



# Wealth Management

KANE COMPANY

A FEE-ONLY REGISTERED INVESTMENT ADVISOR

Certified Public Accountants and Financial Advisors

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Winter 2009

## Do Roth IRA Conversion Rule Changes Help You?

**W**hy would you volunteer to pay income tax next year by converting a traditional IRA to a Roth IRA? If you leave things alone, you won't owe any current tax on the assets in your account, regardless of their investment performance. But the promise of a future tax payoff—combined with the prevailing economic conditions—may warrant this unusual approach. And thanks to a recent tax law change, a conversion to a Roth in 2010 will be a possibility for all investors, regardless of income.

With a traditional IRA, contributions may be tax deductible, but the amount you deduct and subsequent earnings will be fully taxed as income when withdrawn during retirement. (The same rules apply to IRAs holding assets rolled over from traditional 401(k)s or other employer-sponsored plans.) And you generally must begin taking those taxable distributions during the year after the year in which you turn age 70½.

In contrast, contributions to a Roth IRA are never deductible, but qualified distributions from a Roth that has been established for at least five years are completely tax free. And because the government won't benefit when you take distributions, it doesn't require you to take them.

Until now, the catch has been that high-income individuals can't contribute to a Roth IRA, and converting a traditional IRA to a Roth hasn't been allowed if your adjusted

gross income exceeds \$100,000. The latter rule changes in 2010, when the income cap for conversions is eliminated. And though a conversion to a Roth requires you to pay income tax on the amount you convert, if you make the conversion in 2010, you're allowed to spread out your tax payment over 2011 and 2012.



Choosing between saving for retirement with a traditional IRA or a Roth is in part a question of whether it's better to pay the IRS sooner or later. Being taxed on current contributions to a Roth IRA or for a conversion from a traditional IRA takes money out of your pocket now, but you may do better later, either enjoying tax-free distributions or passing along the account to your heirs, whose withdrawals also won't be taxed. But the law permitting anyone to convert to a Roth, coupled with the bear market's depressed asset values, adds interesting twists to this debate. Consider these four reasons it may pay to convert.

### **1. You'll pay less to convert an IRA whose value has plummeted.**

Rare is the investor who hasn't seen retirement account values fall by at least 25% during the bear market. As painful as that has been, however, it can be an advantage if you choose to convert to a Roth IRA in 2010. You'll be taxed on the value of the account at the time of the conversion, regardless of what it may have been worth a few years earlier. Suppose the assets in your IRA were worth \$500,000 a year ago,

*(Continued on page 4)*

## The Holidays Are Almost Upon Us!

**W**ith the holiday season almost upon us, it is important to finish any remaining 2009 tax planning soon! Please give us a call at 270-2727 if you would like us to estimate your income tax situation, suggest planning ideas to avoid any surprises, or simply to discuss any year-end questions you may have.

We have all been attending update income tax workshops to stay current on any changes and also to learn new planning ideas to help you minimize your tax burden. We can also assist in any pension, IRA rollover, or required minimum distribution you may need to accomplish or rollover before year-end.

Remember, conversions to a Roth IRA or a College Savings Iowa contribution also need to be completed by December 31. You may even transfer funds online at College Savings Iowa to beat the deadline.

Please note: Our offices will be closed November 26 and 27 for Thanksgiving and December 24 (closed at noon) and 25 for the Christmas holiday.

We thank you very much for your continued patronage and referrals and want to wish all of you a happy and healthy holiday season, as well as a prosperous New Year!

*Steven L. Kane, CPA/PFS, CFP®*

# Four Steps *Not* To Take Right Now

**A**s the tough economic times push on and stock prices fluctuate, it's hard to know what moves to make as an investor. Though the panic you probably felt during the early months of the bear market may have ebbed, your account balances still aren't fun to look at, and the direction of the market is anything but certain. Was the spring-summer market rally the first leg of a new long-term bull market? Or will unemployment, lackluster corporate profits, and a shift from consumer spending to saving post-pone the recovery and keep share prices volatile?

Definitive answers may be a long time in coming. But in the meantime, there's no reason to abandon the fundamental investing principles that have worked for you in the past. Here are four moves *not* to make now.

