



Welcome to the second edition of the Latest financial News. We want to wish everyone a Happy New year. We are excited to see what the year holds for us and glad that you will be a part of it.

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## SECTION 1: SHOULD I CONVERT TO A ROTH OR NOT?

With the New Year brings new opportunity, but this an opportunity that you want to be a part of? Beginning January 1, 2010 everyone can convert their Deductible and Non Deductible IRAs to a Roth IRA. (In 2009, conversions are permitted only for those with Adjusted Gross incomes of less than \$100,000.00.)

Converting is tempting. If you don't, you'll pay taxes when you make withdrawals in retirement. This will also mean that you will need to start making withdrawals in your early 70s. The up side is that those withdrawals from Roth IRAs are tax-free, and there is no requirement to withdraw money at any age.

Before you act on this make sure that you have read the fine print: The money you convert is fully taxable (which explains why future withdrawals are tax-free; instead of paying taxes latter you pay then up front. To make the tax bite a little easier, those who convert in 2010 will be allowed to pay half the tax in 2011 and the rest in 2012.

The choice is yours: Pay now so that you are paying on the current balance. Or pay later when you make withdrawals from the (theoretically higher) balance.

Pay now or pay latter? Getting this question wrong could cost you tens of thousands of dollars in unnecessary and premature taxes, and many tens of thousands more in lost wealth.

The Roth Conversions Conundrum is a timely issue that investors should address; we do not believe that the conversion is in everyone's best interest. The situation is complex and it would take a detailed analysis of your personal situation to determine if this is the right decision for you. Money Guide Pro is a good start point to test a Roth Conversion. Schulmerich & Associates can help you make that decision.

### **Dose conversions make sense?**

If you're current tax bracket is low because of divorce, job loss. And you believe that your income is going to rise in the coming years, placing you in a higher bracket, converting now makes sense.

### **Conversion Could Increase Your Children's Inheritance.**

If you convert your IRA to the Roth, you pay the taxes now. If you want your children or grandchildren to inherit the account when you die, they will receive the money without having to pay income tax. With proper estate planning, their inheritance can be increased compared to a traditional IRA.

### **Could this conversion increase your Federal and State Income Taxes?**

If you're in a low tax bracket, be aware that converting could push you into a higher bracket and possibly even the highest bracket of 35%. That's because the amount you convert is added to your taxable income (it is not just the conversion amount).

If you live in a state with income tax, you will owe the state taxes.

### **This Conversion Could cause You to pay at 10 Percent IRS Penalty.**

Ask yourself are you able to pay the tax earned income or money held in other accounts? If you use money held in the IRA, and if you're under the age of 59 ½, you will owe a 10% IRS penalty in addition to the tax itself. Not to mention the state taxes that you will owe (paying those from the IRA could further increase your taxes and IRS Penalties.)

### **Conversion Could Require You to file Estimated payments.**

You will be expected to pay taxes in the calendar quarter in which you earn the money per the IRS. This is something that is normally done by your employer through payroll. If you convert a large IRA this could require you to file a 1040-ES. If you don't, you will pay in interest and Penalties.

### **Conversion Doesn't Necessarily Increase Your wealth.**

Weather to convert or not? Here is how the math works: your Deductible IRA has \$100,000 and it doubles between now and retirement to 200,000. You withdraw the money paying 35% in taxes on the current balance. That ends up being \$35,000, leaving you with \$65,000. Then this amount doubles so that by retirement you have 130,000 (all withdrawals are now tax free). So weather you convert you end up with the same amount of money. The difference is that one strategy has you pay 35,000 in taxes now, while the other has you pay \$70,000 later (the net after-tax value is the same.)

### **Conversion Dates**

If you convert your IRA to a Roth in 2010, you will not need to pay the tax that year. You will need to pay half in 2011 and the other half in 2012. This may benefit you because if you were to convert 250,000 IRA to the Roth. This means you will owe income taxes on that \$250,000. At the 35% federal income tax bracket, that's \$87,500 (plus more for state income taxes.)

