleo Brasileiro (Petrobras), which has recently found what could amount to 30 billion barrels of oil in the Tupi and Carioca discoveries off the shore of Brazil. The two companies have a technology-sharing alliance, a pact to cooperate on biofuels development and joint ventures to develop offshore fields. In March the Norwegians acquired from Anadarko Petroleum the remaining 50% it didn't own in an offshore Brazilian field called Peregrino.

Petrobras has great growth potential, with one caveat. Elizabeth Collins, an analyst at Morningstar, points out that Petrobras, which is 32% government-owned, has a mandate to help keep petroleum affordable for Brazilians, so the company's profits won't be as high as if Brazil let prices float freely.

StatoilHydro and Petrobras are both working the diplomatic shoe leather to get on better terms with Pemex, a state-owned oil company famous for politics and ineptitude. Mexico's constitution bars non-Mexicans from owning its oil. But with output declining, Pemex hopes to find some way to bring in foreign capital and expertise. The presidents of Mexico and Brazil have discussed Petrobras and Pemex's jointly exploring Mexico's technically challenging deepwater fields.

It's something StatoilHydro would like to get in on. Last year it initiated a project to cut natural gas flaring at Pemex's Tres Hermanos field, using StatoilHydro technology to capture the gas and bring it to market. In a nice twist, StatoilHydro gains emissions-reduction credits it can apply to other efforts worldwide.

A bigger idea: Reinertsen foresees a time when StatoilHydro could help Pemex recover oil from the middle of the gulf, where the Norwegians have leased exploration blocks nearly flush with the U.S.-Mexico maritime border. Pipeline infrastructure already reaches nearly that far from the U.S. coast. Deepwater wells could be drilled in Mexican waters and their output tied in with the subsea pipelines on the U.S. side. Says Reinertsen: "A part of being a small country with few people is that you have to look for these possibilities. And when you find them, you grab them." F

SUBTLE SHADES OF GREEN

It's not too late to find cheap "green" stocks. Look beyond the obvious to companies quietly boosting the sector's growth.

BY ERIKA BROWN

SAY WHAT YOU WILL ABOUT global warming, there's no denying that "green" stocks—the ones promising to help the world burn less fossil fuel—are hotter than a July day. SunPower, a maker of solar cells and panels, is trading at $82, or 326 times trailing earnings. That makes First Solar, at $275 a share but only 110 times earnings, a relative bargain.

If you'd like some exposure to green stocks but fear getting scorched by such multiples, look around—beyond the billboard players. "When your average investor thinks of renewable energy, he thinks of solar, wind and biofuels," says Shez K. Bandukwala, "but there is so much more opportunity hidden in the green tech sector."

Bandukwala, 42, worked on public offerings at William Blair & Co. before moving in 2005 to what is now the San Francisco investment bank ThinkPanmure. As the Chicago partner in charge of alternative energy, he has done offerings for First Solar, SunPower, Evergreen Solar and Real Goods Solar.

You have to be a true believer to find stocks like these appealing; companies available at low multiples of their sales or earnings are pretty scarce *(see table)*. One Bandukwala favorite is New Age carbon fiber maker Zoltek. Headquartered in Bridgeton, Mo., and a ThinkPanmure client, it originally designed carbon fiber for car brakes. These days it sells the lightweight material to wind-power generators like Gamesa to make huge windmill blades. Despite Zoltek's stratospheric price/earnings multiple (135), Bandukwala says it can't make its product fast enough to meet demand.

Xantrex Technology makes components that help convert—or, more specifically, invert—power from direct to alternating current. That process is necessary to turn DC power collected in solar panels into AC power usable inside homes. The Toronto-listed shares trade at $8.08, giving a $234 million market value to a firm that had but $234 million in revenue last year.

Metalico is a Cranford, N.J. company that recycles copper, aluminum and other metals. With commodity prices rising, its sales rose 61% in 2007 to $334 million. This one is cheap, after a fashion; its shares go for 15 times the earnings that analysts expect this year.

Fuel Tech, a firm in Batavia, Ill., produces a chemical spray that cuts down the acid-rain-producing nitric oxide spewed by power plants. Fuel Tech is one of the few firms addressing this problem, says Bandukwala.

Sanghvi Movers, which trades on the Bombay exchange, rents out heavy equipment, including 300 cranes. Most of its growth is coming from Indian wind farms and other alternative energy projects. It also leases gear to chemical plants and refineries.

Westport Innovations, listed in Toronto, has partnered with enginemaker Cummins to develop technology to shoot clean natural gas into diesel truck engines. This could be a reasonable business if states and cities mandate or subsidize natural gas engines.

Itron, of Liberty Lake, Wash., sells meters to utilities to monitor (and to prevent wasting) water, gas, electricity and heat. "From the substations, where energy is created, to the premises, where it's used, there are a lot of opportunities to minimize waste," says Bandukwala. "Meter readings are a key component in that process."

American Superconductor sells power converters and superconductor wires to energy companies, including wind energy producer Sinovel Wind. Its parts help connect wind turbines to power grids. The company, whose sales are expected to rise 52% this fiscal year to $170 million, also designs wind turbines.

"What I like about these companies is that they can be successful no matter which solar or wind companies win," says Bandukwala. "Out of the PC industry came Microsoft. Out of e-commerce came infrastructure company Cisco." **F**

The Color of Money

Value investors aren't going to love these stocks. But for those seeking growth, and confident in green technology, here are some little-known plays.

COMPANY	PRICE RECENT	PRICE 52-WEEK HIGH	PRICE/ SALES	3-YR ANNUAL SALES-PER-SHARE GROWTH
AMERICAN SUPERCONDUCTOR	$25.50	$32.74	11.0	–5%
FUEL TECH	24.51	38.20	7.0	32
ITRON	102.78	112.92	1.9	34
METALICO	12.91	14.24	0.9	22
SANGHVI MOVERS	6.09	8.55	5.0	60
WESTPORT INNOVATIONS	2.76	3.42	4.5	14
XANTREX TECHNOLOGY	8.08	13.54	1.1	10
ZOLTEK	27.50	51.77	5.6	36

Prices as of Apr. 29, in U.S. dollars. *Source: Worldscope via FactSet Research Systems.*

GABRIELA HASBUN FOR FORBES

TAX SHELTERS 2.0

Bad tax ideas, like viruses, tend to mutate and claim new victims.

