Phillips Publishing, Inc.
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The Retirement Letter®

HELPING YOU BUILD AND ENJOY A RICHER RETIREMENT

September 2000
Issue #413

Dear Friend,

Keep the faith. Investors are confused and frustrated about the stock market. But this will pass for the simple reason that our economy continues to turn in rock-solid performance. Over the next few months, investor uncertainty about stock valuations, future corporate earnings and interest rates will inevitably fade. The shares of dominant, high-quality companies will resume their long-term advance.

In this letter, I ll explain why our economy will continue to provide a strong foundation for our investment strategy as you approach and enjoy your retirement (contrary to the simplistic headlines and comments by the talking heads on CNBC that we re growing too fast).

For some time now, the stock market has been volatile, with few clear-cut investment trends. I know this can be irritating and may test your patience. But this choppiness makes it all the more important that you stick with high-quality investments, stay diversified and maintain a long-term perspective.

To help you keep your focus on the big stuff and tune out the day-to-day activity and commentary, I want to guide you through this difficult period. So I ve dedicated this issue to providing the best possible advice to you.

To help you best position your retirement portfolio for the good times I see ahead, I ll provide a frank assessment on every one of my recommended stocks, while highlighting my favorites. We ll also sell three stocks. And I urge you to read my Special Report if you re considering setting up a revocable living trust you may not need one after all.

Solid Economy: High Growth With Low Inflation

It s no wonder so many investors are confused about what s really happening in the U.S. economy. Despite 19 years of almost uninterrupted economic growth, with falling and low inflation, the conventional wisdom still holds that inflation and interest rates should soar.

The Federal Reserve hiked short-term interest rates six times in the past 12 months through June. Yet the economy has grown at a robust 5% annual rate so far in 2000. Inflation remains moderate at about 2.5%, despite rising labor and energy costs.

There s more good news. Our economic growth is being driven in large part by business spending on technology equipment and software, to increase productivity and stay competitive. Accounting for just 5% of the economy, this spending was responsible for nearly one-third of the economy s total increase in the second quarter! Consumer spending, which accounts for two-thirds of our economy, rose at a 3% annual rate, its slowest pace in three years. And get this: Labor productivity has jumped 5.1% over the last year the biggest gain in nearly 17 years. So the economy is slowing down a bit, but it will keep growing nicely, with continued low inflation.

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INVESTING STRATEGY

Investors have been whipsawed by various opposing forces all year, including the New Economy-Old Economy debate, extreme divergences in market-sector stock performance and valuations, huge market swings and rising interest/inflation rates. Most recently, choppy market activity, worries about faltering corporate profits and the presidential campaign have only increased the uncertainty.

My goal is for you to own stocks that offer a high probability of generating excellent compound earnings growth (and income if necessary) for many years. Despite the short-term stock market uncertainty, the vast majority of our growth companies continue to deliver excellent earnings. And most of our stocks are reasonably priced in light of their probable future growth. Remember, the more uncertain you are of the short term, the more important it becomes to take the long-term view.

For your growth investments, your primary focus should be large-company leaders in today s global economy. These companies share several essential characteristics: reliable double-digit growth of revenues and profits; rising market share; the ability to use technology to achieve major economies of scale and productivity growth; and superior, proactive management.

The six stocks below are my best RETIREMENT LETTER recommendations for the long term. When purchased at good prices and held for years, they ll keep your retirement wealth compounding over time and protect it from changing economic, business and investment conditions.

This year s market swings have provided many good chances to start or add to positions in top-quality stocks. Other opportunities will inevitably come in the future. So I urge you to buy my recommended stocks only when they re available at my specified limits.