You will then need to decide where the funds will come from to pay this tax bill. Few have that sort of cash lying around and that will mean that you will need to use the money in your IRA to pay the tax bill. This reduces your IRA and thus your future wealth. And depending on the market conditions this could force you to sell when the market is low.

You may have the opportunity to pay those taxes over the two year period using your earned income, thus not having to liquidate a chunk of your IRA. This is a huge benefit to someone

with sufficient discretionary income.

### **Medicare Premium Could Increase with conversion.**

If you are covered by Medicare, your Part B premium is based on your Income. Converting increases that income (for a year or two). This could add hundreds of dollars to your monthly Medicare cost.

This doesn't mean that converting is a bad idea for everyone. And don't assume that you should convert because of general comments you see, hear or read about. The Roth IRA Conversion Conundrum is an important thing to consider, and there is no substitute for personal advice based on your individual circumstances. If you are interested in to looking at this Conversion for your own personal situation please call our office.

## **Section 2: The Rough Road To Recovery**

Investors are always very interested in the returns they get on their portfolios. As Will Rogers famously remarked, the return OF his money was more important to him than the return ON his money.

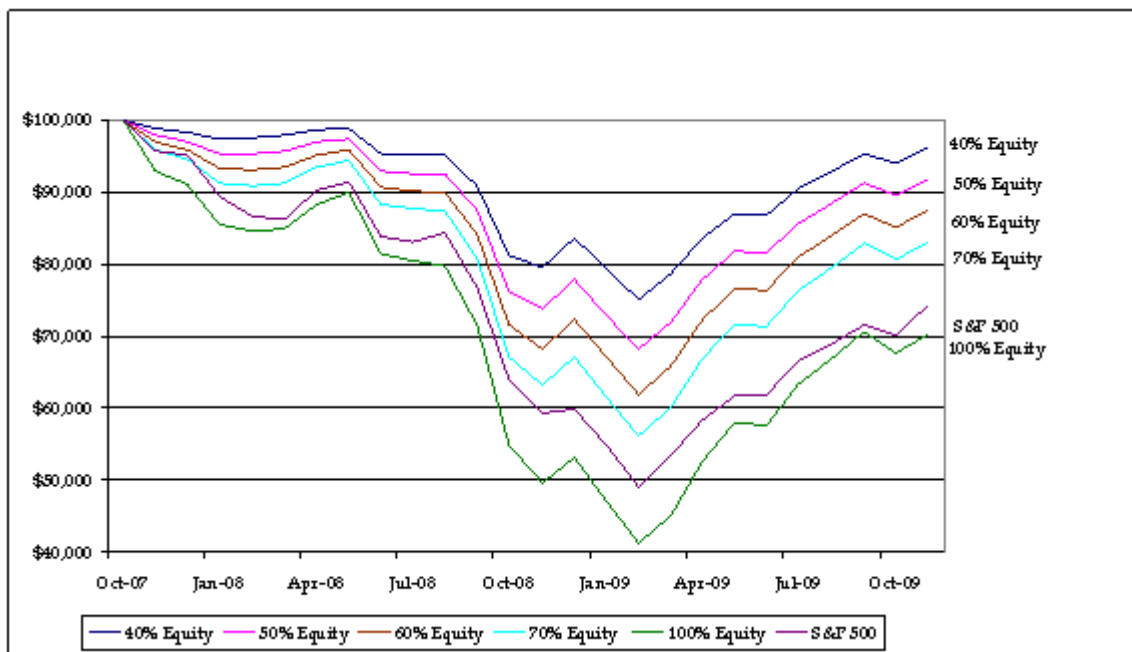
Millions of investors may be feeling the same way these days, waiting for their portfolios to return in value to their high point, which for most people occurred in the fall of 2007. How fast a portfolio bounces back from adversity is an important measure of the risk of that portfolio.

