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# MAKING A DIFFERENCE

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Glenn Woody  
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## Wither Taxes?

**I**ncome taxes are much on every mind now, before the April 15 tax deadline. But, once the return is done and the checks are written, then we will hear more and more about where the tax rates may be going.

Most everyone believes they are headed up at some point in time. Most of that belief is credited to the extreme amount of government spending in the last year or so, which "has to be paid for".

But there is a more concrete issue surrounding the speculation of changing income tax rates: What will Congress do about the so-called Bush tax cuts?

In 2001, Congress passed the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). In the area of income taxes, it made several changes:

- It reduced tax rates in stages so that by 2006, the maximum was 35%.
- It reduced the tax on long-term capital gains (on assets held more than one year) and dividends to 15%.

The bill contained a "sunset provision" which provided the changes would expire on January 1, 2011, unless Congress took some additional action in the meantime.

The bill also made some significant

changes in estate taxes. It provided for the estate tax unified credit exclusion, which was already set to increase to \$1,000,000 by 2006, to ratchet up to reach \$3,500,000 in 2009 and 100% in 2010. In other words, by 2010, there would be no estate tax at all. Those provisions were also to expire on 1/1/11, unless Congress acted in the meantime.

So, here we are in 2010 and Congress has not acted. If they do not act before 1/1/11, income and estate taxes will revert to the levels they were in 2000, before the passage of EGTRRA.

That means the maximum income tax rate will go back to 39.6%, the tax on long-term capital gains will go back to 20%, the tax on dividends will go back to the rate on ordinary income and the estate tax exclusion will revert to \$1,000,000.

Congress has three choices:

- 1) Do nothing, let the changes expire.
- 2) Vote to extend the changes for a period of time, maybe one more year.
- 3) Let the changes continue only for singles with income under \$200,000 and marrieds under \$250,000, and let cap gains/dividends be taxed at 20%.

Many think they are likely to vote for choice #3, but not until after the November elections.

# Roth IRA Conversions

**M**uch has been written already about the fact that in 2010, anyone may convert a Traditional (Trad.) IRA into a Roth IRA. In the past, there was a level of Adjusted Gross Income above which one was not eligible to make the conversion. That cap has been eliminated so one may now make the conversion regardless of the level of their taxable income.

There is much about a Roth IRA that mirrors the Trad. IRA. Neither is taxed while funds are growing. The limit on how much may be contributed annually is the same, \$5,000 in 2010, \$6,000 catch-up for those over 50 years old.

But, there are some major differences. If one has held a Roth IRA for at least five years and is over 59.5 years old, funds may be withdrawn from a Roth tax-free. There is no Required Minimum Distribution (RMD) from a Roth after age 70.5 as there is with a Trad. IRA.

So, why would everyone not make the conversion to a Roth? The big consideration is the fact that the funds converted are taxable as ordinary income to the extent they were before-tax additions to the Trad. IRA.

Who should make the conversion? As with

most things financial, the answer is, "It depends".

A Roth conversion is worth considering only if one can pay the resulting income tax with other money. If some of the converted money is used for the tax, thus diluting what goes to the Roth, the trade-off of tax now vs. tax free withdrawals later is not a good one. Congress has made that consideration somewhat easier this year by allowing the tax resulting from a 2010 conversion to be spread between tax years 2011 and 2012 (at the then tax rates).

Beyond the issue of being able to pay the tax from another pocket, making the conversion might make sense if:

- You have a long time horizon before you think you might need the money (long enough for the tax free growth to offset the lost opportunity on the money used to pay the tax now).
- You believe you will be in a higher tax bracket when you withdraw.
- You don't expect to need the money at all and want to leave a tax-free inheritance to your heirs.

Your decision is borderline if:

- You are unsure about future tax brackets.
- RMD's might bump you into higher tax brackets down the road.
- The conversion itself bumps you into a higher tax bracket.

You may make partial conversions, but if you have some after-tax money in the Trad. IRA, you cannot "cherry-pick" and just convert those funds; you have to aggregate all IRA's and pro-rate the taxable and after-tax funds.

There are other esoteric considerations. Call us if you want to talk them through.