**1. Keep your money idle.** It's tempting to sit on the sidelines while the markets sort themselves out. But there are two problems with that approach. The first is that if you're going to reach your retirement goals, you'll need growth in your portfolio, and that means putting your money to work in suitable investments. The second is that if your plan is to sit out

until markets improve, you'll inevitably miss much of what the market provides. The best time to buy is when the market is down, not when you feel comfortable, and trying to time your entry and exit into the market almost never works.

## **2. Chase the golden goose.**

Trying to get well in a hurry by

jumping on the bandwagon for high-flying stocks or high-yielding bonds is another common investing mistake. The best time to invest in a particular

sector or category is before a market run-up, not after. You'll probably be too late to the party if you invest heavily when substantial gains have already been realized, and you may be left holding overvalued investments vulnerable to sharp declines, especially while the markets remain volatile.

**3. Rely too much on "safe" investments.** Diversifying your portfolio with reasonable allocations to low-risk, low-return

investments such as bonds and money markets is smart, but veering too far in that direction can be just as damaging to your long-term prospects as chasing hot stocks or trying to time the market. "Safe" investments bring their own risks, including a loss of value when interest rates rise and inflation picks up.

## **4. Stop saving for retirement.**

When times are tough, paying bills may have to take precedence over saving. But your future needs are also crucial, and

continuing to contribute to your 401(k) or other retirement plan—even, or especially, if its value has plummeted—is the only way to ensure that you'll reach your long-term goals. These turbulent times too shall pass, and it only makes sense to keep working toward your ultimate objectives. In fact, cost averaging into your 401(k) enhances returns when the market drops—a reward for continuing to save. ●



# When Should You Amend A Tax Return?

**F**iling a tax return once is enough of a hassle. Doing an amended return for the same tax year—in other words, filing twice—seems like way too much. Yet millions of amended tax returns are filed by individual taxpayers each year.

Does an amended return increase your chance of being audited? Technically, no. But it will extend your exposure to IRS challenges. The agency can come after you for back taxes for up to three years from the date you file a return, and if you re-file, say, a year after the fact, that restarts the clock.

Still, filing an amended return can

put money in your pocket. So here are some of the most common reasons to file IRS Form 1040X.

**You get an amended 1099, K-1, or W-2.** These are forms sent to you by banks, brokerages, investment partnerships, employers, or others. It's not uncommon for these firms to make mistakes and resend a corrected form months after sending the original. And even if the corrected form will mean only a small change in your tax liability, you'll still need to file an amended return, since the government also receives a copy of revised forms and will match them to your return.

**You're a sole proprietor, a**

**shareholder in an S-Corporation, or the owner of a partnership.** As

such, you may have strong incentives to file an amended return, since pension or profit-sharing plans for one year can be funded with earnings from the following year. Say you get a windfall after filing your 2008 return. You can use it to increase pension plan funding for 2010, retroactively giving yourself a larger deduction. You can reflect the change on an amended return. You have until the extended due date for the 2009 return (at least until October 15, 2010).

**You discover an overlooked deduction** when checking through

# The Dynamics Of China-U.S. Economics

In the autumn of 2008, China became the United States' biggest creditor, and Chinese leaders have wasted little time in flexing their growing economic muscle. China is demanding a stronger voice in global economic affairs and has proposed a new international currency that would supplant the dollar as the world's dominant medium of exchange. Should U.S. investors worry about China's emergence as a powerful economic force? And how will this "new world order" affect American consumers?

The Chinese have been buying up U.S. Treasury bonds for years, and by January 2009, China held \$740 billion in U.S. Treasury securities, or 24% of the total outstanding Treasury debt. In September 2008, China had surpassed Japan as the U.S.'s largest creditor. China also has amassed the world's largest cash reserves, totaling about \$1.9 trillion, and maintains the world's most lopsided trade surplus with the United States. That reflects the fact that China has become the world's No. 1 producer while America has become a nation of avid consumers. Monies from throughout the world are pouring into China's booming economy while American dollars flow outward to buy more goods and services.

These trends have led to controversy, with U.S. officials

accusing the Chinese government of manipulating its currency to keep its exports competitive. But the Obama administration backed away from those claims early in 2009 after China allowed its currency to appreciate slightly against the dollar, thus slowing the nation's accumulation of cash reserves.

