THE H GROUP INC.
INDEPENDENT WEALTH MANAGEMENT SOLUTIONS™

THE KELEMEN WAY
financial PERSPECTIVE
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Creators of The Planning Vision Process®

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Moving Forward with Realistic Expectations

As we said to our clients in a June email update, "It's safe to open your account statements again!" In fact, it's almost enjoyable. For those that held the course in our carefully-constructed portfolios, their accounts are up significantly for the calendar year, more than the Dow and the S&P 500 Indexes.

So even though in late July the S&P 500 Index is up a stunning 44% from its March 9 low, it is still about 37% below its October 2007 peak. And it's not just stocks and bonds, as home prices are still lower—sometimes significantly lower—than they were two years ago. So, you may wonder, where am I now, and what will it take to get back to where I was? And how do I do so?

The answer is not pretty. To recoup a 37% loss, you need a 58.7% gain. It's mathematics, pure and simple. (Divide the amount of the loss by the current value.) If you did not participate in this recent rally, your required return is even more daunting. If your home has declined 25% in value, then it needs to appreciate 33% to get back to what you think it was previously worth. But was it really worth that amount? In the end stocks, bonds, and homes are only worth what a buyer is willing—and able—to pay. And until the employment picture improves, it will take time for demand to increase.

While the future is constantly evolving, inflation is not the problem in the near future. Deflation is a far greater risk with more severe consequences. But we do think that the worst is over. The dynamic with our economy and the global financial system has shifted. We no longer worry about a complete meltdown of the global financial system as we did 11 months ago. Regardless of the politics involved and the long-term cost implications, we agree with many respected economists that massive interventions by the Federal Reserve and other central banks, as well as actions by many governments helped stabilize the situation.

What can you do about it?

You can't control the economy, the financial markets or general real estate prices. But you can control your responses to them.

1. **Cut back on your consumption of financial and political noise in the media.** Get your information from a variety of sources, even those that don't fit your political or economic view of the world.
2. **Get a portfolio review.** It should address:
   - ✓ The appropriateness of your asset allocation and your holdings for your goals and risk tolerance
   - ✓ Changes that may enhance your financial security
   - ✓ Positioning for changes in the economy, both positive and negative (such as long term inflation)
3. **Review your goals.**
   - ✓ Are they realistic?
   - ✓ What is negotiable and nonnegotiable?
4. **Develop a plan of action to achieve your goals in this new reality.** It could be a combination of working longer, postponing Social Security, saving more, adjusting your expenses, changing your portfolio, and much more. (We'll have more about this in a future article.)

We do items 2-4 at no charge for our portfolio management clients. We do it for a fee for non-clients. (Some or all of the fee can be credited against future portfolio management fees for those that later become clients.)

We can't change history. All any of us have for certain is the present and maybe the future. We're here to help you focus on what needs to be done so that you can enjoy both the present and the future.

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Start Thinking Now About a 2010 Roth IRA Conversion

Get ready for a "Blue-Light Special." This isn't something by the popcorn stand near the mothballs and laundry detergent in a big discount store, but a major opportunity to reduce your taxes on retirement income. We're talking about converting your IRA to a Roth IRA.

A Roth IRA (named after Senator Phillip Roth) is an IRA where the withdrawals are tax-free on contributions made to it. For earnings on those contributions or for proceeds converted from a regular IRA, the distributions are tax free after the later of five years or age 59½. No minimum distributions are required starting at age 70 ½. You do, however, need to pay the income taxes on the amount of the converted IRA, which is a big roadblock for many.

Why 2010 and not now?

Roth IRA conversions normally are limited to individuals and couples with an adjusted gross income (AGI) of $100,000 or less. This precludes many of our readers from even considering it. **But in 2010, the income limit is waived. Furthermore, you will have two years to come up with the money to pay the income taxes.**

Congress inserted this revenue-raising provision in the 2005 tax bill to raise an anticipated $6.4 billion in the short run. In the long run, this will cost the government $14 billion in future tax revenues in present-value terms, according to an analysis by the Tax Policy Center. The government's loss is your gain. Unfortunately, as you enjoy your tax-free Roth distributions, your children and grandchildren will have to pay for it down the road with higher payroll and income taxes.