BY JANET NOVACK

IF YOU NEED A REMINDER THAT MONEY doesn't buy happiness, consider the sad case of Henry T. Nicholas III. The billionaire cofounder of Broadcom has made the news lately over a nasty child-custody battle, a stock-options-backdating scandal in which he's been identified as an unindicted potential co-conspirator, allegations of drug use and the indictment of the former manager of his family holding company for hiding cash transactions. Nicholas checked into the Betty Ford Center in April.

One Nicholas nightmare that's gone unnoticed is his fight with the Internal Revenue Service over whether his family can claim $290 million in tax losses from a $6 million investment in junk Asian debt and securities.

The ploy—which the IRS calls a "distressed asset/debt," or DAD, shelter—was sold to Nicholas and other tech high rollers in 2001 by Chenery Associates and MyCFO, a financial advice firm backed by Netscape cofounder James H. Clark and venture capitalist John Doerr. Three years later Congress changed the tax code to bar partnerships from being used to transfer foreign losses to U.S. taxpayers. Even though that law doesn't apply retroactively to Nicholas' 2001 shelters, the IRS sent his family's partnerships notices declaring them illegitimate economic shams. In March the partnerships filed five lawsuits challenging the IRS' denial of their losses and its imposition of penalties.

You might think that congressional action, vigorous enforcement and complications like Nicholas' would have killed off DAD and the rest of the tax shelter racket. But that would be to underestimate the tenacity of shelter salesmen and the greed and gullibility of their marks. Instead, like shelters that garnered unwanted attention in the past, DAD has mutated—in its case into DAT, or the "distressed asset trust," which replaces partnerships with trusts to transfer losses.

"Once you find one type of tax shelter and list it [as abusive], you will get a creative accountant, tax lawyer or other type of promotional salesperson tweaking the shelter," says Nathan J. Hochman, head of the Department of Justice's Tax Division.

All this comes on the heels of the government's efforts earlier this decade to squash tax shelters. It indicted lawyers and accountants, extracted $456 million in fines, penalties and restitution from KPMG and squeezed billions in back taxes, interest and penalties from individual shelter users.

KPMG is no longer cold-calling shelter prospects. Yet smaller accounting firms, independent CPAs, lawyers and insurance salesmen continue to flog new—and old—shelter mutations to business owners and the successfully self-employed.

"After all the enforcement, I'm surprised at the level of tax shelter activity that's still out there," says Ian Comisky, a partner at Blank Rome in Philadelphia who defends taxpayers in civil and criminal cases.

Court records indicate the IRS is investigating whether John E. Rogers, a Chicago partner in law firm Seyfarth Shaw LLP, promoted DAD and later DAT to dozens of investors nationwide. The government asserts in court papers that Rogers' clients claimed $223 million in dubious losses from Brazilian consumer debt in the three years through 2005. Rogers defends the deals as legit and accuses the IRS of harassment. Seyfarth Shaw wrote a 104-page opinion before the 2004 law change saying the shelters would "more likely than not" withstand IRS and judicial scrutiny. The firm declined comment.

Jay D. Adkisson, an attorney who has tracked offshore tax schemes for a decade, says that since the IRS crackdown, lawyers and CPAS appear to have become even more central to selling such schemes. "Offshore promoters have become more sophisticated in what they do," he says. "People think, 'If my lawyer showed it to me, it's okay.' But if something involves offshore, get a second opinion."

Beware: Sanctions have been ratcheted up for shelter buyers. Congress created a mandatory $100,000 penalty four years ago for any individual who fails to disclose on his tax return that he participated in a transaction that is the same as, or substantially similar to, one the IRS has listed as abusive. A corporation, including one used in an individual's tax shelter, faces a mandatory $200,000 penalty for not disclosing a listed transaction.

Amazingly, even banned shelters are still being touted. The IRS listed the "abusive Roth IRA" five years ago. Yet promoters are still encouraging clients to shelter huge business profits in Roth IRAs, rather than stick to the $5,000 or $6,000 limit for legitimate contributions.

Two partners at Grant Thornton began pushing the Roth ploy in the late 1990s. In 2001, after the firm got squeamish, they left to promote it further. (Grant Thornton says its national tax practice never approved the shelter.) In February the Justice Department sued the two seeking to enjoin their activities.

Meanwhile, the bad idea has spread. The IRS says it's now investigating two dozen promoters of what it believes may be abusive Roth IRAS or similar questionable transactions. **F**

SAFETY TIPS

- Stay onshore.
- Don't pay outsize fees.
- Don't do deals with your own IRA.
- Get a second opinion.
- Be wary of a tax loss bigger than your investment.

TAPPING YOUR IRA EARLY

There is a way to get at your retirement account early without paying a fat penalty. But once you take this route you have to stay on it for years.

BY CHRISTOPHER STEINER

Individual retirement accounts are a good deal for people who want to stash savings away for a few decades. A big downside to such accounts, however, is that once you put the money in, taking it out before age 59 1/2 typically means paying a 10% early withdrawal penalty on top of ordinary income taxes.

There is another way. The IRS allows investors to dodge the standard early-withdrawal tax at any age, and for any reason, via a so-called 72(t) distribution. Roth IRA owners can also withdraw principal at any time penalty-free without the 72(t).

As with many IRS rules, there's a catch. The 72(t) distributions are subject to ordinary income taxes, and once started they must continue for five years or until the beneficiary is 59 1/2, whichever is longer. That means a 40-year-old who signs up must continue taking taxable withdrawals for at least 19 years. Investors can lessen the resulting decline in tax-deferred savings along the way by making contributions to a separate IRA (up to $5,000 a year for those 49 and under and $6,000 from age 50), even as they take the 72(t) distributions out. Not everyone is eligible to make deductible IRA contributions, however.

Who should consider 72(t) distributions? Such withdrawals are best suited to people with fairly large IRAs who want to enjoy their money before retiring, while also putting it to productive use, says Harry J. Abrahamsen, a financial planner in Holmdel, N.J. "Maybe you're 50 and ten years away from a retirement that you dream will include a Nantucket cottage," he explains. "Why not use your IRA to start enjoying the beach house now, when real estate is cheap and you can lock in low interest rates?"