We created A chart that plots the declines and (so far) partial recoveries of five diversified portfolios and the Standard & Poor's 500 Index. In each case, we wanted to see what happened after the high point, the beginning of October 2007, through the end of November 2009, giving us a 26-month market snapshot.

The graph below uses that time frame to track the values of hypothetical worldwide portfolios with equity allocations of 40 percent, 50 percent, 60 percent and 70 percent, which represent the risk profiles taken by most of our clients, as well as a 100-percent-equity diversified portfolio and the S&P 500 Index.

You'll see that the interim peaks and valleys all occurred at about the same times. But some portfolios fell further and faster than others. And some recovered faster than others.

## Six portfolios compared: Oct. 1, 2007 through Nov. 30, 2009



Each hypothetical portfolio started with \$100,000 and was rebalanced monthly. No money was added or withdrawn. While these don't duplicate any real-world portfolios, the size and speed of their declines and recoveries are similar to those of many accounts that we manage for clients.

The graph is based on the assumption that investors stayed the course through the tough times of 2008 and 2009 – something that wasn't easy for a lot of people.

You can see at a glance why some investors may be feeling more stress right now than others. The all-equity diversified portfolio, for example, fell the farthest from its high, hitting a low month-end value of \$41,363 (a drop of nearly 59 percent) last February. In the next nine months, March through November, it bounced back to \$70,276, a gain of about 70 percent.

### Pains and gains

As you would expect, the decline in value of each of the five diversified portfolios was directly correlated with how much equity it contained. In the bad times, more equity meant more pain.

Just as important, though maybe not quite so immediately obvious in the graph, the portfolios with more equities bounced back at a faster rate this year. In March

through November, the 70 percent equity portfolio gained 48 percent, compared with a 28 percent gain in the 40 percent equity portfolio. In the good times, more equity meant more gain.

The graph shows only one snapshot in time. We don't believe these 26 months are necessarily typical or that they in any way predict the future. We chose that period in order to illustrate the "break-even" psychological struggle that we believe is on many investors' minds these days.

You may look at this graph, think about these numbers and conclude that you should minimize your exposure to equities. But for many people, that could be a costly mistake. The long-term bias of the stock market is upward, and during good times, more equity exposure is likely to lead to higher returns.

Getting your asset allocation right requires a delicate balance that should be based on your emotional makeup and all your circumstances. If you invest too heavily in equities, you could sustain losses that you will have a hard time making up, or you could lose your confidence and bail out of the market at a bad time. On the other hand, if you invest too heavily in fixed-income funds, your assets and income might not keep up with inflation thus losing wealth.

These are challenging issues, and some investors make their asset allocation decisions too casually. Many investors could benefit from having a professional advisor help them through this tricky territory

### **SECTION 3: THE TALE OF THE DECLINING DOLLAR, INFLATION & THE EFFECT ON YOUR PORTFOLIO.**

Over the last several months, the U.S. dollar has declined in value against other currencies, raising concerns that the dollar may depreciate further. There is also the fear of future inflation. Both of these can impact investment portfolios. We have to ask ourselves how investors can protect themselves against this declining dollar and Inflation.

In this article, we will discuss how a portfolio can be structured to offset the potential negative impacts of dollar depreciation or rising inflation. We will then review how three portfolios – Schulmerich & Associate's suggested worldwide portfolio (Global), the S&P 500 and our

recommended bond portfolio – each performed during times that the dollar depreciated or inflation increased.

A well diversified portfolio can provide reasonable shelter against these economic tempests, and can also outperform the S&P 500.