Roth Conversion Benefits on $400,000 IRA*

Number of Years	Current Tax Rate	Future Tax Rate	Account Balance Difference
5	28%	30%	1.38%
5	28%	35%	6.38%
10	28%	30%	1.93%
10	28%	35%	7.69%

**Assumes a hypothetical 7% investment growth rate and that the conversion taxes of $120,000 were paid from non-IRA funds. The results would be even more dramatic over long period or with higher future tax rates. (There is little or no value in using IRA assets to pay conversion taxes, especially if future tax rates remain the same.)*

Not for everybody

Many Roth conversion calculators are available on the web, but most are overly simplistic. Roth IRAs are not the panacea that their loudest supporters clam it to be. There are many nuances and things to consider. The real issue is this: "Do I pay taxes now or later?" Here are some factors to consider:

- ❑ Will I be in a higher or lower tax bracket during retirement? Remember, there are a number of "stealth" taxes in retirement, such as means testing, phase-outs, etc. that could make your tax bracket effectively higher than it appears.
- ❑ Will tax rates be higher in the future than now? (That's a no-brainer!)
- ❑ What is the mix of your retirement assets—is the overwhelming majority in tax-deferred qualified plans? If so, you may want to include a mix of tax-free income sources.
- ❑ Can I afford to pay the taxes?
- ❑ Do I have money outside the IRA to pay the income tax bill?
- ❑ Could I put that tax money to better use elsewhere—such as maximizing a tax-deductible 401-k contribution, paying off debt, etc.?
- ❑ How soon before I need to take distributions? The longer you wait, the more it pencils out, especially for younger individuals. Roth IRAs are the perfect investment to leave as an inheritance.

Timing

When to convert is a big consideration. Early in January 2010 gives you a whole 28 months to come up with the taxes. Or, if you change your mind, it gives you extra time to recharacterize it back to a regular IRA. (That must be done by October 15 of the year after the conversion.) With account values down considerably, the tax-cost of converting is less than it would be at the top of a stock market boom. Partial conversions during 2010 may be a way to hedge a market drop or rally.

For some of you, the blue light may already be flashing. If you have the ability to increase your income this year so that next year's is lower, that could make the conversion cost lower. Also, account values for most people are generally low now, meaning that there is less to convert. And many people have loss-carry-forwards which can be used in a number of ways both now and during the conversion period.

Yet for some of you, this may be a year when your AGI is less than $100,000. This means that you can get an early start on your conversion, possibly spreading it out over two years, and the taxes over three years.

If your Modified AGI as a married couple is less than $166,000, you could at least make a non-deductible Roth IRA contribution of $5,000 each, or $6,000 each if you are over age 50. **Still make too much income? This would be an excellent time to make a non-deductible IRA contribution for the same amount.** Your conversion cost would only be the taxes on the gain that occurs between now and the conversion, not the entire balance. **If your IRA consists of mostly non-deductible IRA contributions, then you should definitely plan on converting it in January.** (You cannot, however, "cherry pick" between the deductible and non deductible IRA accounts—the conversion must be done on a prorated basis.)

We'll be happy to help you start planning now by coordinating with your professional tax and integrating the complex details into a well-coordinated big picture.

The Many Dimensions of Risk

We've written several times since 1991 on the topic of risk tolerance, but nobody seemed to care when times were good. Now, it seems people are much more aware of it, and they are looking at risk from a broader perspective.

Most Investment 101 courses identify at least seven kinds of risk that apply to any particular investment: market, credit, inflation, liquidity, economic, business, and interest rate risk. Interestingly enough, some of these same terms can be applied to one's personal risks in life as well. Losing one's income, business, health, credit, home, or the inability to retire or pay for college are big risks that have come front and center.