Alfonse DeMaria, a 41-year-old New Jersey chiropractor, followed Abrahamsen's script four years ago when he drilled into his $700,000 IRA to buy a six-bedroom house on 269 acres in rural Franklin, N.Y. His $3,000 monthly distribution more than covers his mortgage payment and real estate taxes. "My kids and I can start enjoying the house now rather than 25 years from now, and it will still be here then, too," he says. "I'm not throwing the [IRA] income away."

Matthew Riccardi, 37, films weddings, recitals and other events out of his Franklin Lakes, N.J. videography venture, with ten employees and gear bursting the seams of a 2,000-square-foot office. Riccardi started 72(t) distributions last year from the $500,000 IRA he'd amassed by rolling in a profit-sharing plan. The $25,000 annual distribution will ease the cash crunch of spending $700,000 to buy and renovate his own building. "This gave me the capital I needed," he says.

If a 72(t) makes sense for you, the next step is deciding on one of three ways to calculate distributions. The simplest involves dividing the total size of the IRA by your remaining life expectancy in years. Under this method, a 50-year-old with a $500,000 IRA would be required to take distributions of $14,620 a year.

A different calculation method is preferred by many financial advisers because it yields the largest distribution. Under it, the account balance is amortized over the IRA owner's life expectancy, assuming an annual growth rate anywhere from 80% to 120% of an interest rate known as the federal midterm. The high-end assumption is now at 3.3%. With year-end withdrawals for a half-million-dollar account, it would yield annual payments of $24,572 for a 50-year-old.

The third method divides account balances by a factor that is the present value of an annuity worth $1 annually to the account owner. A 50-year-old's factor of 20.44 would yield $24,461 yearly from a $500,000 IRA.

Those whose needs are less grand can divide IRAs into two accounts and do 72(t) distributions with only one. **F**

Alfonse DeMaria used his IRA to buy, and enjoy, a retirement retreat while still in his forties.

NATHANIEL WELCH FOR FORBES

BUILDING BOOM

Financial troubles have turned net leases into a high-yield way to get into commercial real estate.

BY MATTHEW SWIBEL

THEY'VE GOT INVESTMENT-GRADE credit, pay your property taxes and insurance and increase their rent payments every year. Meet the typical tenant who has signed a net lease on a retail, office or industrial building. If you are the landlord, you get a pretty well-protected income stream for the next 20 to 30 years.

It's a great time to buy the building. Users of space sell property and lease it back as a way to raise cash. Over the past six months SunTrust Banks has raised $736 million unloading 421 branches. Pep Boys, the auto parts chain, closed on a sale-leaseback of 23 stores in April for $74 million.

The average yield on net-leased property rose six basis points to 7.6% in the fourth quarter of 2007, reports Price-waterhouse-Coopers. The number comes from a survey of the top seven institutional net-lease investors, who trade mostly in class A property. What's the catch? Mainly, that at the end of the lease term the landlord may have an empty fitness club or warehouse on his hands that needs significant improvements before it can be leased again. Another is that if the tenant goes bankrupt, the property may be empty for several months.

The icy residential market offers another silver lining for net-lease hunters. Until recently, soaring prices were prompting speculators to dump investment homes and swap into commercial real estate as a way of deferring capital gains taxes via so-called 1031 swaps. Over the past few years such deals drove a majority of net-lease volume and sparked multiple bids for many properties. Not anymore.

"Now's a good time to be a buyer," says Michael Houge, a principal at Upland Real Estate Group in Minneapolis. "I have twice as much retail property for sale as six months ago, with higher-quality tenants, better locations and more aggressive sellers."

Here are ways to get into this market.

Buy specialized REITs. Equity real estate investment trusts (the kind that own buildings rather than mortgages) are liquid and average a so-so 4.9% yield. Net-lease REITs do considerably better by acquiring, owning and managing net-leased office, industrial and retail properties *(see table).*

Among net-lease pure plays, National Retail Properties and Realty Income both offer 6.7% yields. Realty, which owns 2,375 properties, acquired 106 of them with 100% occupancy rates in the first quarter of 2008. The average initial yields came in at 8.7% on leases averaging 20 years in length. The company's funds from operation (roughly speaking, net income plus depreciation minus maintenance-level capital expenditures) may dip 1% in 2008, but its dividend should climb 4% over the next year, estimates Philip Martin, an analyst with Cantor Fitzgerald. Even if the economy enters a nasty downturn, Realty Income should be able to take care of itself, having recovered an average of 97% of prebankruptcy rent in the 16 bankruptcies its clients have suffered in the past decade.

Two other net-lease

BOB CROSLIN / AURORA SELECT FOR FORBES

Jack Diamond is earning a tasty yield on his six net-lease properties.

New Lease on Property

Want to earn income from a building? Equity real estate investment trusts yield below 5%. Net-lease specialists, like those below, offer considerably more.

REIT	RECENT PRICE	DIVIDEND YIELD	3-YEAR ANNUALIZED GROWTH NAV[1]	FFO[2]
CAPLEASE	$8.05	9.9%	NA	23.0%
WP CAREY & CO[3]	29.99	6.4	NA	NA
LEXINGTON REALTY TRUST	14.23	9.3	1.3%	–1.2
NATIONAL RETAIL PROPERTIES	22.31	6.7	13.6	10.1
REALTY INCOME	24.64	6.7	6.0	6.6

Prices as of May 7. Growth figures are from 2005 through 2008 estimate. [1]Net asset value. [2]Funds from operations. [3]Real estate operating company. NA: Not available.
Sources: SNL Financial; Reuters Fundamentals via FactSet Research Systems.

REITS offer even juicier yields. Lexington Realty Trust (9.3%) has had its share price bruised by worries that an economic slowdown will hurt its lease renewals. CapLease's dividend (9.9%) is covered by cash flow (in the sense of net income plus depreciation), and most of its portfolio is under fixed-rate financing. Even so, debt market turmoil has raised fears it will have a hard time raising capital for the future acquisitions it needs to boost its dividend. Both REITS are trading near 52-week lows.