## Dollar depreciation

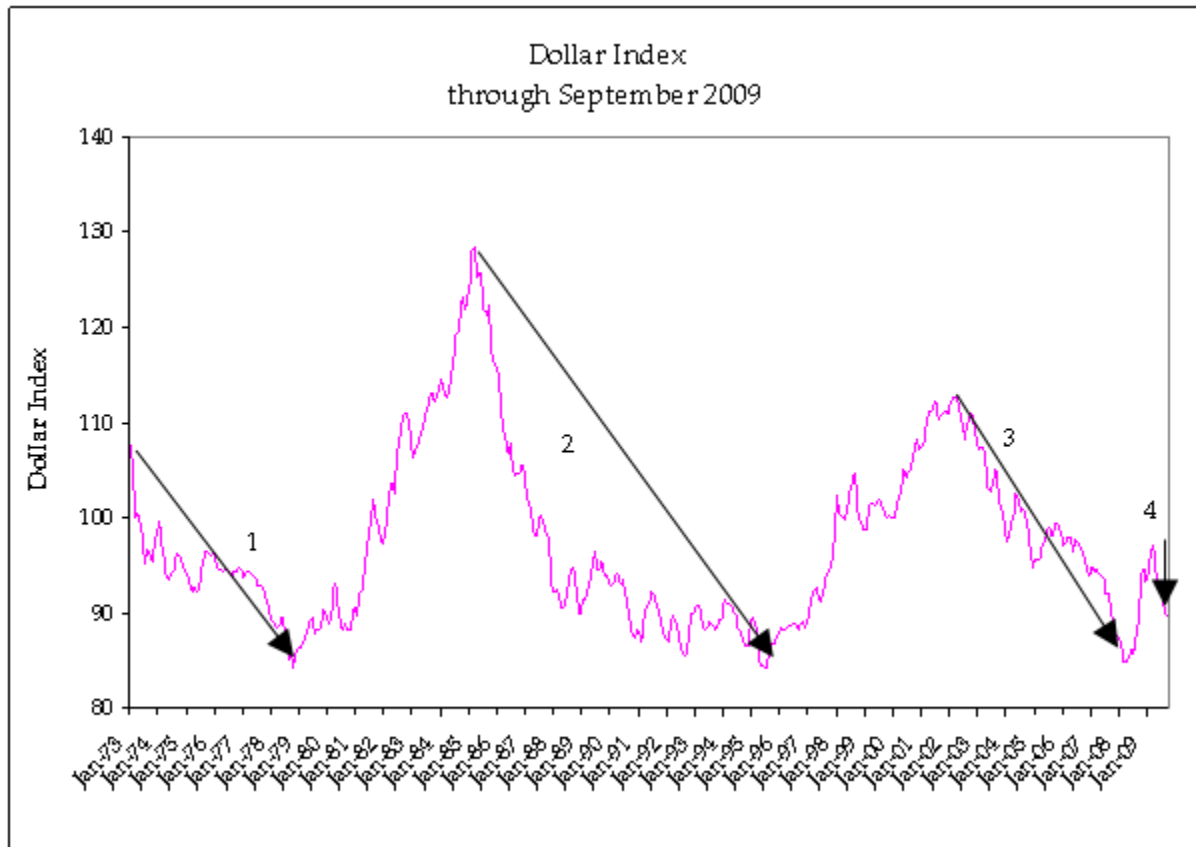
### Portfolio structure and the dollar

We have purposely structured our client portfolios to withstand various economic scenarios, including dollar depreciation. The equity component is equally divided between U.S. and international funds. Any decline in the U.S. dollar will increase the value of foreign currencies, which could increase the dollar value of foreign securities. A client with a 60/40 stock/bond account has 30 percent of assets denominated in foreign currencies. That offers significant protection against a dollar decline.

### Periods of dollar decline

Figure 1 shows the value of the dollar compared with a broad group of currencies, as compiled by the Federal Reserve, from January 1973 through September 2009.

**Figure 1 – Dollar index**



The arrows and numbers show four periods when the dollar was generally depreciating relative to other currencies.

