The Financial Navigator - Fall Newsletter

In this edition of the Financial Navigator we discuss where the investment market is today. I can't pretend to be a market soothsayer, and my crystal ball is a little foggy, but there may be some value to review where we have been and how far we have come since last spring. In addition, we review the opportunity to convert traditional IRAs to Roth IRAs, regardless of income level, in 2010. This could be an invaluable opportunity to increase your after-tax income in retirement as tax rates most likely will be higher in the future.

Finally, if you are over age 70, or own an inherited IRA, we end with a quick reminder concerning required minimum distributions (RMDs) from these IRAs as the IRS has waived any RMDs for 2009.

Sincerely,
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The Year in Review

First the bad news-good news if you are a Red Sox fan. Unfortunately the NY Yankees won the World Series. However, on a positive note, according to Richard Peterson, director of credit, markets and risk at Standard & Poor's, in the previous 22 World Series since 1936 in which the Yankees were victorious, the Standard & Poor's 500-stock index returned an average of 10 percent in the next year. However, stocks fell an average of 13 percent when the Yankees lost the World Series. Furthermore, his research also indicates that when the World Series ended in six games, as it did on Wednesday night, the average return was 15 percent. So as hard as it is to accept the evil empire's victory, according to Mr. Peterson there may be a silver lining to the current state of baseball in New England.

On a serious note, the third quarter has ended and the fourth quarter has started out in the same volatile manner in what continues to be a most eventful year. It's also one year since the weekend that shook the foundations of Wall Street and of the global financial system – when Lehman Brothers collapsed, Merrill Lynch vanished as an independent entity and AIG was taken over by the U.S. government. In light of that, I believe it is important to briefly summarize where we've been this year, where we are today and the prospects for the period ahead – and also to highlight some lessons from last year's collapse.

Where we've been

Just six months ago, in early March, it truly did feel like the world might be coming to an end. Talk of a return to a 'Great Depression' like economy dominated the media. Understandably, fear was rampant and stocks responded to these nightmarish scenarios by hitting the lowest levels in years, with financial firms being especially hard hit. Since then, the economy has moved back from the precipice. There is a growing consensus that we'll return to the economic growth in the second half of this year. The Economist recently ran a cover story discussing the extent to which the economic recovery is being led by Asia. Most recently, after four straight quarters of negative growth the U.S. Commerce Department reported that gross domestic product expanded in the third quarter at an annual rate of 3.5%.

As a result, we've had a strong recovery in the markets. From their bottom in the beginning of March, stock markets are up over 50%, retracing a good portion of the losses since last fall.

Where we are today

A year ago the market was characterized by optimism as the U.S. market had returned to a new high in November of 2008. By contract seven months ago the market was overwhelmed by absolute pessimism, there was no sign of hope anywhere.

Today the market is somewhere between those two extremes and many investors can be characterized as extremely nervous. As a general rule, a certain level of healthy anxiety is positive, what gets investors in trouble is an excess of either optimism or pessimism. While today's mood may be a bit too pessimistic, being cautious in the current market makes sense provided that prudent caution doesn't cross the line into panicked inertia or hasty decisions.

The outlook going forward

The good news is that there are still excellent opportunities for investors who are prepared for short-term volatility. I spend a lot of time listening to the best market minds and managers who have lived through multiple cycles. I am reassured that many say that they are still finding very good value, not to the extent that they did earlier this year, but still well ahead of what they would have seen a year ago.

In August, Business Week ran a cover story called "The case for optimism." The premise was simple: beyond the issues facing the global economy, there are many underlying positives that give cause for optimism if we look out two or three years or beyond. Powerful forces under the surface will drive economic growth, and that economic growth will drive stock prices. Examples include the positive impact of technology, the recovering U.S. housing market, the revitalization of economies and the incredible energy from the developing world's educated and emerging middle class.

Final word – volatility

Let me close by discussing market volatility. In 1907, U.S. financier J.P. Morgan single-handedly averted a banking panic among U.S. investors. Later in life someone asked him his best guess as to the direction of the markets. His response: "They will go up and they will go down."

One hundred years later, that response holds true and that is still the best answer to someone looking for a short-term market forecast. No one can predict market movements in the immediate period ahead, all we can do is understand clearly how much short-term volatility we can live with, adjust our portfolios accordingly and stay focused on our ultimate goals as we deal with market turbulence. No one likes volatility, but for most of us it's the necessary price to arrive at our ultimate destination.

Converting IRAs to Roth IRAs in 2010

Today your modified adjusted gross income must be under $100,000 to be eligible to convert a traditional or rollover IRA to a Roth IRA. In 2005 tax legislation created an opportunity to convert existing IRA accounts to Roth IRA accounts as it removed the income restrictions for conversions that take place after December 31, 2009. An additional advantage to a conversion in 2010 is you will be allowed to pay any taxes owed on the conversion to be delayed and spread ratably over the two-year period of 2011 and 2012.

There are significant benefits to Roth IRAs as contributions and earnings grow tax deferred until needed in retirement, and withdrawals are tax-free once you are in retirement. Traditional IRAs and other retirement plans are taxed at ordinary income tax rates upon withdrawal. Roth IRAs are not subject to required minimum distributions at age 70½, the funds do not have to be withdrawn until they are needed. If they are not needed for retirement income, they can be left to your children or grandchildren and they can then take distributions (tax-free) over their life expectancy.

Note that any additional contributions to your Roth IRA are not tax deductible in the year they are made as they are with 401(k) plans and, depending on your income, traditional IRAs. However, the fact that you can take tax-free withdrawals from Roth IRAs during retirement could be quite valuable. Traditionally it is assumed that one's tax bracket will be lower in retirement than during the working years. Thus taking a deduction now for contributions to retirement plans while in a higher tax bracket in anticipation of making withdrawals from these plans during retirement at a lower tax bracket makes sense. However, with the high deficits the country is now incurring, the necessity to eventually start paying back our lenders, and the already scheduled tax increases in 2011, it is likely that many retirees will be in the same, or higher, tax bracket than they were during their working years. Therefore the tax-free income of a Roth IRA could really boost retiree's after-tax income.

Required Minimum Distributions (RMD) Waived for 2009

Because of the market turmoil in the past year, the IRS announced that required minimum distributions (RMD) for 2009 are waived for IRAs and other retirement plans, including Traditional IRAs, SEP, SIMPLE, Inherited IRAs, 401(k), and 403(b).

As a result of this waiver and its late announcement last year, the IRS recently issued new guidance for additional relief. IRA owners, plan participants and eligible beneficiaries who already took an RMD in 2009 now have the option to roll it back into the same account or into another tax-deferred retirement account. They have until **November 30, 2009**, or 60 days from the date the funds were received, whichever is later. Only one RMD distribution roll-back is allowed. 2008 RMDs were not waived and may not be rolled back, under this new guidance.

Please take note of the time sensitive nature of this issue and act accordingly.

If you have any questions on this topics, or need some help with other financial issues you are facing give me a call at (603) 373-8793.