OUR STOCKS NOW: BUY, SELL OR HOLD

Super Six Growth Stocks

OK, here are my **Super Six growth stocks**. Let s start with **three stocks for superior growth potential** (using money you won t need for at least 10 years, if ever):

#1: Cisco Systems, Inc. (NASDAQ: CSCO). Data communications equipment for computer networks and the Internet is one of the fastest-growing segments of our economy. Cisco is a leader that s extending its reach and dominance every day. Despite its size, Cisco s revenues soared a stunning 55% in its just-completed fiscal year, while operating income jumped 56%. The company should expand at least 35% annually over the next few years, benefiting from the Internet s continued rapid growth. Buy Cisco up to $65.

#2: EMC Corp. (NYSE: EMC). EMC keeps the world s information safe and easily accessible. Rapidly increasing use of the Internet by businesses and consumers for text, data, video, music and much more will fuel accelerating demand for data storage with quick access. EMC is the world leader, another 30%-plus growth company. This stock has been very strong, and it rarely stays down for long. Buy on any price dips to $70.

#3: Intel Corp. (NASDAQ: INTC). This longtime winner for us has often been underestimated by Wall Street. But Intel time and again has adapted its expertise to new markets and products that are now leading it far beyond PC microprocessors

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to communications, networking and more. Intel can still grow more than 20% a year. Buy up to $60 (adjusted for a recent stock split).

Here are my top **three favorites for conservative long-term growth** (with assets you can set aside for seven years or more):

#1: Automatic Data Processing (NYSE: AUD). This great company s stock hardly ever falls below my buy limits. It s the leading provider of computerized payroll and tax-filing business services. Rock-steady ADP, while not a highflier, increases profits 13% 15% year after year. Buy if it slips below $47.

#2: Home Depot, Inc. (NYSE: HD). Shares of this dominant home-improvement retailer are under pressure because of rising interest rates and slower consumer spending. But HD has an outstanding long-term record of robust earnings and market-share growth, regardless of how the economy is doing. Use the current price weakness to buy, up to $57.

#3: Pfizer Inc. (NYSE: PFE), the world s foremost drug company, should generate an average compounded profit growth of 20% 25% over the next few years, fueled by strong demand by an aging population, a stellar R&D program, exceptional marketing and significant cost-cutting. Buy up to $45.

Two Top-Tier Conglomerates

BEST MOVES NOW

General Electric Co. (NYSE: GE) is a remarkable company whose growth has actually accelerated in recent years despite its size. With many industrial and financial-services businesses, GE s earnings have climbed 13% annually over five years, and 20% so far in 2000. GE isn t among my top stocks only because the retirement of legendary CEO Jack Welch next year will bring new uncertainty. Buy GE on any decline to $43 for conservative long-term growth.

Tyco International Ltd. (NYSE: TYC) is a leading player in four distinct areas, and an up-and-coming force in the red-hot fiber optics market. Tyco s proven growth formula combines acquisitions, cost cutting and internal expansion. Buy Tyco up to $57 for expected 20%-plus annual earnings growth and superior appreciation potential.

Our Other Technology, Telecom Stocks

It s more evident every day that technology is our economy s main engine of growth, that capital is moving from the Old Economy into the New Economy, and that today s leading growth stocks are primarily in this area. At the same time, rapid change, brutal competition and investment volatility clearly raise the short-term risk of investing in technology stocks. So I urge you to use only assets you won t need for many years, focus on quality and stay diversified.

Since transforming itself from a commodity semiconductor chip manufacturer a few years ago, **Texas Instruments** (NYSE: TXN) has emerged as the leader in digital signal processors (DSPs) and other products used in a wide range of electronics. Earnings should grow 25% or more over the next two years. Buy TI up to $65.

Hewlett-Packard Co. (NYSE: HWP) continues to evolve for the better, with a new, clear focus on Internet products and services. I look for 15% annual growth. Buy up to $112.

Flextronics International (NASDAQ: FLEX) is a leading contract manufacturer for companies such as Cisco, Motorola, Philips, Ericsson and Hewlett-Packard. This is a diversified way to invest in many types of technology, and I think Flextronics will average 50% annual growth over the next few years. But this is a volatile stock, so make it a fun money investment. Buy up to $73.