### Portfolio returns when dollar declines

How have our recommended portfolios done when the dollar declined? To answer this question, we will focus on the 100 percent Worldwide equity portfolio. This Global equity portfolio is comprised of Dimensional Fund Advisors (DFA) mutual funds or their underlying indices. The portfolio has 40 percent U.S. stocks, 10 percent U.S. real estate investment trusts (REITs), 40 percent international developed country stocks and 10 percent emerging market stocks. The portfolio has a value and small cap tilt. The recommended bond portfolio includes short term Treasuries, intermediate term government bonds and Treasury Inflation-Protected Securities (TIPS).

Figure 2 shows the returns of the Global equity portfolio, S&P 500, and our recommended bond portfolio during the four periods in Figure 1 when the dollar was falling. The numbers in the first column correspond to the numbers in the graph above. Global and Worldwide are one in the same.

**Figure 2 – Portfolio returns during periods of dollar depreciation**

Dollar down period	High date on dollar	Low date on dollar	Annualized returns				Difference: Worldwide equity minus S&P 500
			Dollar index	Worldwide equity portfolio	S&P 500	Bond portfolio	
1	Jan-73	Oct-78	-4.2%	11.2%	0.5%	4.9%	10.7%
2	Mar-85	Jul-95	-4.0%	17.2%	15.3%	8.6%	1.9%
3	Apr-02	Mar-08	-4.7%	13.2%	5.4%	5.2%	7.7%
4	Mar-09	Sep-09	-15.3%	145.1%	79.3%	2.1%	65.8%

Returns are from the end of the first month to the end of the last month for each period, annualized.

During each of these periods, which varied from five months to over 10 years, the dollar declined at an annual rate of at least 4 percent. The three portfolios each had positive returns during the four periods of dollar decline. During each of these periods, the Global equity portfolio increased by over 10 percent annualized, and also beat the S&P 500. Our recommended bond portfolio (all U.S. dollar denominated) also had

positive returns in each period.

**Each of the three portfolios had positive returns during these periods of dollar declines.**

### **Rising inflation**

#### **Portfolio structure and inflation**

Our portfolios also have safeguards to protect against rising inflation. Their allocation to emerging markets should benefit from increases in commodity prices. REITs also provide long-term protection against inflation. Asset classes such as small cap value and small cap have also generally performed well during periods of high inflation.