Piggyback big deals. Most sale-leasebacks involve deals north of $20 million, which is too pricey for most individuals. They can still participate, however, since REITS and other institutional net-lease buyers often sell off some properties to turn a profit or balance holdings geographically.

That's how investor Jack A. Diamond, 60, became the net-lease holder for a Checkers drive-through hamburger joint. Taxi Holdings, a subsidiary of private equity firm Wellspring Capital Management, took the burger chain private in 2006 and then unloaded branches on Trustreet Properties of Orlando, Fla., via a sale-leaseback deal.

Diamond paid Trustreet (now part of General Electric) $387,000 for one of the Checkers stores in Sarasota, Fla., on a busy intersection shared with a Super Wal-Mart. The restaurant pays $27,000 a year in rent, net of operating costs. Rent increases of 2% annually are locked in for the next 20 years. "I like the steady income stream and not having day-to-day responsibility" for managing the real estate, says Diamond, a retired building supply executive, who co-owns five other net-lease properties via an S corporation.

Shop solo. A lot like house-hunting, this approach requires lots of legwork, but there's plenty to choose from. Nationwide, 21,000 net-lease properties, worth $60.5 billion, are on the market. That's up from 7,000 at the end of 2005, Boulder Net Lease Funds estimates. Among them, the most affordable are 11,000 single-tenant retail outlets, 60% priced below $2 million. Based on asking prices in the fourth quarter of 2007, one-third of retail properties were yielding 8% or more.

Brokers peddling net-lease properties include Boulder, Calkain Cos., Net Lease Capital Advisors and Upland Real Estate Group. They typically represent sellers of properties whose tenants boast investment-grade ratings or high net worths—such as Starbucks—rather than build-to-suit developers. It is usually up to the seller to pay the brokerage commissions of 1% of the sale price.

It's well worth paying an experienced lawyer to review a deal before closing since its value depends on the details. "Make sure the tenant is responsible for the parking lot and the roof," cautions Sidney Domb, president of United Trust Fund, a Miami, Fla. net-lease investment shop. "People use the words 'net lease' openly."

Another red flag: flat rent over 25 to 30 years or a series of options at meager increments. It's a good idea to check out tenants' credit standing and business strategy. Even if the lease guarantees a highly rated firm will keep paying rent after closing a branch, it might not maintain the property. Diamond learned that one the hard way when he acquired a net lease on a central Florida Eckerd drugstore that CVS shuttered, and neglected, after acquiring the Eckerd chain.

Financing the purchase of a net lease presents another challenge. No matter how highly rated your tenants, virtually all lenders will require 30% down payments. A pullback among pension funds and conduits, which formerly securitized commercial mortgages, has made loans tougher to find. Regional and European banks are stepping in, albeit at higher interest rates, says Upland Real Estate's Michael Houge. F

PIPELINE TO PROFITS

You want a piece of the energy business that won't get hurt if oil crashes? Take Gabriel Hammond's advice and own some buried steel.

BY ZACK O'MALLEY GREENBURG

GABRIEL HAMMOND IS A FUND manager from central casting. Raised in a posh Washington, D.C. suburb, he got a degree from Johns Hopkins, spent two years at Goldman Sachs and then set up his own fund firm (current assets under management: $250 million). The one kink in his story is that Hammond, 29, doesn't dabble in growth stocks or distressed debt. His game is rusty metal tubes buried deep underground. Hammond's Dallas firm, Alerian Capital Management, taps into oil and natural gas pipelines via tax-advantaged vehicles called master limited partnerships, or MLPs.

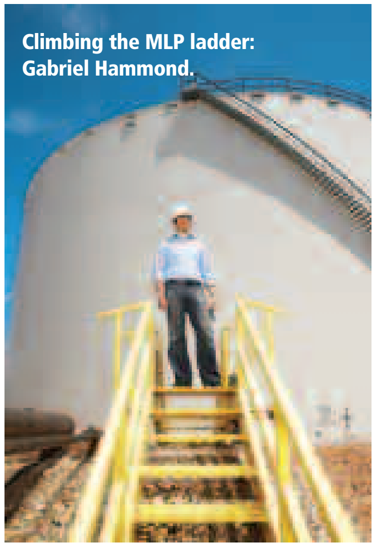
Every day 280,000 miles of pipelines shuttle 63 billion cubic feet of natural gas around the U.S. About a quarter of them are held as MLPs. A separate 100,000-mile network hauls 20 million barrels of crude daily, with 70% in MLP hands.

The 50 exchange-listed MLP pipelines and storage units have a combined value of $120 billion. There's more capital en route. The U.S. is expected to put another $100 billion into its natural gas infrastructure over the next decade. The pipelines' income streams should hold up even if energy prices drop. That's because they get so much per pound shipped, not per dollar of product.

"These companies are all toll-road business models," says Hammond. "They're agnostic about whether crude oil is at $30 or $115 a barrel."

The partnerships are typically formed when big companies decide to raise cash by hiving off hard assets. Once public, MLPs trade like stocks. The twist is that they're partnerships, which means they pass on earnings and depreciation to investors. Come tax time, that means investors typically pay ordinary income taxes on about one-fifth of distributions, which have grown 8% to 10% annually in recent years.

The other 80% of distributions are considered nontaxable returns of capital that reduce a partner's cost basis. That means they turn into future capital gains, taxed either much later (when the investor sells the shares) or never, if it winds up in his estate and enjoys the capital gains step-up at death. There are some further subtleties (the tax treatment of partnerships is bizarrely complicated), but the bottom line is that investors holding MLPs that own depreciating assets


Climbing the MLP ladder: Gabriel Hammond.

SCOGIN MAYO FOR FORBES

A Nice Set of Pipes

Gabriel Hammond likes pipelines for their high yields and steady growth rates. Here are nine MLPs to gas up your portfolio.