Risk tolerance is the risk normally chosen by you. It's a personality characteristic, a leaning. But risk tolerance has three other elements of risk that play into this.

1. **Risk required:** This is the risk associated with the return required to achieve your goals, a financial projection. The higher a return you need, the more risk involved. **Keep in mind, that not achieving an important goal (such as enough money to retire) can be a far bigger risk than a volatile portfolio.**
2. **Risk capacity:** This is the risk that you can afford to take, a financial characteristic. **If we could offer one take home piece of advice in this article it would be to evaluate your ability to absorb financial losses.** If your income is good, you are saving every month, and you have low debts, then you have a higher capacity to absorb risk.
3. **Risk perceived:** This is the risk perceived by you in the course of action being considered, how risk feels to you. It's not the actual risk, but it colors everything else. Just recognizing the following elements that affect your perceptions can help you clarify your thinking:
   - **Familiarity.** The more familiar you are with something, the less risk you feel. We may perceive a higher level of risk for a routine medical procedure than a doctor would, but the doctor may perceive more risk than we do about an investment strategy.
   - **Voluntariness.** The more you voluntarily participate in the decision making or activity, the less risk you feel. Someone forced to go along with a decision, global economic situation, or an activity will perceive a higher level of risk. The current economic environment was forced upon us, so we perceive the current situation to be very risky.
   - **Controllability.** This is a big one. The more you have control over the situation, the more you can rely upon your abilities to minimize risk. **The lesson here? Focus upon what you can control.**
   - **"Dreadedness" of consequences.** Obviously, you will perceive a higher level of risk if the consequence is postponing your retirement for 10 additional years, rather than 10 months.
   - **Professional uncertainty.** A patient is going to feel more risk if the doctors aren't certain of a diagnosis, or worse, they all disagree. The high degree of disagreement and ambiguity by so-called policy experts, central bankers, and market gurus is increasing the public's perception of risk.
   - **Fairness.** If we are all in the same boat together, that's one thing. But if we feel singled out that's different. Prudent investors may sense that the risk-taking investment bankers didn't suffer enough risk for their potential rewards, so they may feel this current market correction is unfair, and thus more risky.

The bottom line? Risk is inevitable in nearly all endeavors. Without risk, there would be no reward. There is a fine line between sleeping well now and eating well later. If you feel that your perception of investment risk is justified, then meet with us and create a portfolio that is more comfortable, but that also gets you to where you ultimately want to be. **You may not be able to do much about fairness, professional uncertainty, and consequences. But you do have some degree of control over the decision making, how you educate yourself about investments, and whether or not you become an active participant in the investment planning process.**

The Team Advantage™

Ron Kelemen and Mary Way are independent Certified Financial Planner™ certificants. They jointly serve their clients as a team with over 42 years of combined experience. They are members of The National Association of Financial Advisors (NAPFA), and as such work on a fee-only basis and do not accept any third party compensation or finders fees. Their practice focuses on wealth planning and management for professionals, business owners, and retirees. They are advisory associates of The H Group, Inc., one of the largest independent fee-only registered investment advisory firms in the Northwest with 18 professionals and over $400 million under active management.

About Ron Kelemen, CFP®

In practice since 1981, **Ron Kelemen, CFP®** is a contributing author of three financial planning reference books. *Medical Economics* continues to list him as one of the 150 best financial advisors for doctors. He is Past President of the Rotary Club of Salem, chair of the Willamette Academy Advisory Board, and immediate past president of the Medical Foundation of Marion and Polk Counties. Ron is frequently quoted in the national press and professional journals.

About Mary Way, CPA, CFP®

Mary Way, CPA, CFP® joined the practice in 1995. She is also a non-practicing CPA with 16 years experience in banking, business, and finance. She sits on the Investment Policy Committee of The H Group, Inc., is Vice President of the Willamette Valley Estate Planning Council, and a board member of the Salem Rotary Foundation. She is also active in the Financial Planning Section of the Oregon Society of CPAs.