For now, leaders of both countries have agreed to work together to fight the global recession, joining countries in the European Union and around the world. But in the long run, China is building up a potentially alarming amount of influence over the American economy, analysts say. "The scale of financing the U.S. now receives from China truly is unprecedented: it now not only tops the largest inflow the U.S. ever received from another country, but it is clearly by far the largest inflow the U.S. has ever received from a government that the U.S. doesn't consider a close military ally," writes Brad W. Setser, geoeconomics fellow at the Council on Foreign Relations, in his blog for the Center for Geoeconomic Studies. "And I don't think it is in the interest of the United States to rely so heavily on a single country's government for financing."

Chinese leaders have recently expressed concern about the strength of

the U.S. economy—and, by extension, the safety of China's Treasury investments—and signaled a desire to diversify. Should China shift a significant amount of money out of U.S. government bonds, other international and domestic investors could follow the Chinese lead. Any run on Treasury bonds would hurt the U.S. government's ability to pay for hundreds of billions of dollars in recession-fighting stimulus spending and would increase borrowing costs for U.S. companies and individuals. Such a move could, however, improve the trade deficit, because it would weaken the dollar, making U.S. exports more affordable. Currently, the U.S. imports from China five times as much as it exports to China.

While China cut back on U.S. Treasury purchases earlier this year, analysts agree that at least in the near term, the Chinese will continue to invest in U.S. bonds, both to maintain China's trade advantage and because the global recession presents few safe investing alternatives. Still, China's emergence as America's No. 1 creditor signals a basic change at a time of great economic uncertainty. During past economic downturns, the U.S. was always the largest creditor nation in the world. That was a good position to be in, because it meant other countries owed the U.S. more than it owed them.

During the current global recession, the reverse is true. America has become the world's largest debtor nation. As long as interest rates stay low, that alone is not a problem. However, as interest rates increase, it will become more expensive for American companies and consumers to borrow money, for everything from business equipment to houses. And that can only make emerging from the recession a longer and more difficult process. To put individual households and the country as a whole on more sustainable footing in preparation for future downturns, Americans will need to make the painful transition from spending to saving more of their hard-earned dollars. ●

your records, such as from a charitable contribution.

## **The law or IRS rules have changed.**

Sometimes the IRS clarifies a rule or a court ruling will liberalize a tax break.

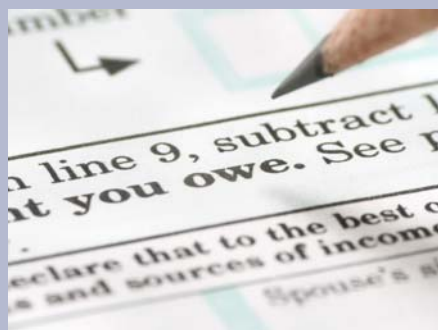
**You miscalculated when figuring your tax liability for selling a mutual fund.** Often, investors count only their original purchase

price as their cost, not realizing that reinvested income also qualifies. Your actual gain could be much lower than the amount you reported to the IRS.

In most cases, filing an amended

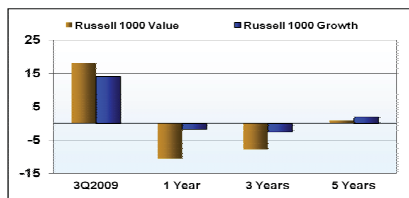
return will cost \$200 or less. And if only one or two calculations have to be changed, it shouldn't be a big deal. No one likes to deal with the IRS and taxes, but you could be leaving money on the table by shunning a 1040X.

To keep up-to-date on tax law changes affecting your taxes and your business, visit [www.irs.gov](http://www.irs.gov) or call 800 829-1040 (individuals) or 800 829-4933 (businesses).



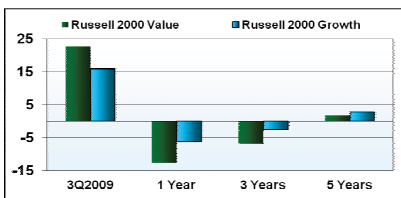


# Market Data Bank: 3rd Quarter 2009



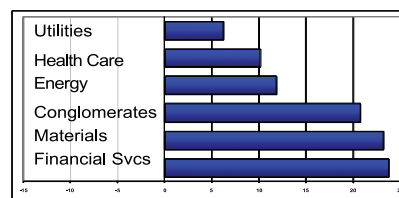
## LARGE VALUE VS. LARGE GROWTH

Resurgent bank stocks were especially bullish for value portfolios as the spring rally continued into 3Q09. Large-cap value and growth shares climbed 18.24% and 13.97%, respectively.



