SHERMAN TANK, ANYONE? (Continued)

retirement, I'd better do it myself." With this in mind, workers are choosing the vehicle in which to ride into retirement. Unfortunately, many are choosing Sherman Tanks when something with a little less armor will get them there more quickly, and just as safely.

"We find it interesting that people are attracted to five year G/Cs promising an 8% return from major insurance companies when those same companies are earning more than 11% on their own money and selling below book value."

Vernon Hodge, chief investment officer at PRIMCO Capital Management, says the growth of Guaranteed Investment Contracts (GICs) has been "fantastic" over the past several years, and has come primarily from defined contribution plans. A guaranteed investment contract is a Sherman Tank. Safe, simple, and secure, it is basically a term loan, or, (typically) an intermediate term-bond. Sold primarily by insurance companies as a low-risk alternative to equities, GICs have become the number one investment alternative for defined contribution plans. Among plans offering GICs in 1987, 59 percent of employee contributions were directed to that option, according to a survey by Bankers Trust.

GICs are popular. How do they work? Using a five-year GIC as an example, an insurance company will buy a package of five-year corporate bonds and then offer a rate on the GIC one-half to three-quarters of a percent less than it receives on the bonds. On this margin, it makes its own return. Anyone can capture this one-half to three-quarters of a percent for themselves by simply buying a spread of bonds directly. (If you think intermediate term bonds are attractive, Muhlenkamp & Co. will gladly help you do this!) As with all bonds, the issuer guarantees an annual or semi-annual interest payment, and the return of principal at maturity. Since the market value of the bonds will fluctuate with interest rates, the insurance company cannot and will not guarantee the market value of the GIC prior to maturity. For this reason, it charges a penalty for early withdrawal.

We find it interesting that people are attracted to five-year GICs promising an 8% return from major insurance companies, when those same companies (Average of Aetna, CIGNA and Travelers) are earning more than 11% on their own money, and selling below book value. Of this 11% annual return, 6% is paid out as dividends, and the other 5% is retained in the companies, increasing their equity. While not guaranteed, these returns are likely to be realized over a period of five years or more.

So for the next five years you can get 8.7% (current quote) by lending money directly to General Motors Acceptance Corp. (GMAC), or you can get 8% by adding Aetna's AAA GIC guarantee to GMAC's AA guarantee. Alternatively, should you wish Aetna's management to work FOR you, you can invest in the company at 85 cents on the equity dollar so that if they earn 11% on their money they're earning 13% on YOURS. The choice is 11% probable versus 8% guaranteed. The difference of 3% per year doesn't sound like much, but over a 15-year period $100,000 grows to $478,459 at 11%, vs. $317,217 at 8%, a difference of more than $161,000.

ONE FAMILY'S PERSPECTIVE ON THE U.S. FEDERAL BUDGET

When people set out to discuss the Federal Budget, they often get glassy-eyed after the first few $100 billion. We have all seen graphic examples of the sums involved, such as the stack of dollars bills rising to the moon and beyond. Designed to help us understand the magnitude federal finance, these "visual aids" are often as overwhelming as the raw numbers, and don't really help at all.

I find it more useful to view the federal budget in terms of cost per person or cost per household. At right is a listing of the 1988 U.S. Federal Budget, broken down (approximately) by category. Also calculated is the cost per capita and cost per household. These calculations allow me to determine what I (my family) pay for the various categories. For example, I pay $114 for Foreign Aid (213 of which goes to Egypt & Israel) and $159 for Federal Highways. Note that these numbers are federal budgets only. Public Education, for example, costs an additional $280 billion ($3182 per household) at the state and local level.

I have also gone one step further. Where possible, I calculated the dollars involved per intended recipient (very approximate). For example, because fewer than 3% of American families are farmers, the Department of Agriculture's budget exceeds $8,000 per farm family. Similarly, since fewer that 14% of our people are over 65, the sum of Social Security, Medicare, and Federal Pensions equals $11,000 per senior citizen. Note: that these benefits are not based on need, and are in ADDITION to income from private sources.

1988 U.S. Federal Budget
Population: 260 Million
Households: 88 Million

	$Bill	$/Cap	$/Hhld	$Recip
Defense	285	1096	3238	
Foreign Aid	10	38	114	
Science/Technology	11	42	125	
Energy/Environment	18	69	204	
Agriculture	22	85	250	8333
Commerce	12	46	136	
Federal Highways	14	54	159	
Airports	6	23	68	
Other Transport	7	27	80	
Nutrition	20	77	227	
Unemployment	15	58	170	
Medicaid	28	108	318	
Other Health	30	115	340	
Veterans	28	108	318	
Education	20	77	227	
Social Security	214	823	2431	5878
Medicare	85	327	965	2335
Federal Pensions	100	385	1136	2750
Interest	148	569	1681	
TOTALS	1073	4127	12193	
REVENUES	909	3496	10329	
DEFICIT	164	631	1864	