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SENIORS/BOOMERS NEWSLETTER

"THE RETIREMENT EXPERTS"

July 2009

………..'the market can stay irrational longer than you can stay solvent'..
- John Maynard Keynes, noted British economist

Happy July 4th! It certainly is a time for celebration…and for a whole host of reasons. If you are involved in the stock market, your hope is probably now springing eternal as we come off the best quarterly gains in over 10 years. Many investors may now feel that the worst is behind us in terms of the economy, unemployment and the banking/housing sectors. But is it?

As Mr. Keynes is quoted above, the stock market has a nasty habit of doing almost the opposite of what many people may expect. Typically new bull markets are born with a surge in volume as individual & institutional investors come rushing through the doors. This current rally however has materialized on the lowest volume levels for the year. The stock market drop we sustained between October and March was, to put it mildly, overdone. The sharp run up in Q2 may have also gotten ahead of the fundamentals.

This is not to suggest that I think this rally is done for. It may still have legs to it. What I think needs to be focused on in the 2nd half of the year are some drivers that could accelerate or de-rail the forward progress. A quick snapshot of the economy first:

- Of the $787 billion stimulus package, just $43 billion has been spent up till now. This is not stimulating!

- We are running record deficits. The Budget Office estimates over $11 trillion between now and 2019. In order to stimulate the current weak economy, all this excess spending would appear to be a good idea…until it's no longer a good idea. Who is going to continue buying up our debt? Foreign governments? Not forever! Many of our benefactors are already voicing concerns about how we are going to pay them back. If we as individuals overspent to this degree, we'd probably be in jail.

- The United States GDP (Gross Domestic Product) is approximately $13 trillion/year. Our current National Debt is….are you sitting down??? **$64,000,000,000,000**. That's about 5 times annual GDP. That means that every household in this country is indebted to the tune of $546,668. (This does not include our personal debts such as mortgages, car loans, credit cards, etc). God help our children, their children and their children's children!

- Even the Fed Chairman, Ben Bernanke, has sounded the alarm. In recent testimony on Capitol Hill he stated that we have to start reining in soaring budget deficits, or '…we will have neither financial stability nor healthy economic growth'. As much as he's trying to lower long term interest rates by buying up Treasuries, the markets and lenders are not cooperating. Long rates are rising. The world is afraid that we will ***monetize our debt.*** That's polite for printing money to cover deficits. Many analysts fear future hyper-inflation.

O.K. So the economy doesn't look so hot.

- Well, at least we got some good news out of the banking sector, which has a symbiotic relationship with the housing sector. Ten of our largest 19 banks repaid their TARP funds in June. We have 9 'zombie' banks that could not. According to Institutional Risk Analytics, a firm who performs their own stress test on 7600 banks, it doesn't feel that we're there yet. They had this to say. "it's pretty clear that the condition of the U.S. banking industry is continuing to deteriorate and we are still several quarters away from the peak in realized losses".

 Just what losses? The research firm T2 Partners stated that we still have three waves to get through yet:

1) Prime mortgages guaranteed by Fannie Mae & Freddie Mac.

2) Home Equity Lines of Credit.

3) Commercial Real Estate loans amounting to $3.5 trillion.

4) A 4th one that I've been following is credit card defaults. Bank of America said that their default rate in May jumped from 10.47% up to 12.5%. People stop paying credit card debt before they stop paying their mortgages!

O.K. The banks don't look so hot either!

How are things on the employment scene?

 A couple of weeks ago we got a great report about a dip in continuing claims for unemployment insurance. That sounded good until:

1) A King report noted that roughly 50% of people who had been on unemployment insurance had exhausted their benefits.

2) The U-6 tally (which I've cited several times before) that includes discouraged people who stopped looking for work …and those only able to find part-time work, estimate that the true unemployment number is at 16.4%, or said another way, 25 million folks are out of work!

3) We have yet to see the effects of the automotive cut-backs. There are a few more unfortunate souls headed for the unemployment office.

As many of you know, I lived in France for a good number of years. Thinking about the ease in which companies in the United States can downsize (right-size, under-size, etc) their work-force reminded me of a comment I heard about labor laws in France (which I **know** to be true). "The way the French employment laws work, it's safer to murder an employee than to fire him". I wonder how our European allies are going to get back on their feet.

So, that leaves us pondering the question: where do we go from here? We have a contraction in consumer spending, consumer credit and consumer wages. I'm finding it difficult to believe that happy days are here. At least not quite yet.

As bleak as the overall picture looks, I would not counsel any investor to head for the hills and bury their money in the back yard. I say this repeatedly - not every stock goes down in every down market. The better ones either hold their own…or go up! In this market environment however, you need to be ***very vigilant*** in watching your holdings and be on the look-out for signs that it's time to cash in individual securities.