International Business Machines Corp. (NYSE: IBM) has been a laggard. Y2K issues have reduced revenues, the long-term growth rate is falling and management does a poor job of communicating its story. But IBM is a major player in information-technology products and services. The financial results for the second half of this year may well determine whether we should keep this stock. Hold on for now.

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SPECIAL REPORT:

Do You Really Need That Living Trust?

In recent years, the revocable living trust increasingly has replaced the will as the cornerstone of many estate plans. A living trust can certainly help if you have a large or complicated estate, or you want to achieve various estate-planning goals.

But a living trust isn t always the best way to go. In fact, it may no longer be necessary, as I ll explain in a minute. What s more, if you do choose a living trust, you need to know about, and deal with, possible problems that can develop.

With a living trust, you keep control of the assets you put into it while you re alive: You can change the trust terms at any time, serve as trustee and be a beneficiary. At your death, a successor trustee you ve named manages the assets. They can pass to your heirs, according to your instructions, or flow into a different type of trust that meets a particular goal.

Living Trust Advantages   Relevant to You?

A living trust can be a big help in some cases. First, its assets bypass probate, while assets you transfer through a will must go through it. Probate generally isn t as expensive as it once was. But time delays can still be significant, particularly for a large or complicated estate. The states where a living trust usually is most desirable for avoiding probate are Arizona, California, Connecticut, Florida, Illinois, Massachusetts, Michigan, Minnesota, Nevada, Ohio and Virginia.

Avoiding probate carries two other potential benefits. First, it maintains privacy for your heirs because there is no public record of the trust s terms. By contrast, every asset that passes through probate becomes public record. It s also much easier for your estate to turn back a time-consuming and costly challenge to your will, because the amount of time it takes to pass assets is minimized without probate.

But before setting up a living trust, you should ask yourself how much of your property will avoid probate anyway. Several types of assets pass directly without going through probate. Jointly held property, which may include your home, automatically goes to the co-holder at death. Retirement plans, annuities and life insurance policies pass directly to persons named on beneficiary forms. Property in any irrevocable trust has already been removed from your estate. You may not need a living trust if much of your estate will avoid probate anyway.

What s more, a new development makes it even easier to avoid probate. Major financial institutions increasingly now allow clients to designate beneficiaries for regular brokerage and mutual-fund accounts outside of retirement plans. After death, the assets pass directly to the beneficiaries you specify, thereby avoiding probate and possibly the need for a trust. Charles Schwab, Fidelity Investments and Vanguard Group are among the institutions offering this service.

A living trust can help if you want a successor trustee to handle your affairs in the event you become mentally or physically unable to do so. Having a successor trustee in place provides for a quick transfer of management. In the trust, you should spell out the circumstances in which you no longer can manager your affairs, and who will make that determination.

But if you don t have a living trust, you can draw up a durable power of attorney to name someone to take charge of your assets if necessary. Without either alternative, the courts would appoint a conservator to manage your property for your benefit a potentially time-consuming, disruptive and expensive process.

If you own property in more than one state, a living trust will speed estate settlement at reduced cost. Otherwise your will probably would have to be probated in each state.

A Warning on Living-Trust Scams

While a revocable living trust can help you meet some important goals, it can t do everything. That s why I need to warn you that fly-by-night operators in various parts of the country currently are targeting senior citizens with high-pressure sales tactics involving living trusts. The federal and some state governments have just targeted these living trust mills.

Many of these living trusts are useless because they don t comply with state laws and aren t tailored to clients needs. But what s worse is that the trust sold typically is merely a springboard for promoting dubious estate-planning schemes that involve two high-commission products: annuities and life insurance. You may not need either product. In any event, your decision to buy them has nothing to do with whether you have a living trust.

Three Common Misconceptions

If you do set up a revocable living trust, you should know what it cannot do. Let s set the record straight right now on three widespread myths concerning living trusts:

#1: *A revocable living trust avoids taxes*. **Wrong**. This trust, by itself, does not enable you to reduce income or estate taxes regardless of what promoters may tell you. Reason: You retain control over the assets by acting as trustee, and you can change or terminate the trust at any time. You re taxed on any income the trust earns as if you owned the property directly, and all the property remains in your taxable estate. But the good news is that you can use traditional tax-saving techniques combined with a revocable trust.