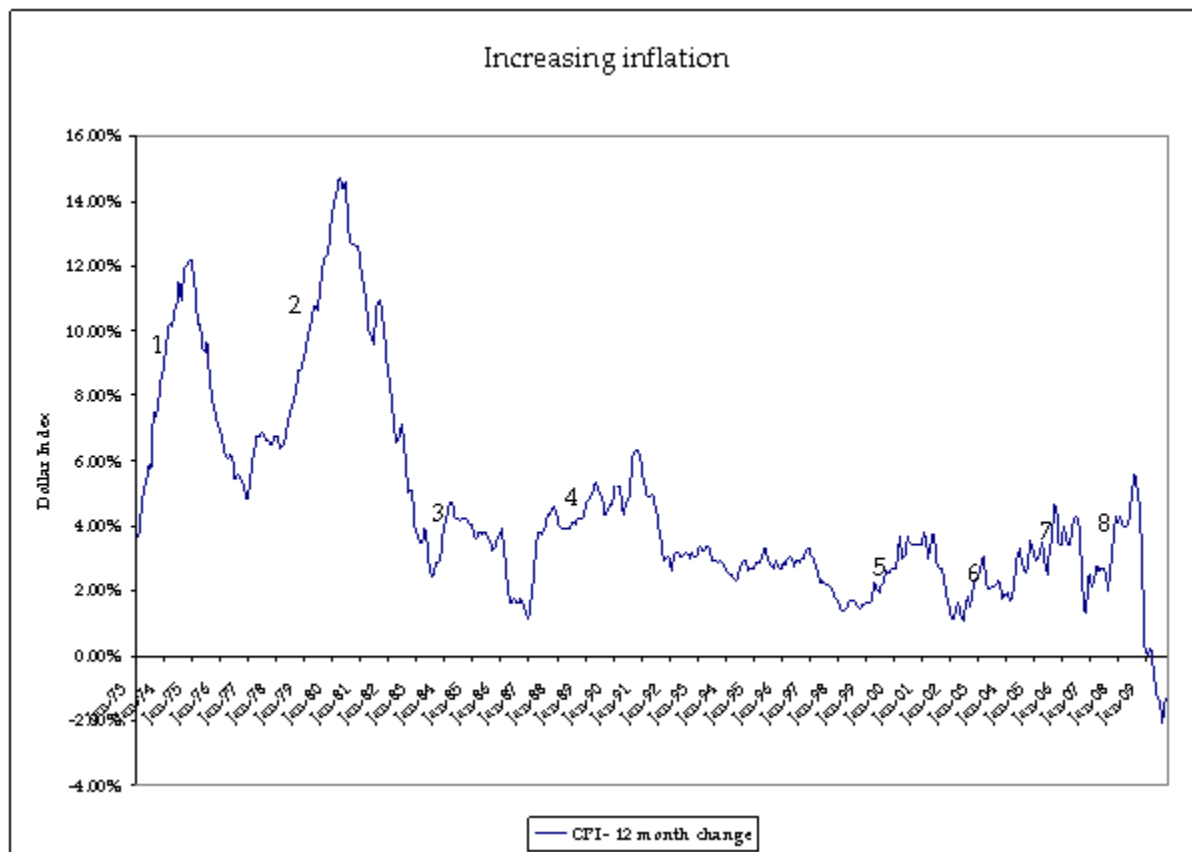
Our bond allocation includes TIPS whose principal increases with the U.S. Consumer Price Index (CPI). We also include short-term Treasuries, whose interest rates will reset at higher levels in an inflationary environment as the underlying bonds mature.

(SEE FIGURE 3 BELOW)

### Periods of rising inflation

Figure 3 shows the rolling 12-month change in U.S. CPI, with numbers one through eight corresponding to periods of generally rising inflation.

**Figure 3 – CPI: 12-month change**



### Portfolio returns when inflation increases

Given the worrisome increase in the projected U.S. budget deficit, and the possible resulting impact of increasing inflation, how have the portfolios done during periods of increasing inflation?

Figure 4 shows how the portfolios performed during these eight periods of increasing inflation. The numbers in the first column correspond to these periods. The next four columns show the month that 12-month inflation was at a low, the month that inflation peaked and the associated 12-month inflation rates. The next three columns show the annualized returns for the three portfolios during each period. The last column shows the difference in returns between the worldwide equity portfolio and the S&P 500.

**Figure 4 – Portfolio returns during periods of rising inflation**

Periods when inflation is increasing								
Periods when CPI is up (Number on graph)    Low date on CPI    High date on CPI			CPI - 12 month change		Annualized Returns			Difference: Worldwide equity - S&P 500
			Low	High	Worldwide equity portfolio	S&P 500	Our bond portfolio	
1	Jan-73	Dec-74	3.7%	12.2%	-22.1%	-20.9%	5.0%	-1.2%
2	Dec-76	Mar-80	4.8%	14.7%	19.6%	3.7%	0.8%	15.9%
3	Jul-83	Mar-84	2.4%	4.8%	20.9%	1.6%	8.1%	19.3%
4	Dec-86	Oct-90	1.1%	6.3%	11.7%	9.8%	6.2%	1.9%
5	Mar-98	Jan-01	1.4%	3.8%	4.4%	9.2%	5.7%	-4.8%
6	Jan-02	Mar-03	1.2%	3.0%	-10.4%	-20.5%	11.1%	10.1%
7	Feb-04	Sep-05	1.7%	4.7%	16.8%	6.4%	1.2%	10.4%
8	Oct-06	Jul-08	1.3%	5.6%	-2.6%	-2.8%	6.0%	0.1%

The worldwide (Global) equity portfolio had five periods of positive performance, and outperformed the S&P 500 in six of the eight periods.