NAME	MARKET VALUE ($BIL)	PRICE	YIELD	DISTRIBUTION PER SHARE LAST 12 MONTHS	DISTRIBUTION GROWTH 5-YR AVG	RETURN OF CAPITAL 5-YR AVG	STATES WITH OPERATIONS[1]
ATLAS PIPELINE PARTNERS	$1.6	$41.85	8.6%	$3.50	10.1%	90%	6
COPANO ENERGY	1.8	37.66	5.0	1.73	32.6	90 [2]	4
ENBRIDGE ENERGY PARTNERS	4.8	49.91	7.5	3.73	0.5	90	42
ENERGY TRANSFER PARTNERS	8.3	49.10	7.3	3.26	6.0	80	34
ENTERPRISE PRODUCT PARTNERS	14.0	32.06	6.1	1.92	7.0	90	42
INERGY	1.5	29.06	8.5	2.32	10.4	85	33
LINN ENERGY	2.5	21.49	10.9	2.18	25.5	100 [3]	7
MAGELLAN MIDSTREAM HOLDINGS	1.5	24.42	4.8	1.07	24.5	90 [3]	22
PLAINS ALL AMERICAN PIPELINE	5.5	47.00	7.2	3.28	9.5	90	40

[1]MLP shareholders aren't necessarily taxed in every state in which the partnership operates. Some states have tax thresholds; others, e.g.,Texas, have no income tax. [2]Three-year average. [3]Two-year average. *Sources: Alerian Capital Management; companies; Bloomberg.*

are taxed leniently.

The downside of investing directly in MLPs is complexity. Pipeline partnerships are a particular problem because they must calculate, and investors must report, gains and losses in each state they traverse. The resulting K-1 tax forms are so cumbersome that many financial advisers suggest bothering with MLPs only for six-figure investments.

A simpler alternative is to own the exchange-traded iShares in one of two industry stalwarts, Kinder Morgan and Enbridge. These trade, and are taxed, like ETFS and require no K-1 filings. Kinder Morgan is the largest MLP by market cap at $15.2 billion; Enbridge is valued at $4.8 billion. They are precisely the sort of workhorse pipelines that Hammond favors (*see table*).

In 1997, in Hammond's freshman year at college, he put $2,000 earned as a swimming instructor into his first online brokerage account and started trading. The tech bust was raging by the time he graduated in 2001 with a double major in economics and international relations. Yet Hammond's account had ballooned to $17,000, thanks to blue chips like Caterpillar and Altria.

After graduating, Hammond, who maintains his swimmer's physique on a diet that includes a gallon of egg whites a week, took a job as an energy analyst at Goldman Sachs in New York. It turned out to be a front-row seat for Enron's collapse and the shock waves it sent through the pipeline industry. "Companies were selling assets to stave off bankruptcy," recalls Hammond.

As firms like El Paso and Dynegy raced to raise capital, some spun off pipelines into MLPs. When it was over, Hammond was the only one in Goldman's energy and power group interested in covering the partnerships.

In the 15 years since tax changes had paved the way for modern MLPs, a mere 15 had been launched and had a combined value of $20 billion by 2003. In the market recovery that followed Enron's collapse, however, the partnerships started to draw yield-hungry investors. Hammond was convinced the MLP business was poised for a growth spurt, like the one REITs had enjoyed a decade and a half earlier.

He began putting together Alerian in July 2004 and trading MLPs with $5 million under management from Hans Utsch, a portfolio manager at Federated Investors, whom Hammond had met at a luncheon. Hammond struggled just to pay the bills but earned 15% his first half-year in operation. That was good enough to lure investments from two Wall Street firms, which declined to be named.

A year after Alerian's launch Hammond had $50 million under management. His timing was outstanding. In the four years after he set up Alerian, the MLP sector's market cap tripled and Alerian's total returns came in at 20% annually. In June 2006 Hammond's little firm launched the Alerian Master Limited Partnership Index, the first to track MLPs. A year later he added BearLinx Alerian MLP Select, an exchange-traded note that trades like an ETF and tracks the firm's MLP index.

Despite MLPs' hefty returns over the past decade, tax-exempt institutions have shied away from investing directly in them because of tax complications. (It's similarly a bad idea to hold MLP shares in a tax-deferred account.) But they are a fine choice, he says, for retail investors in high tax brackets who can stomach the paperwork.

MLP distributions average 7.5% of market prices today, or 3.6 percentage points more than yields on ten-year Treasurys. That compares with a historical average of only 2.25 points over Treasurys, says Stephen Maresca, an MLP analyst at UBS. No surprise, he's a bull on the sector. **F**

HOME, BUT NOT ALONE

Want to live out your last years in your own home? Long-term-care insurance can help.

BY CARRIE COOLIDGE

PATRICIA GLASCOM NEVER FELT so hopeless as when she watched her parents burn through their life savings paying for Alzheimer's care for her mother. The elderly couple ended up destitute together in a nursing home paid for with help from Medicaid. Glascom, a 60-year-old retired school teacher, vows never to succumb to a similar fate.

To avoid it, she and her husband, Gary, a public defender in Allentown, Pa., bought long-term-care insurance in 2000. Thep-olicy came in handy long before Glascom ever expected she'd need it when, in 2002, she required back surgery, was laid up at home for ten months and, in the comfort of her own home, received $110 a day to cover an aide and an in-home hospital bed.

"The policy did what it was supposed to do," she says of the coverage bought from Genworth, the largest vendor, which took in $1.8 billion last year in premiums on long-term-care policies. Rival vendor John Hancock had premium income of $1.4 billion.

As with most Americans, when the Glascoms first contemplated old age, their top priority was to spend as much of it as possible in their own home. When they started shopping for long-term-care insurance, that meant focusing on in-home coverage.

A decade ago that would have been a tall order. But policies have evolved rapidly in recent years, from covering nursing homes and little else, to providing services at assisted living facilities or right at home. Indeed, Genworth says that it wrote checks for $240 million to cover at-home benefits from its long-term-care policies last year; 75% of policyholders chose to have care at home.

The evolution of the long-term-care market is merely following broader demographic trends. Two in five Americans will eventually need long-term care, which neither health nor disability insurance covers. What's more, 80% of that care is already delivered at home, versus 18% in nursing homes and 2% in assisted living homes.

"Insurers have gotten more progressive and responsive to the market," says Shay Jacobson, president of Life Care Innovations, a Chicago geriatrics consulting firm.