#2: *You don t need a will*. **Not true. A will is essential**. People rarely transfer all of their property into a trust, either because they procrastinate, overlook it or because the property is difficult to title properly. And you have no way of knowing exactly what you ll own in the future. A will covers property that s not handled by other means, either deliberately or inadvertently.

A pour-over clause in the will can specify that any property not titled to the trust be placed in it after death. The property will go through probate, but the ultimate disposition remains private because the property goes into the trust. You also need a will, for example, to name an executor of your estate and possibly a guardian for minor children or others.

#3: *Once you set up the trust, you re all set*. **Unfortunately not**. You must actually transfer title of your assets to the living trust for you or your heirs to achieve any benefit. People often set up a trust but then neglect to put assets into it. Property you want to put in a living trust must be retitled to the trust. Moving property into your trust can prove time-consuming because you must locate all property deeds and titles, and contact financial institutions to have the assets retitled.

Avoiding All Probate May Not Be So Smart

Many people use living trusts primarily to avoid probate. But that can cause other problems, particularly if much of your estate property outside the living trust is in retirement plans or is jointly owned. Reason: If little or nothing passes through probate, who will pay any estate tax that comes due?

If none of the trust beneficiaries or surviving co-owners willingly pay this expense, the IRS can proceed against any heir or beneficiary for the full amount (limited to what they actually receive). This can cause confusion, ill feeling and extra legal fees. Worse, if assets must be withdrawn from an IRA to pay the estate tax, the income-tax expense and lost tax deferral can prove very costly.

So you may need to make provisions for your estate to pay expenses before distributions. The best way to do so is to leave more than enough in your probate estate to pay taxes, legal and other professional fees, and other expenses.

Before You Act

If you still think you may want a revocable living trust, I advise you to first find out whether that s the practical choice in your area. For instance, probate may be more or less expensive and time-consuming than you think. Ask how long asset transfers should take with a living trust. Determine the cost of setting up a trust and transferring property into it.

Finally, the greater your assets and the more complicated your situation, the more you need a professional specialist in estates in your state, not just a legal generalist and never a salesperson. If you need to find an estate attorney, you can call the National Academy of Elder Law Attorneys (520/881-4005) for a copy of its directory (cost: $15), or log on to their Web site at: www.naela.org.

(continued from page 3)

SunGard Data Systems Inc. (NYSE: SDS) is another Y2K-related disappointment. But it s expanding on its financial-services technology base to Internet web hosting. Stay with it for now.

Lucent Technologies Inc. (NYSE: LU) has stumbled. It didn t adapt fast enough to changes in the telecommunications-equipment market, such as increased emphasis on data transmission and optical networking. Lucent has now begun to restructure and cut costs. Since Lucent is in a fast-growth industry and the stock is relatively cheap, let s give it some time to turn things around.

WorldCom, Inc. (NASDAQ: WCOM) is out of favor despite solid results. It s a world leader in fast-growing Internet and data services for businesses. It now plans to restructure and unload its slow-growth consumer long-distance operation. With 20% annual profit growth still likely, buy this cheap stock up to $43 for superior potential.

SBC Communications Inc. (NYSE: SBC) increasingly is focusing on high-growth DSL Internet access and wireless phone services. I look for 10% annual earnings gains. Buy up to $43 for conservative growth.

Our Financial-Services Leaders

Careful investing in financial-services stocks will continue to generate good returns for conservative growth investors in the years ahead. The top companies will benefit from steadily increasing demand for investment, insurance, banking and other services around the world. The three major global forces driving this demand are the aging populations of industrialized nations, solid economic growth and financial deregulation. There are two additional reasons to buy the best financial-services stocks right now. First, they re cheap compared with the broad market based on historical valuations. Second, they ll benefit from falling interest rates.