What Does the H Stand For?

It's been 11 years since we moved our investment advisory affiliation to The H Group, Inc. And yet, we still are asked, "What does the H in The H Group, Inc. stand for?" When the company was founded in 1990, The H Group, Inc. was a temporary name, and the H stood for last name of the president and founder, Brent Hicks. One by one, many of the other advisors from our previous firm joined. Two of the earlier ones also had last names that started with H, so the H name stuck. Some of us have been together since 1981.

The H Group, Inc. is a collaborative of several different advisory practices, and one of the largest fee-only wealth management firms in the Pacific Northwest. As a strategic partner, we use it to provide portfolio management and administration, technology support, and compliance on a very cost-efficient basis. This profitability has enabled us to weather the financial downturn without layoffs at a time when other advisors have been under severe financial stress. Through an affiliate, Focus Point Solutions, Inc., these services are provided to numerous financial advisors from around the United States on a private label basis, with assets over $1 billion under active management.

Behind the scenes, we operate the Salem office of The H Group, Inc. as Kelemen Advisory Associates, LLC.

TEAM UPDATE

We love the summer, and so do our clients. In addition to many client update meetings, it's a time to catch up on projects and clients, do more research, and take some extra time off. One of our projects is the floor plan design for a move to a new office building, currently under construction just three blocks north, it's called "Water Place," and it is Salem's first LEED green office building. The tentative occupancy date is in November, and we'll have more about that as the building is finalized.

Lani hosted a two-week family reunion at her home. She was really in her element with her many grandchildren. Unfortunately some if it was during our record heat wave.

Debbie and husband Bob vacationed in Kauai.

Mary served as the sole financial advisor on a panel for the annual Estate Planning Evening, sponsored by the local Leave A Legacy group. She is working on the investment policy for the Salem Rotary Foundation, and she spent some of June meeting her CPA continuing education requirements. Her Mexico trip scheduled for last May was cancelled due to the H1N1 Influenza outbreak. So instead, she and husband Steve enjoyed an adventure-filled week in Maui.

Ron was a featured speaker at the Central Oregon Estate Planning Council in May. Then he and Kathy finally moved into The Meridian, their new condo just two blocks from the office. Now that the downsizing is over, they love it, especially the convenience and the view. Ron and Kathy attended their Uzbek exchange student's graduation from nursing school in Philadelphia, then Ron completed his term as President of the Rotary Club of Salem. In July he backpacked for five days in the Colorado wilderness with his brother and nephew.

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Will New Regulations Affect You?

In the wake of last year's financial crisis and the Madoff scandal, Congress and various federal agencies are finally getting around to revising regulations of the financial industry. It's a complicated task with multiple dimensions and several well-entrenched—and well funded—interest groups.

You will hear the word "fiduciary" in these hearings. The Merriam-Webster Dictionary of Law defines a fiduciary as: *one often in a position of authority who obligates himself or herself to act on behalf of another (as in managing money or property) and assumes a duty to act in good faith and with care, candor, and loyalty in fulfilling the obligation.*

> **We agree with The CFP Board of Standards, the Financial Planning Association (FPA), and the National Association of Personal Financial Advisors (NAPFA). They are taking the position that any individual or firm that provides financial advice must be held to the fiduciary standard of care and ethics, which is already the standard for us and other Registered Investment Advisory firms (RIAs).**

The brokerage, insurance, and banking industries want to be exempt from being held accountable as fiduciaries. And if you follow the money, they will most likely get their way. Our clients, however, and those of other independent fee-only RIAs, need not worry. Although you won't get the slick advertisements and brand recognition (especially with a firm name like ours), we will continue to operate as fiduciaries with a duty to you, our client, and not to an employer with manufactured products and complicated conflicts of interest. And as always, we will continue to keep abreast of these industry issues and communicate them to you.