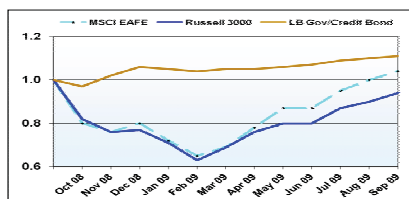
## SMALL VALUE VS. SMALL GROWTH

Small-cap shares flourished amid hopes that the end of the recession may be in sight. Small value surged 22.70%; small growth gained a slightly less boisterous 15.95% over the course of the quarter.



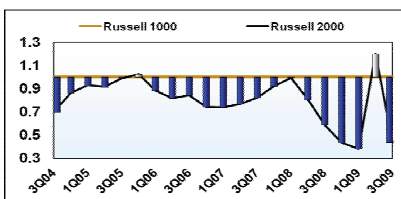
## THREE BEST AND WORST SECTORS

Once again, all major sectors participated in the rally. The battered banks and cyclical commodity producers led the way; traditionally defensive sectors like utilities and health care fell from favor.



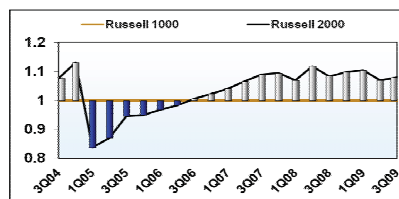
## FOREIGN, US STOCKS & US BONDS

Although stock markets around the world have rebounded off their March lows, they remained flat to slightly lower on a year-over-year basis by the end of 3Q09. Bonds continued to hold up better.



## LARGE VS. SMALL STOCK EARNINGS

As the recession dragged on, the largest US companies saw their profits shrink 10.9%. Smaller companies held up better, but still saw earnings contract by 4.8% in 3Q09 compared to 3Q08.



## PRICE-TO-EARNINGS RATIO

Given the extent of corporate losses, investors were willing to pay richer premiums for profitable companies, especially smaller enterprises that may prosper when the economy recovers.

Small-cap stocks represented by Russell 2000 index, large-cap stocks represented by Russell 1000 index. Foreign stocks represented by the Morgan Stanley Capital International's Europe, Australia, Far East Index, and US bonds by the Lehman Bros. Government/Corporate Bond Index. P/E ratios exclude negative earnings. Small-cap stocks tend to be more volatile than large-caps. Bonds offer a fixed rate of return while stocks will fluctuate. Indices are unmanaged and do not represent any specific investment. Foreign investing involves special risks, including political unrest, economic instability, and currency fluctuation. Past performance does not indicate future results.

Source: Russell/Mellon

## Roth IRA Conversion

(Continued from page 1)

but in 2010, they are worth only \$400,000. At the top current income tax rate of 35%, that saves you \$35,000.

**2. You'll avoid a higher tax bill later if rates rise.** With individual tax rates at near-record lows and tax revenue falling far short of federal budget commitments, tax rates are likely to go up in the near future. It may be better to take your lumps under current tax law—even if all or part of the conversion is taxed at the top rate of 35%—than to risk losing much more of your investment to the IRS later.

**3. Converting to a Roth IRA gives you maximum flexibility on distributions.** There's not much give in the rules on withdrawals from

traditional IRAs and 401(k)s.

Beginning the year after the year you reach 70½, you'll face minimum annual distributions designed to use up the account during your expected life span—and you'll pay a 50% penalty on any shortfall from the required amount. With a Roth, you can take as large or small a distribution as you choose each year, and you have the option of leaving the account intact to provide tax-free income to your heirs.

**4. A partial conversion to a Roth lets you customize your tax liability**

**and benefits.** A Roth IRA conversion needn't be an all-or-nothing

proposition. You can convert as much or as little as you want each year (although the option of stretching out tax payments applies only to conversions in 2010). Making a partial conversion

lets you limit current payments to the IRS while also providing some tax-free income during retirement.

We can help you decide whether a conversion makes sense in terms of your unique situation and overall financial goals. ●