My best recommendations are **Citigroup** (NYSE: C), **MBNA Corp.** (NYSE: KRB), **Marsh & McLennan** (NYSE: MMC) and **State Street Corp.** (NYSE: STT). MBNA dominates the U.S. market for affinity credit cards, with steady foreign expansion. The other three are global leaders that derive a large chunk of earnings from ongoing fees, generating a relatively predictable earnings stream. Each stock is currently above my limit, so look for temporary declines to buy Citigroup up to $65, MBNA ($30), Marsh & Mac ($105) and State Street ($93).

Berkshire Hathaway (NYSE: BRKb) is rebounding from its decline. The cycle for property/casualty insurance is now turning positive for the first time in many years. Some of Berkshire Hathaway s investments are also doing better, notably Coca-Cola and Disney. Buy up to $2,100.

Fannie Mae (NYSE: FNM) has been under pressure because Congress might tinker with its government charter. Fannie Mae can borrow money at a lower cost than its competitors partly because of the perception that the federal government (and American taxpayers) would have to pay up if Fannie Mae gets in trouble.

But Fannie Mae lowers the cost of home ownership because of its less-expensive mortgage loans. And its finances are exceptionally strong, minimizing the risk of credit problems. So it s clearly in the consumers interest to leave Fannie Mae alone. With this controversy, Fannie Mae shares are greatly undervalued in light of its consistent double-digit profit and dividend growth. So keep Fannie Mae if you own it.

Bank of America (NYSE: BAC) is restructuring following disappointments related to acquisitions and rising interest rates. This stock is too cheap to sell now. My advice: Give it more time.

Our Other Growth Stocks

For diversification, we own more growth stocks in various industries. Here s the rundown:

#1: Industrials. Here are three solid companies, but ones that are considered by Wall Street to be dull Old Economy stocks ignored in the rush to the New Economy: **Honeywell International Inc.** (NYSE: HON), **Ingersoll-Rand Co.** (NYSE: IR) and **Johnson Controls Inc.** (NYSE: JCI). Ingersoll-Rand and Johnson

Controls consistently exceed expectations and are growing 15% 20%. Honeywell has had minor earnings disappointments but is still growing 13% 15%. Yet all three stocks carry bargain-basement price/earnings multiples of 10 or 11! Stay patient for a turnaround in investor sentiment.

#2: Retailers. Dollar General Corp. (NYSE: DG) and **Safeway Inc.** (NYSE: SWY) are both dominant leaders in their niche products that people use everyday (discount stores and supermarkets, respectively). Both have a long record of 15% 20% annual growth, fueled by rapid expansion and increasing efficiency. Buy Dollar General up to $22 and Safeway up to $43 for conservative growth.

#3: Here are the last four growth stocks in my roundup. **Robert Half International Inc.** (NYSE: RHI) is the largest provider of temporary personnel in finance, information technology and other areas. It has adapted to tight labor markets with more effective recruiting and expansion into promising new personnel areas. Buy this longtime winner up to $34.

Schering-Plough Corp. (NYSE: SGP), a strong seven-year performer for us, is now seeing somewhat slower annual growth, about 15%. But the stock already reflects lowered expectations. Buy up to $44.

Shares of **Schlumberger Ltd.** (NYSE: SLB), the premier energy-services company, are climbing because of rising industry expenditures for exploration and production. But the stock is expensive, so I may recommend selling it soon. Let it ride for now.

Viacom Inc. (NYSE: VIAb) is a leading media company. Among its many holdings are CBS, Paramount Studios, Infinity Radio Blockbuster and several top cable properties. This efficient operator generates big cash flow. Buy up to $65 for conservative growth.

Your Income Stocks Are Solid

CHOICE INCOME STOCKS

Amid difficult times for growth stocks, shares of real estate investment trusts (REITs) and electric utilities provide good retirement income and have some growth characteristics.