**While there were periods of negative performance, the worldwide (Global) equity portfolio, on average, generated positive returns during periods of rising inflation.**

In economics and finance there is much uncertainty between potential cause and ultimate effect. Deficit spending may run out of control or politicians may successfully rein in the spending. Inflation may or may not increase as a result. More often than not the rising inflation leads to dollar depreciation. Portfolio returns can be positive or negative during periods of dollar depreciation or increasing inflation.

We believe the best solution for the long term investor is to structure a diversified portfolio which can withstand many (note that we are not saying all!) of the potential economic scenarios which may be encountered over time. While past results are no guarantee of future performance, the appropriate portfolio structure and asset allocation have been used in the past to mitigate the impacts of a falling dollar or rising inflation.

## SECTION 4: WAIT TO FILE YOUR TAXES UNTIL MARCH!

### ***Avoid the risk that you'll have to file an amended return***

Many taxpayers rush to file their tax returns as quickly as possible. And normally that would be fine. But if you own mutual funds, don't file your tax return before March 1!

This is why you should wait: Everyone involved in the financial industry — including employers, banks, insurance companies, mutual funds and brokerage firms — is required to mail W-2s and 1099s by January 31. But in 2006, 2007, and 2008, either because of last-minute changes in tax law or accounting reconciliations, many mutual fund companies and brokerage firms discovered that their 1099s contained incorrect information — which forced them to issue “amended” 1099s.

This was not only very expensive for the firms — they doubled their printing, postage and mailing costs — it was also a huge headache for their clients who had already filed tax returns based on the original documentation. These hapless consumers found themselves forced to re-do their returns and file amended tax returns, adjusting the amount they owed or were due in refunds — and paying their tax preparer additional fees to do the extra work.

It looks like 2009 will be the same. In fact, at least one custodian has already announced that it has received IRS permission to mail its 1099 forms in mid-February 2010, and other firms are expected to make similar announcements. Others that plan to mail their forms in January could find themselves issuing amended forms weeks later.

Therefore, if you own mutual funds, we recommend that you do not file your tax return before March 1. Waiting a few extra weeks might help you avoid the hassle and costs of having to file an amended return.

Waiting shouldn't bother you. But you might be annoyed if you're expecting a large

refund. If that's the case, you might be handling your taxes incorrectly. That's because you're not supposed to be due a large refund — if you are, then you're giving the IRS a tax-free loan for months. See if you can correct this by reducing the amount of money that your employer withholds from your paycheck.

Remember: Refunds are not gifts from the IRS, but simply a return of the money that's yours in the first place.

## SECTION 5 RESOLUTIONS FOR THE NEW YEAR

Now that 2009 is behind us it is time to look at new goals for 2010. So maybe your pants fit a little tighter but that doesn't mean we should not set new goals for this year. If you have been racking your brain trying to figure out what this year's resolution should be, let us help you!

1. **Get organized:** I don't mean your sock drawer. I mean your finances. We have a great tool that we offer our clients at Schulmerich & Associates. Our own Advisor Vault! This is a great way to keep up to date on your finances. You can view your performance reports and store all financial documents in the vault. This includes Bank statements, Trust documents, and Wills. Any personal documents. Please call us if you would like to get logged on to Advisor Vault.
2. **Save money** and get a written financial plan. We bought an amazing program that makes us able to put together a written financial plan. Most institutions and advisors charge extra for this but we provide this to all of our clients without charge. Take advantage.
3. **Meet with Stephen Schulmerich** to touch base, go over your accounts, ask any questions you may have. We are here to help you meet your financial goals. Please call us to set up an appointment.

Schulmerich & Associates is excited for this upcoming year and we hope you are too. Too often it is easy to over look the important things in this life. So make sure to love laugh and smile and enjoy every moment every day.

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