JANUARY | 2010

financialjourneys

Financial & Retirement Planning for Life

Economic Outlook: Expect U.S. Recovery To Be Gradual, Fragile

By Dr. Scott J. Brown, Chief Economist

Scott Brown, PhD
Raymond James
Chief Economist

The U.S. economy appears to be recovering from its worst financial crisis since the Great Depression. Normally, recoveries from severe recessions tend to be sharp as housing and auto sales snap back.

The labor market typically lags in

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William K. Dermann, CFP
Financial Advisor

Amy L. Smith, CFP
Financial Advisor

Dermann & Smith Personal Wealth Management
535 Wellington Way, Suite 260
Lexington, KY 40503
859-252-2780|Toll-Free: 877-252-2780
bill.dermann@raymondjames.com
www.dermannsmith.com

Retirement Sharpens Focus on Risk

No matter how carefully you try to protect your portfolio, you can't stamp out risk. In various forms, it is always present, ready to subvert any ideas about safety.

In your earlier years of investing, if you concluded that the assets you held were not very wisely chosen, you had time on your side. By simply restructuring the elements of your portfolio, you could allow many years of growth and compounding values to overcome earlier mistakes. Historically, at least, financial assets have tended to grow in value despite cycles of recession and recovery and bear and bull markets.

When you retire, the pattern of market cycles won't change, but your personal timeline has – it is not as likely to work in your favor. What can you do?

Sharpening the Image

First, you can sharpen your focus as you near retirement. Don't put off carefully analyzing how your portfolio is functioning. If it doesn't appear to be ideally suited to your changing needs, make adjustments sooner rather than later.

The asset allocation that works best for you depends largely on your time horizon and your ability to tolerate risk. Your time horizon is shorter than before. How do you regard your risk tolerance now, in the wake of the market volatility over the past two years? Within your mix of cash, fixed income and equity investments, are you diversified in an appropriate manner, so as to provide a firm financial foundation for the kind of retirement you've planned? Are there other considerations that need to be addressed, such as concentrated equity or mutual fund positions?

Are you better able, now that you're a little older, to estimate what financial resources you'll need to handle family or health issues? There are no certain answers, and health and longevity are unknowns, but realistically assessing their likely impact on your retirement may help you better position the assets in your portfolio. Poor health can lead to costly care that can quickly drain your wealth. If you're in great shape, on the other hand, you may decide to travel more extensively and longer into your

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Economic Outlook (continued from page 1)

an economic recovery. The financial crisis of late 2008 was severe, leading to a sharp rate of job losses in early 2009. Nonfarm payrolls fell by nearly 700,000 per month in the first quarter of last year, but the pace of job losses moderated considerably over the course of the year. There is some hope that job growth will return in early 2010, aided partly by government hiring for the 2010 census.

The Federal Reserve is expected to keep short-term interest rates at exceptionally low levels well into the second half of the year and possibly into 2011. The timing of the Fed's decision to begin tightening monetary policy will depend on the unemployment rate (which must begin to fall significantly), inflation expectations (which have remained well anchored) and the underlying trend in inflation (which has stayed relatively low).

Stimulus at Work

Fiscal stimulus helped support the economy in 2009. However, this will ramp down in the second half of this year and into 2011, effectively acting as a drag on overall gross domestic product (GDP) growth. Hopefully, the private sector will pick up steam, offsetting the impact of reduced government demand.

A bigger uncertainty will become apparent heading into the second half of the year.

The Bush administration's tax cuts are scheduled to sunset at the end of 2010. An increase in taxes would not be good for a fragile recovery. Uncertainty regarding which tax cuts might be extended and which might be allowed to expire will likely be a problem for investors and the economy. ■

There is no assurance any of the trends mentioned will continue in the future.

Risk Focus (continued from page 1)

retired years than you had imagined – that could strain your resources, too.

Risk Realities

In retirement, you face the same risks you always have as an investor, but your frames of reference are different.

Keep those changing points of reference in mind as you monitor the performance of the assets in your portfolio. You may have easily made the necessary changes to turn your financial engine from an accumulation machine into an income generator, but that doesn't mean your investments aren't subject to the same market, inflation and currency risks they always faced.

It may be time to give your portfolio a little retirement-related risk therapy. If you have changes in life circumstances that should be reflected in your portfolio, please feel free to call me. ■

Financial Planning:

Solving the Riddle of the Roth IRA Five-Year Holding Rule

As investors consider the merits of the Roth IRA – contributing to one or converting a traditional IRA to a Roth in 2010 – questions about the Roth five-year rule keep popping up.

For contributions, the five-year clock starts ticking retroactively on January 1 of the calendar year in which you make your first contribution. So, if you opened the account with a contribution in June 2001, whether or not you periodically made more contributions, your five-year holding period was met after December 31, 2005.

Each conversion, however, sets its own five-year clock in motion. In order to make penalty-free withdrawals that include earnings, you must have held the assets in the Roth IRA for five years or be 59½. If you're already 59½ when you convert, you can withdraw the converted amount without penalty or tax (which you paid when you converted).

The appeal of the Roth, which is funded with after-tax money, is that you may take tax- and penalty-free distributions from the account as long as you meet all the rules. It's important to remember that in a Roth IRA, the five-year rule applies to *earnings*.

The original contributions are yours, because you funded the account with after-tax income. ■