Spieker Properties, Inc. (NYSE: SPK), long my top stock recommendation for income, continues to benefit from double-digit rent increases at its West Coast office properties. Buy on any weakness below $51. **Kimco Realty Corp**. (NYSE: KIM), a leading shopping center owner/operator, continues to deliver double-digit growth of profits and dividends. The stock is languishing because of investor concerns about slowing consumer spending. Hold this REIT leader for the long term.

The national transition to retail competition is affecting the way utilities do business. Our RETIREMENT LETTER focus is on financially strong operators that are low-cost producers with a proven record in deregulated businesses.

Duke Energy Corp. (NYSE: DUK) delivers electricity and natural gas to customers throughout the U.S. and abroad. Earnings should grow 10% a year, but dividend hikes have stopped. Buy this industry leader (3.2% yield) up to $63. **Southern Co**. (NYSE: SO) is mainly in retail and wholesale electricity generation in the South and abroad. My annual growth projection is 8%, with minimal dividend growth. Buy Southern (5% yield) up to $28.

NiSource Inc. (NYSE: NI) will soon complete its acquisition of Columbia Energy to form a diversified gas and electric company. Growth prospects are improving 10% earnings gains are a reasonable goal, with 5% dividend hikes. Buy NiSource (5.4% yield) up to $23. **TECO Energy Inc.** (NYSE: TE) has struggled despite its growing Florida market. But its other electric and gas operations are now fueling faster growth. I look for profits and dividends to each rise about 6% a year. Hold TECO.

Shares of most energy companies, despite soaring oil & gas prices and corporate profits, are well below their highs. That s why I recommend investing in the international majors for long-term growth, current income and capital preservation. Over the long haul, I expect 10% earnings growth and 5% dividend increases on average from my three recommendations. Current yields run 2% 2.5%.

Exxon Mobil Corp. (NYSE: XOM) is dominant in just about every part of the

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industry. The company now says it will save $4.6 billion from its merger (much more than previously expected). And the company is buying back stock, boosting earnings per share. Buy up to $80. The two other leading majors in financial strength are **BP Amoco P.L.C.** (NYSE: BP), buy up to $57; and **Royal Dutch Petroleum Co.** (NYSE: RD), buy up to $61.

Three Stocks to Sell Now

INVESTMENTS TO SELL

As you can see, many high-quality companies are available at reasonable prices. So it s a good idea to weed out the stocks that offer less long-term growth potential or carry more uncertainty. I recommend that you sell three of our stocks now: **Cendant Corp.** (NYSE: CD), **U.S. Bancorp** (NYSE: USB) and **Total Fina Elf S.A.** (NYSE: TOT).

Cendant has been a big disappointment. The stock is undeniably cheap, and management has worked hard to turn things around. But I believe it may take longer than previously expected for Cendant to deliver superior, sustainable growth. We lost 49% on Cendant.

At U.S. Bancorp, it now appears that resumption of double-digital growth following its merger-related restructuring is less certain than before. We had a total return of 61%. Total Fina Elf is doing fine. But BP Amoco, Exxon Mobil and Royal Dutch Pete all offer better income and lower risk. Total Fina returned 273% for us.

Look Over the Valley to the Mountaintop

The year 2000 has proven exceptionally challenging for investors. Nevertheless, there s no denying that a host of economic and business megatrends bode well for your retirement wealth. So please stay ultrasafe with assets you ll need for living expenses soon. But focus on top-quality, diversified growth for your long-term investments.

I continue to recommend that each of you keep a cash position of 10%. When making new investments, start with my Super Six growth stocks. Next, look first at technology if you seek superior growth, and financial stocks if you re more conservative. Income investors, look primarily at REITs and utilities. For the stocks where I didn t list buy-price limits, I suggest that you hold off on new purchases for now, until improving prospects become more evident. Then just sit back and relax!

Sincerely,

Philip A Springer

Philip A. Springer

P.S. Please see the enclosed letter for some important news about your RETIREMENT LETTER subscription.

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