Medicare, for which 65-year-olds are eligible whatever their income, covers long-term care only in a nursing home, and then only for 20 days (with a co-pay after that) following a hospital stay for the same condition. It does not pay for at-home or assisted living care. Medicaid, by contrast, already pays for 44% of total long-term-care services but covers only the indigent—like Patricia Glascom's parents in their last days.

"There's a silent epidemic in the U.S. involving hardworking middle-class citizens going broke because of long-term-care costs," says Donald Grimes, executive director of Long Term Care Education Specialists, a nonprofit that gets funding from government agencies and insurance companies and educates the public about long-term care.

For most middle-class people, deciding what to do presents a tough choice. They can buy costly private insurance or risk that their savings will expire before they do. It might pay to take that chance and self-insure if your retirement income will cover $100,000 to $150,000 annually in care costs, says Grimes.

Patricia Glascom vows not to end up old and impoverished, like her parents.

BILL CRAMER FOR FORBES

Another option is to combine personal savings and insurance. "I tell clients to have a lump sum stashed away for long-term care and purchase some base level of insurance to cover the rest," says Gregory Zandlo, a fee-only certified financial planner in Minneapolis. "This helps preserve the estate plan."

Those interested in at-home or assisted living coverage should shop for a "comprehensive" plan rather than a "facility-only" one. Comprehensive policies typically will cover in-home hospital beds and other equipment; skilled nursing services; and help with daily tasks like preparing meals, housecleaning and laundry. Benefits extend to hospices and adult day care, if it involves social programs and health-related services.

Just moving into an old-age home won't launch benefits. To collect, you must need substantial assistance with at least two of six daily activities, like bathing, eating and dressing, or supervision made necessary by cognitive impairment. To qualify for benefits outside the home, a facility must be a state-licensed assisted living or nursing home that has a dining room.

Most comprehensive policies offer benefit periods of two to ten years, as well as a lifetime benefit option that's most likely to be of use to those with chronic conditions such as Alzheimer's or Parkinson's disease. Guardian's lifetime benefit costs 22% more than its five-year plan. When shopping, keep in mind that the average care claim is for two and a half to three years. Given the long-term nature of these policies, and the short-term nature of most benefit periods, it may make more sense to opt for an inflation-protection rider than a lifetime benefit.

Payment of benefits can be through reimbursement plans, which pay actual expenses, or indemnity plans, which are more expensive and pay specific daily benefits regardless of costs. Daily benefits range from $100 to $400. When selecting, consider that nursing homes currently cost $76,000 a year, or $208 a day, on average. Full-time home health aides run about $44,000 annually, or $121 each day you need help. If you are really disabled, you'll keep four full-timers busy.

The earlier you start paying for a policy, the less it costs. A 55-year-old man will pay an annual premium of $1,128 for a guaranteed renewable John Hancock policy with a $200 daily benefit to be paid for up to three years (or a total of $219,000 in benefits). If he waits until age 65, the yearly premium jumps to $2,200. For $3,948 a year, the 65-year-old can get a policy that doesn't have the three-year ceiling on benefits. Neither of these policies has an inflation adjustment. That can add another 65%.

Another advantage of buying early is that your chances are better of finding coverage. Only 11% of applicants in their 50s are turned down, versus 57% who are 80 or older. Once you're in a policy, the insurance company can kick you out only if you stop paying premiums. F

THIS HOME BOOM IS STILL ALIVE

Brazil is enjoying a residential building bonanza for all the right reasons. And foreign investors are welcome.

BY KERRY A. DOLAN

HYPERINFLATION. POLITICAL crises. A plummeting currency. For decades something always supported the adage that Brazil is the country of the future—and always will be.

Not anymore. Fueled by low interest rates, sound fiscal policy and robust demand for its commodities, Brazil is a darling of emerging markets these days. The economy grew 5.4% in 2007 and should deliver something close to that again this year. Stocks, measured in Brazilian reais, are up 55% since January 2007. Inflation is down two-thirds in six years to 4.29%, about the same as in the U.S.

As in Mexico four years ago, Brazil's real estate market has been a prime beneficiary of the drop in borrowing rates and other good economic news. The difference is that Brazil's market is open and drawing in enormous amounts of foreign capital, says Citigroup Latin America strategist Geoffrey Dennis.

U.S. institutions started sniffing out Brazilian real estate deals a few years ago. The $242 billion California Public Employees' Retirement System has partnered with Houston developer Hines to invest a reported $1.2 billion in Brazilian real estate. Equity International, owned by Chicago tycoon Sam Zell, began investing in Brazilian real estate in 2004.

Is it too late to join the party? Hardly. Decades of capital scarcity have created huge pent-up demand; buyers are ready to soak up 7 million houses and apartments. In Rio de Janeiro the vacancy rate for high-end office space is 3.4% (versus 7.2% in Manhattan).

"Brazil has become the nimble sprinter among emerging markets," says Equity International Chief Executive Gary Garrabrant.

Nor has it stumbled the way the U.S. has. The term "subprime" has yet to enter the vocabulary in Brazil, where home buyers traditionally borrowed from relatives and paid cash. When the mortgage market started taking off a few years ago, the longest term on a home loan was 10 years. Now 30-year loans are available, with interest rates of 13% to 14%. "In the past no one would get financing. We had inflation of 30% a month," says Fabio Maceira, chief executive of the Brazilian subsidiary of property management firm Jones Lang LaSalle.

Brazilian mortgage originations have more than quintupled since 2003 to $22 billion last year, according to Jones Lang. There's plenty more room for growth. The total came to 2% of gross domestic product; the corresponding ratio for the U.S. was 14%.

Another big change: Property developers have been tapping the equity markets for capital, with much of it coming from abroad. All told, 20 Brazilian real estate firms, most of them residential home builders, listed shares last year. Consolidation now seems inevitable, with the smart money betting on the strongest builders, says Tomás Awad, senior strategist at Itaú Securities in São Paulo.

Equity International began investing four years ago in Gafisa, which began building high-end homes but has expanded down-market. With American Depositary Shares at $37.35, Gafisa has a market value of 37 times projected 2008 earnings of $73 million on $869 million in revenues.

