

WEALTH Management

FOURTH QUARTER 2009

Should Your IRA Take a Tax Haircut?



In the debate over which is better—the immediate tax deduction for contributing to a traditional IRA or the potential for tax-

free income from a Roth IRA—the answer tends to turn on one’s assumptions about tax rates. Conventionally, one expects to be in a lower tax bracket during retirement, perhaps dramatically so. That favors the traditional IRA. These days, however, those at higher income levels have been told repeatedly that their tax rates will be going up in the future, perhaps sharply. If so, the advantage shifts to the Roth IRA.

Those who are convinced that they will face higher tax rates in the future may want to consider converting their traditional IRAs to Roth IRAs, locking in at today’s relatively lower income tax rates. Conveniently, Congress has made that possible for everyone, beginning January 1, 2010.

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Estate planning strategies

Patchwork?

Estate planners and their clients face a remarkably difficult and unprecedented tax environment at this writing. As of January 1, under current law, the federal estate tax will be suspended, replaced by a complex new tax regime with the short-hand name “carryover basis.” In effect,

greater capital gains tax receipts would offset, to some extent, the loss of estate tax revenue at the death of wealthy individuals.

After one year of that experience, the federal estate tax roars back in 2011, with a \$1 million exemption and a top tax rate of 60%. (In contrast, this year the exemption is \$3.5 million, and the

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Then and Now— A Generational Perspective



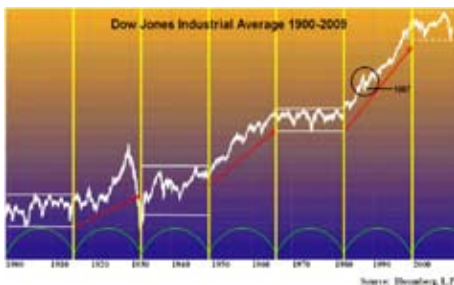
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Some years ago a speaker addressing generational financial planning pointed out that it takes four generations for financial lessons to be “unlearned.” Over the last two years, we have witnessed the worst financial crisis since the Great Depression—and we don’t think it’s a coincidence that this happened four generations later. Have we learned from the mistakes of the past?

Today, the media make comparisons to those years regarding market drops and corrections, economic weakness, and bank failures. The baby-boomers did not practice the financial lessons learned by their grandparents; they failed to pass those lessons to their children. These children, the “Sesame Street” generation, may become more like previous generations as they learn about thrift, savings, and living within their means.

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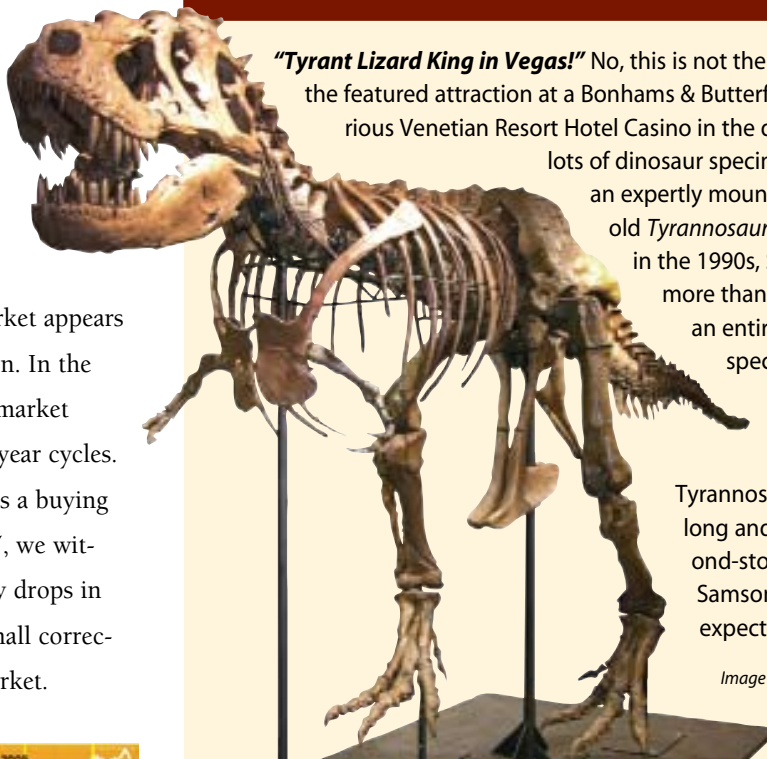
A Wall Street pundit has been referring to the current market and economy as the “new normal.” However, looking at history, the transition from the bull market of 1982-2000 to the current market appears to be a normal market rotation. In the logarithmic chart below, the market tends to move in roughly 16-year cycles. In a bull market, every drop is a buying opportunity. In October 1987, we witnessed one of the largest daily drops in history, but this was just a small correction in a much larger bull market.



In the period from 1966 through 1982, we saw a very different market with increased volatility and little capital appreciation. During these times, it is as important to preserve capital as it is to grow capital, while dividends and interest become more important to investment returns. We may be in a similar market today.

Economy

The government stimulus leads us to believe that the economy is stabilizing. Does this move in stocks of almost 60% from the bottom in March 2009 mean that the economy is out of the woods? If we are in the middle of a 16-year correction, more volatility is expected going forward—both in the economy and the markets.



“Tyrant Lizard King in Vegas!” No, this is not the title of a 1950s B-movie but was the featured attraction at a Bonhams & Butterfields October auction at the luxurious Venetian Resort Hotel Casino in the desert city. The event had over 40 lots of dinosaur specimens and fossils, with “Samson,” an expertly mounted skeleton of a 66 million-year-old *Tyrannosaurus rex*, as centerpiece. Excavated in the 1990s, Samson contains 170 bones, more than 50% of the total bone count of an entire skeleton. This fact makes the specimen one of the most complete T-rexs to have been discovered and possibly an example of an as yet unnamed species of *Tyrannosaurus*. In life Samson was 40-feet long and could have looked into a second-story window. Despite crowd appeal, Samson did not sell at the auction, but is expected to in post-auction offers.

Image courtesy of Craig Cutler

Inflation

While stocks have recovered, interest rates remain low. These low rates indicate that the economy has not yet fully recovered, and inflation may be years away. Inflation can be caused by imbalances in supply and demand, but printing money, which has been the case recently, can also be a source of inflation. Even though the federal government has increased the money supply over the last 12 months, money is not moving (velocity) through the financial system. When velocity increases along with lending, employment, and wages, the challenge will be to reduce the money

supply and avoid inflation. We diligently watch for a time to increase inflation protection in clients’ portfolios.

It has been an exciting and frightening time in the markets over the last two years, but it has also been a learning experience. With the “Sesame Street” generation learning the lessons of the past, our financial system will become stronger—at least for the next three generations! ■

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Or call 484-881-4080 if you’d like to schedule an appointment to discuss your investments.



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