CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

August 15, 2010

Roth Conversion

Converting a traditional IRA to a Roth IRA will trigger possibly substantial tax payments in 2011 and 2012. Although it rarely makes sense to accelerate a tax liability, this may be an exception.

It probably will be a benefit to most people who do not expect to draw from their IRAs for a decade, and for those who expect to leave some portion of their IRAs to heirs.

Core has prepared the tools to analyze whether converting one's IRA (or other qualified plan) to a Roth makes sense for a given individuals and we are ready to help any clients who wish to consider how this may apply to them personally.

By

Jack Mayberry

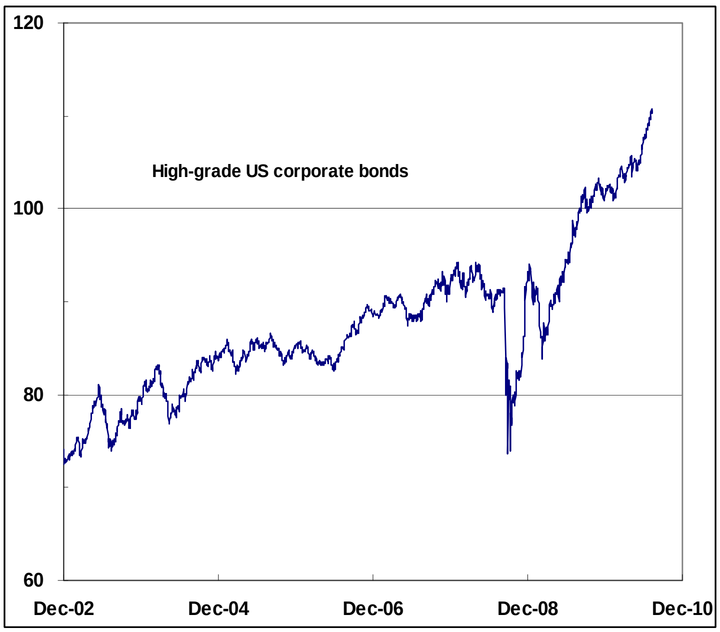
In our *Core Comments* from last October, we wrote about the tax law changes that permit anyone, regardless of income, to convert a traditional IRA (or other qualified plan) to a Roth IRA in 2010. We have studied this matter further and we are prepared to help individual clients analyze whether conversion to a Roth makes sense. We include with this letter ours from last October, which gave a summary description of some aspects of this matter.

Without attempting to describe Roth conversions fully in this letter, I would make two points: First, if one converts a traditional IRA to a Roth this year, one incurs an obligation to pay ordinary income tax on the value of the Roth, less any non-taxable contributions made. The tax is payable, at 2010 rates, in two equal installments in 2011 and 2012. This can be a significant tax liability. Second, the benefit of Roth IRAs and the potential benefit from conversion to a Roth is that all distributions from the Roth in the future, including all investment income earned after the conversion date, are not subject to tax. This feature is what may make a conversion advantageous, despite the obligation to pay a big tax bill presently. This is likely to be especially advantageous to those who expect to be able to pass on to heirs some or all of the value of the Roth upon death.

The trade off in this has to do with the obligation to pay taxes in the next two years that otherwise might not be payable for years to come, against the opportunity to earn investment income on a Roth that will never be taxed. Even assuming that one earns a low investment return in coming years in one's Roth, as time passes, the compounding effect of the never-to-be taxed investment income may well be far greater than the present tax liability. For this reason, a Roth conversion now makes sense if one expects not to draw much from one's IRA for a number of years. It can be an especially attractive estate-planning scheme, if one can expect pass on to heirs the value of a Roth at one's death.

The analysis of all this is full of variables and can be rather complex. Given the variables, given the uncertainties about the assumptions one must necessarily make, there can be no assurance that a conversion makes sense, even if the analysis suggests a good outcome. However, we can perform an analysis and show you what are the variables and what are expected results, so that you can make an informed decision. The opportunity to convert exists in this calendar year. If you would like to have us help you make a decision about its applicability for you, kindly let us know and we will get to work. Call at 415 332 2000, or email me at JNMayberry@coreasset.com to discuss this.

The chart below shows the total return (interest payments included) for an ETF we use for US corporate bonds. After recovering from the panic selling in 2008 at the worst of the crisis, these bonds have continued to move slowly higher in price and to pay the healthy 5% dividend. We expect this to continue.



Each year Core Asset Management files with the SEC a form ADV with information about our company. If you would like a copy of Part II of Form ADV, please contact us.

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The Economy and the Markets

The flow of economic news in the United States has generally been quite poor since April. The 'green shoots' of the early and middle parts of 2009 sprouted and flowered for a time. Sadly, the crop seems to have gotten scorched by a debt-deleveraging sun before seeds for future harvests could germinate. Stocks fell fairly sharply from April to now, with a four-week respite and a decent rally in July. In itself, the selling in equities in recent months has not been too remarkable; it may turn out to be little more than a 'pause' in the second year of a cyclical bull market.

The contrast with the bond market is striking: as the S&P has fallen by about 11% since the high in April, high-grade US corporate bonds have earned have earned about 3%, including interest. The story the bond market seems to be telling us is an ominous one: the economy is weakening and the risk of deflation lingers. Equally worrisome for those who would like to see the economy recover and for more people to find good jobs--probably everybody--is the response by the Federal Reserve. It chairman Ben Bernanke gave rather gloomy testimony to Congress a couple of weeks ago, but, in the Fed statement released on Tuesday after its regular meeting of the Fed Open Market Committee, the Fed was gloomier still. Bernanke and the Fed's official statements are worded very carefully, so we can probably be sure that the gloomy and gloomier reports were intended and meaningful.

As discussed in our letter several weeks ago, we began to reduce stock and commodity investments in May and we have continued the process. We have invested the cash proceeds of our sales in US and foreign bonds. The prices of bonds have been rising over these recent months, in response to growing fears of renewed economic weakness, the possibility of deflation, and the remarkable strengthening of the balance sheets of corporations. It is widely known that, despite the terrible employment environment and generally weak growth, corporate earnings have been remarkably high. As companies have earned growing profits, a large portion of the earnings has stayed in corporate coffers, improving the financial strength of companies. Returns on bonds held in Core's clients' accounts have been favorable so far this year, up about 7% for our US bonds and by more than 11% for foreign bonds. Returns may improve in a weak economic environment teetering on the brink of deflation.

We have by no means given up on equities; we still hold some and we have plans to buy more. However, in the economic environment that obtains now, the risk to stocks is high. If economies worsen, as now seems likely, and if another wave of market panic strikes, stock prices could tumble. If things unfold this way, including with lower equity prices, stocks will become very attractive once again. We anticipate being active then as buyers of stocks; a slow-growth environment, with very favorable monetary conditions and cheap stock prices is a propitious time to buy stocks. In essence, the environment of recent decades, characterized by fairly consistent growth in the stock market and expansion of credit, is over. Now the private sector--and soon the public sector--is reducing debt. In this period, there will be plenty of very good investment opportunities, but they are likely to be of somewhat shorter duration, and to require us as investors to be more selective, more patient and more opportunistic.