The majority of the stocks in the table below trade only on São Paulo's Bovespa exchange. Even so, buying shares online via E-Trade is fairly painless. A $10,000 purchase will cost $13 or so in commissions. For the ones with dividends but without an ADS, there is the added nuisance of converting semi-annual payments from reais into dollars.

Cyrela Brazil Realty, Brazil's biggest home developer, is run by billionaire Elie Horn. It began by building luxury apartments in São Paulo and Rio de Janeiro. It has since expanded into middle- and lower-income housing in 43 cities. Public since late 2005, it expanded revenue 53% last year to $1 billion; profits jumped 74% to $274 million. At a recent $14, it trades at 17 times expected 2008 earnings.

Construtora Tenda, the largest low-income home builder, went public last October and posted a loss of $22 million on $176 million in revenues in 2007. Demand is strong for its apartments and town houses, which sell for an average $43,000. Revenue should more than triple this year to $590 million, with the firm swinging to a profit of $98 million, estimates Itaú Securities' Awad. At a recent $4.91, Tenda trades at an affordable eight times expected 2008 earnings per share.

Says Awad: "Brazil is so behind everywhere in everything that this is not a short-term boost. It's a five- to ten-year cycle we're entering." **F**

From the Ground Up

With Brazilian mortgages becoming available only a few years ago, home builders are capitalizing on huge pent-up demand.

COMPANY	PRICE RECENT	PRICE 52-WEEK HIGH	P/E
BR MALLS	$9.75	$15.18	NM
CONSTRUTORA TENDA	4.91	6.99	NM
CYRELA BRAZIL REALTY	14.43	17.86	20
EVEN CONSTRUTORA	5.68	10.86	38
GAFISA[1]	37.35	42.75	NM

Prices as of Apr. 28, in U.S. dollars. NM: Not meaningful. [1]American Depositary Shares. *Source: Worldscope via FactSet Research Systems.*

FANTASY ISLAND

David Schnittlich dreamed of retiring to the Caribbean. So he bought his favorite restaurant there and became Mango Dave.

BY CARRIE COOLIDGE

DAVID SCHNITTLICH SPENDS most of his nights mingling with customers at Mango's Seaside Grill, the open-air beachside restaurant he owns in Anguilla.

The 65-year-old New Jersey native is one of those rare people who lives out a lifelong dream. Schnittlich says since moving to the island 13 years ago, he has also shed 50 pounds and overcome diabetes, gout and stress. "I'm sure I'll live longer," he says.

While tens of thousands of Americans with warm-weather fantasies migrate to Florida and Arizona every year, a number opt for exotic destinations. Like Schnittlich, many buybusinesses for fun and profit once they arrive and are glad they did. Except that it's not all fun. Along the way, Schnittlich has lived through traumatic changes to his personal life, severed decades-long financial ties and weathered the worst Mother Nature could throw at him.

The Northeasterner was drawn to

Paradise found: Remote Anguilla attracts the rich and famous.

GALEN ROWELL / ALAMY

Anguilla by the idyllic tropical scenery, English-speaking population, safety and laid-back atmosphere. The 16-by-3-mile British Overseas Territory is home to 12,000 people and an intimate getaway for the rich and famous. Its airport's only direct flights are to other Caribbean islands, and no cruise ships make port calls. Most visitors either fly in with their own planes or take a 20-minute ferry ride from nearby St. Martin.

Despite, or because of, its difficulty of access, Anguilla has more than its share of the Caribbean's five-star resorts—including the Malliouhana, Cap Juluca and CuisinArt. It also has pristine beaches and gourmet restaurants. Several resorts are under construction, but the island remains largely undeveloped. The only traffic jams are caused by wandering goats.

Schnittlich saw Anguilla featured in 1989 on TV's *Lifestyles of the Rich and Famous*. The following day he booked a trip with his wife, Carol. Five years and several visits later Schnittlich liquidated Philmour's, an upscale clothing store in northern New Jersey that his father had opened in 1947, and spent a month traveling the Caribbean while considering a move there.

One evening he was sitting in Mango's, his favorite Anguillan restaurant, when the chef mentioned he was trying to sell the place and move to the U.S. so he could be near his daughter while she attended school. "I realized it was the opportunity of a lifetime," Schnittlich says. "I couldn't just retire and live down here. I needed something to do."

The next day Schnittlich handed the owner a nonrefundable deposit for $50,000, a fifth of the asking price. They sealed the deal with a handshake. Then came the hard part. After returning to New Jersey, Schnittlich took three weeks to summon the courage to tell his wife about his decision to become an Anguillan restaurateur.

"She laughed, but not for long," he recalls. "She thought it was a stupid idea and said I was going through male menopause. She told me to get therapy."

Undeterred, Schnittlich arranged for the previous owner to run Mango's for three months so he could sell off most of his U.S. assets. Schnittlich sold his four-bedroom home in East Hampton, cars and several rental properties in the Hamptons. He kept one for home visits. Schnittlich's partner bought his 50% stake in Goldberg's, a 14-store New Jersey bagel chain.

In late June 1995 Schnittlich paid the balance of the restaurant tab. His $250,000 bought him a wobbly structure with 13 dining tables and cooking gear. Its best asset was the name Mango's Seaside Grill, one of Anguilla's best-known eateries.

Schnittlich sank another $75,000 into new furniture, lighting and flooring. Eleven days shy of Mango's scheduled reopening, he was in the U.S. on personal business on Sept. 5, 1995, when he heard that a giant storm was barreling down on the Leeward Islands.

Hurricane Louis was a category five monster with 180mph winds and 25-foot waves. Two days later Schnittlich chartered a small plane to Anguilla. Mango's was in ruins. "The only thing left was the toilet," says Schnittlich, who cried for hours on the beach. It took the island weeks to restore water, power and phone service.

He still chokes up at the memory, but Schnittlich now sees the experience as a blessing in disguise. He'd had the foresight to buy property insurance, and he used it to build a more modern Mango's, with 36 tables. Schnittlich also expanded his menu and his wine list, from 24 to 550 vintages. Reopened in January 1996, the restaurant quickly recaptured its buzz.

Five years into their Anguillan adventure, Schnittlich's wife of 22 years returned to the U.S. and later filed for divorce. "My dream came true, but it became her nightmare," he recalls.