**GLENN WOODY  
FINANCIAL CONSULTANTS INC.**

**COSTA MESA**

151 Kalmus Drive, Suite C-150  
Costa Mesa, CA 92626  
714.850.0534 (Phone) 714.850.0934 (FAX)

**LA QUINTA**

55-365 Riviera  
La Quinta, CA 92253  
760.771.3734 (Phone) 760.771.8434 (FAX)

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**gwfc@planretire.com**  
**www.planretire.com**

# Market Highlights

## April 2010

### Positive:

- The leading economic indicators increased 0.1% in February following a 0.3% gain in January and a 1.2% rise in December. The coincident economic index rose 0.1% in February following no change in January. The lagging economic index increased 0.3% in February following a 0.2% decline in January.
- Real gross domestic product (GDP) increased at an annual rate of 5.6% in the fourth quarter of 2009. In the third quarter, real GDP increased 2.2%.
- Sales of retail and food services in February increased 0.3% from the previous month and 3.9% from February, 2009.
- New orders for manufactured durable goods in February increased 0.5%. This was the third consecutive monthly increase and followed a 3.9% increase in January.
- Nonfarm business sector labor productivity increased at a 6.9% annual rate during the fourth quarter of 2009.
- Economic activity in the manufacturing sector expanded in February for the seventh consecutive month, and the overall economy grew for the tenth consecutive month.
- Retail e-commerce sales for the fourth quarter of 2009 increased 4.5% from the third quarter 2009.

### Mixed/Cautious:

- Privately owned housing starts in February were 5.9% below the January rate but were 0.2% above the February, 2009 rate.
- Sales of new single family houses in February, 2010 were 2.2% below the January rate and 13.0% below the February, 2009 rate.
- Sales of existing homes slipped 0.6% in February from January, but are 7.0% higher than in February, 2009.
- Overall construction spending during January, 2010 was a 0.6% below December, 2009 and 9.3% below January, 2009.

### Informational:

- The Consumer Price Index was unchanged in February and has increased 2.1% over the last twelve months. The producer price index declined 0.6% in February. This decrease followed a 1.4% advance in January and a 0.4% increase in December.
- All stock asset sub-sets were up in March between 4-6%, with international slightly outpacing domestic, and large vs. small and value vs. growth about equal.

## FYI: Short-Term Observations

*These comments are offered for your information and thought. They are short-term and tactical in nature. We invest for the long-term, three to five years plus. Don't confuse these short-term observations with what may be the best decisions for the long-run. Some even believe it is confusing, at best, and distracting, at worst, to involve short-term issues in long-term investing.*

### Can Market Gains Continue?

**A**fter a pause in its rate of advance in December, January, and February, the U. S. stock market seemed to get back on the rapid rate of growth that it achieved after March 9, 2009.

The growth rates shown in the column to the right for the month of March, if continued through the next eleven months would produce similar gains. No one expects that rate of advance to continue.

We have been saying for months that that rate cannot possibly continue and that a pause would be expected and healthy. Most believe the 2010 growth rate in the S&P 500 for the calendar year 2010 will be single-digit, most likely only in the 6-7% range.

That sort of reasonable growth would be welcomed as being more sustainable.

Market and economic conditions are continuing to improve. The economic data points on page 3 of this issue are predominantly positive. The Federal Reserve, in their recent meeting, continued to hold interest rates at unprecedented low levels and stated they expect to do so for some time, as indication that they see no immediate inflation threat.

There remains a good deal of hand-wringing over the unemployment rate just under 10%, but the jobs picture seems to be slowly improving.

Most believe the foreign emerging markets will continue to grow more than the developed ones or even than the U. S. markets.

Our bet is on continued market growth overall at a slower pace and with a good deal of short-term volatility.

### A Good Month

**M**arch produced some very good numbers for the popular stock averages.

The returns were actually along the same pace (or better) as the torrid gains we saw from March through December 2009. It cannot continue at this same pace.

Here are the results:

#### Dow Jones 30 Industrials

|                |           |
|----------------|-----------|
| March          | + 5.15 %  |
| Last 3 months  | + 4.11 %  |
| Year to Date   | + 4.11 %  |
| Last 12 Months | + 42.69 % |

#### Standard & Poor's 500 Index

|                |           |
|----------------|-----------|
| March          | + 5.89 %  |
| Last 3 months  | + 4.84 %  |
| Year to Date   | + 4.84 %  |
| Last 12 Months | + 46.49 % |

#### NASDAQ Composite

|                |           |
|----------------|-----------|
| March          | + 7.15 %  |
| Last 3 months  | + 5.69 %  |
| Year to Date   | + 5.69 %  |
| Last 12 Months | + 56.83 % |

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