WHAT TO DO NOW

1) **Stick with companies with strong balance sheets (little or no debt) that make things we NEED.**
2) **Continue to avoid the financials & homebuilders for now.**
3) **Check out industries with strong signs of improving business conditions and earnings growth, and buy members of that group.**
4) **Buy dividend paying stocks. They represent *real* money in your account every quarter.**
5) **Corporate bonds still look attractive.**
6) **Ensure that you are correctly asset allocated, and if necessary, re-balance your portfolio.**

When a Rollover is Not a Rollover

The IRS will let you take money from an IRA, hold onto the funds for 60 days, and put it into another IRA without paying any tax or penalty on the transaction. If you don't complete the rollover within the 60-day window, the withdrawal becomes a taxable event. Plus if you haven't reached age 59½, you could face a 10% penalty.[1] Fairly simple rule to follow, right? Well, not exactly, since there are a few lesser-known details that if ignored, could cost some IRA owners or beneficiaries a lot of money.

Investors have been known to run afoul of the "same property" rule, which is within the IRS rollover regulations.[2] This law states that a rollover from one IRA or qualified retirement plan to another IRA can only consist of the same property. For instance, you cannot take a cash payment from a 401(k), buy stocks, and then

1 http://www.irs.gov/pub/irs-pdf/p590.pdf, page 21.

2 http://www.irs.gov/pub/irs-pdf/p590.pdf, page 22.

roll the stocks over to your IRA.

If you did that, the IRS would consider the cash distribution from the 401(k) income subject to taxes at the current ordinary income rate. Plus you might have to pay any applicable penalties. Instead, for the above example, you would have to deposit cash in the IRA in order for the transaction to be classified as a tax-free rollover.

A spouse can roll over an inherited IRA into their own IRA. But they are not under any obligation to do so.[3] It can be done anytime, which allows flexibility for a survivor.

The surviving spouse can move the funds in two ways: (1) withdraw the deceased's IRA and deposit in her IRA within 60 days or (2) directly move the funds via a trustee-to-trustee transfer.

For help in transferring or rolling over money from your retirement plan or IRA, check off and send in the enclosed coupon.

Which Source of Funds Comes First – Taxable or Qualified?

When it comes time to tap your savings and investment accounts, clients often wonder which source should come first. In general, many experts advise investors to draw from their taxable accounts first, then tap qualified accounts such as IRAs and 401(k)s further down the road. There is a logical reason for this--prolonging withdrawals from your qualified accounts gives these assets additional time to grow with the benefit of tax-deferral. There are other reasons why this strategy could be efficient from a federal income tax perspective.

Let's say that you have three sources of investment funds, a regular taxable account (which could hold individual stocks, bonds, or mutual funds) and two qualified accounts: a traditional IRA and a Roth IRA. What happens if you tap your traditional IRA? First, all withdrawals from a traditional IRA are taxed at your current income tax rate. Second, a 10% federal income tax penalty will usually apply to traditional IRA withdrawals taken prior to age 59½ (subject to a few limited exceptions explained in IRS Publication 590. Exceptions include but are not limited to: withdrawals for qualified higher education expenses, first-time home buyers, medical insurance premiums for certain unemployed taxpayers, and withdrawals taken by disabled taxpayers).

What about taking money from a Roth IRA? If you are less than 59½ years of age, or you do not hold the Roth for more than five years, the distribution could also be subject to the 10% federal income tax penalty. By leaving the money in the traditional and Roth IRAs, you have the opportunity to accumulate tax-deferred investment growth over the life of both the owner and the beneficiaries. Assuming the age and holding period requirements are met, all Roth distributions also come out free of future federal income taxes to the account owner, as well as the beneficiaries.

What if you tap your taxable account first? You will owe taxes on any capital gains you realize from the sale of investments in this portfolio. Assuming you have held the asset for more than one year, your rate will be lower than your current income tax rate (5% for taxpayers in 10-15% brackets; 15% for all tax brackets exceeding 15%). You might also be able to soften the blow of your annual tax bill. As you gradually tap your taxable account, the distributions you receive from these investments will slowly recede, thus lowering your tax burden from dividends and capital gains paid to you. Moreover, your qualified accounts could potentially have longer time to grow with the power of tax-deferral, which could enhance the value of your qualified retirement funds.

Eventually, you will have to take minimum distributions from your traditional IRA once you reach age 70½. Although these distributions will be taxed at your ordinary income tax rate, you could be in a lower tax bracket by then. As previously mentioned, these distributions are taken, in many cases, over the life expectancies of the owner and the beneficiaries. On the other hand, traditional IRAs do not receive a step-up in income-tax basis when they are transferred to younger beneficiaries at the owner's death. Although there is something to be said about the power of deferring taxes, one should also consider future income tax consequences to younger family members before making a decision.

Assuming you have assets in Roth IRAs, you should know that minimum distributions are not required. In view of this and the fact that withdrawals will come out free of federal income taxes (assuming the age and holding period rules are met), you may want to consider your Roth assets as your source of last resort.

Deciding which account to tap first depends on your financial and tax situation now and during your retirement years. **If you would like to review some withdrawal strategies for your various investment accounts, please complete the enclosed reply coupon.**

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3 http://www.irs.gov/pub/irs-pdf/p590.pdf, page 17.

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- ❑ Withdrawal Strategies.

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- ❑ CD Shoppers' Guide
- ❑ Creating a Retirement Income You Cannot Outlive
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