Tough as the breakup was, Schnittlich says it didn't make sense for either his wife or him to remain perpetually unhappy. Today he is in love with running a restaurant that draws glitterati like Robert De Niro, Al Gore and the Clintons, who welcomed in 2007 there by dancing late into the night.

Although Schnittlich had acted quickly when he heard Mango's was on the market, it had two ingredients his business experience told him were key: an established clientele and a solid reputation. Nor did it hurt that expenses are reasonable. Schnittlich, who owns his building, pays $78,000 annually for the beachfront acre on which it sits, plus $13,000 for insurance.

Schnittlich's biggest headache is labor. When some employees called in sick early on, he got stuck serving meals and clearing tables himself. These days he pads his shifts with 20% extra workers to avoid having to pitch in. He's also managed to lure and keep a talented chef who graduated from the Johnson & Wales' College of Culinary Arts in Providence, R.I., by offering him 20% of the restaurant.

More than anything, Schnittlich attributes Mango's success to keeping things local. "If we don't catch it, we don't serve it," he says. That may be true of the fish, but he still has to import wine, dry goods and meat from Miami. Mango's revenues have increased from $350,000 to $1.5 million a year under Schnittlich, and it's solidly profitable. He closes the

JEFFERY SALTER FOR FORBES

Follow your dream: David Schnittlich relaxes at Mango's.

> "I couldn't just retire and live down here. I needed something to do."

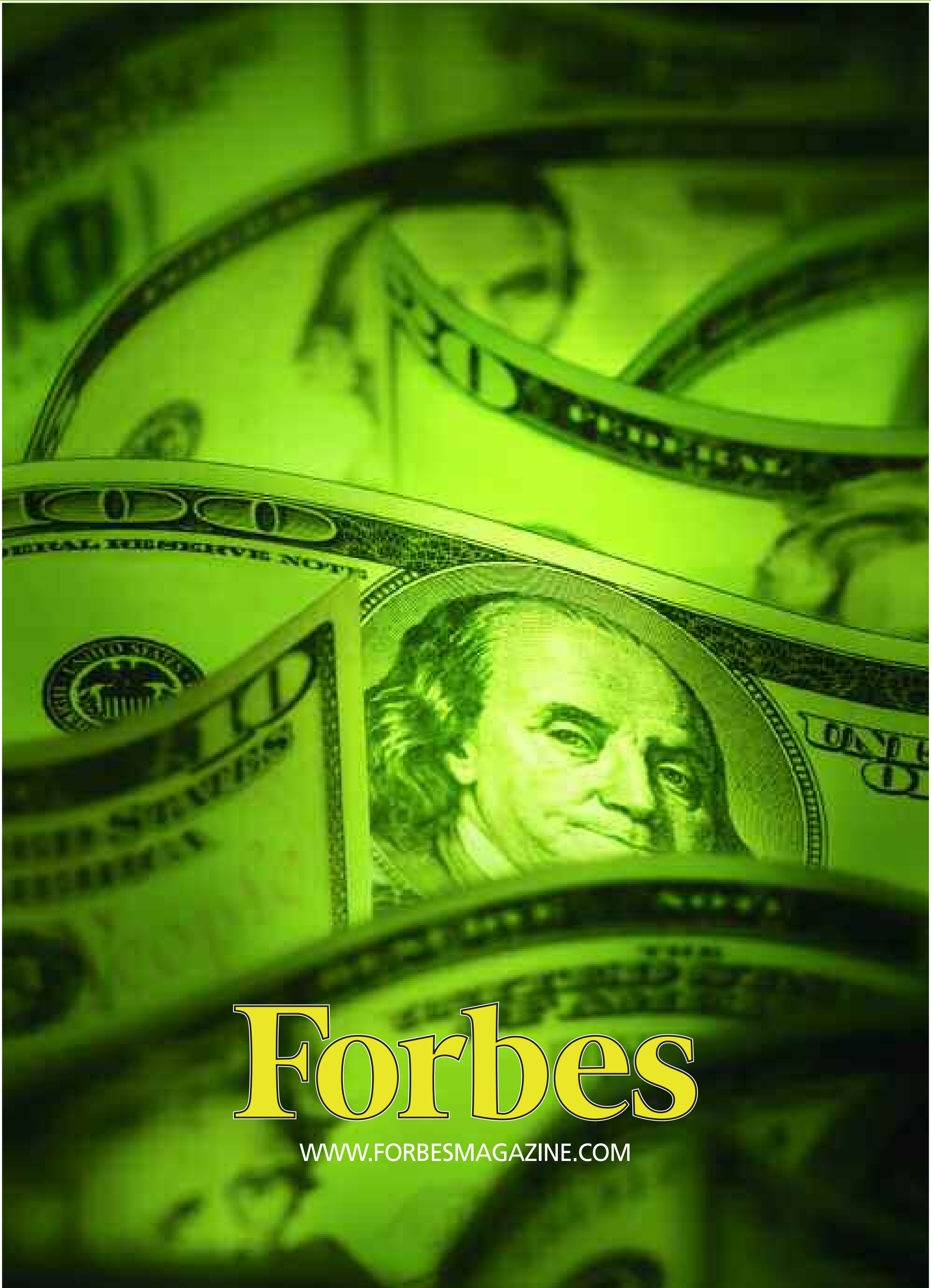
business and visits the U.S. between July and September—hurricane season.

Schnittlich is still a U.S. citizen, which means that, even though Anguilla has no income tax, he's on the hook to Uncle Sam. That includes paying the U.S. self-employment tax—15.3% on his first $102,000 and 2.9% above that.

There are some tax benefits for Americans living overseas. Nonresidents get to exclude up to $87,600 of income earned outside of the U.S., if they spend at least 330 days every 12 months abroad. Schnittlich doesn't qualify.

"Islands are nice, but the cost of living may be higher than you expect," warns Leonard Levin, head of the international tax practice at New York City accounting firm Weiser LLP. "Do your homework," he says, "before you go."

Mere details in the greater scheme of things, insists Schnittlich, who is now known locally as Mango Dave. "I'm a better person now than I used to be, inside and outside," he says. "I used to work 20 hours a day running multiple businesses in New Jersey. Now I only work 4 hours a day." **F**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