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

October 5, 2009

Roth Conversion and Other Matters

Changes to rules relating to Roth IRAs present an opportunity for many investors in 2010. This letter provides a preliminary discussion of this.

Congress has created a very interesting opportunity for investors, the subject of this letter. In 2010, one can convert traditional IRAs and other qualified retirement plans (like 401Ks, SEP-IRAs, and profit-sharing plans) into Roth IRAs without the limitation on the income of the owner of those plans that has previously existed. This is necessarily a somewhat dry subject, but it is worth consideration: it presents us with a very significant opportunity to increase the after-tax value of our investments in IRAs and other plans.

The background. In a traditional IRA (for convenience, I generally refer to other forms of qualified plans with traditional IRAs in this letter), one makes contributions with pre-tax dollars. The investment earnings within traditional IRAs are not taxed until withdrawal, at which time IRA distributions are taxed as ordinary income. In a Roth IRA, one contributes funds on which one has already paid taxes. So long as funds from a Roth are not withdrawn for 5 years, distributions from the Roth are not taxed. Thus, investment appreciation within a Roth IRA is never taxed, unlike the situation with traditional IRAs, for which taxes on investment gains are merely deferred until withdrawal. Despite their attractions, Roth IRAs have not been widely used, because conversions of traditional IRAs to Roths or contributions to them have been available only to those with modified adjusted gross incomes of $100,000 or less. The key feature of this new legislation is that the income limitation is dropped: anyone can convert a traditional IRA to a Roth, without respect to income.

The complicating factor is that, upon conversion of a traditional IRA to a Roth, one must pay the taxes on the sum converted. However, the legislation provides that for conversions in 2010, one can recognize half the income in 2011 and the other half in 2012. Thus, to determine whether it is advantageous to convert one's traditional IRA to a Roth, one needs to weigh the effect of the taxes to be paid in the next two years against the likely tax savings on the future investment income in the Roth. We are preparing a template to analyze the various factors and apply them to individuals' financial situations. We have looked at a couple of websites with tools to make the calculations. I expect there may be some good ones out there, and we would appreciate hearing of any you may find.

By

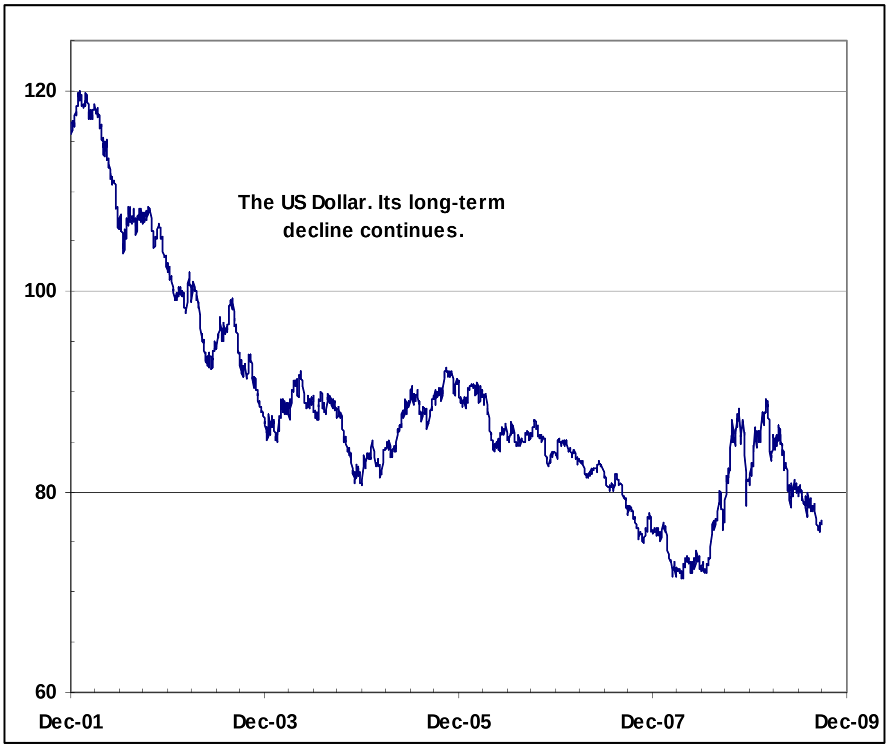
Jack Mayberry

We will write more about this. For now, note that it will probably be very advantageous for many people to make the conversion to Roth IRAs. The opportunity to make the conversion begins in January and continues until the end of 2010. Thus, we have 14 months to consider this before we need to act, but it behooves to begin thinking about this now.

The US dollar has resumed its decline against other foreign currencies. The decline will continue. To our investments in major foreign currencies like the euro, we recently added a position in bonds issued by governments and companies in developing economies of Asia and Latin America.

Schwab and electronic trade confirmations. For some time, Schwab had offered its customers the option to receive statements and trade confirmations electronically by email. In exchange, the commissions charged by Schwab are lower. Many of Core's clients have taken advantage of this; some have not. Schwab will soon be sending notice to those still receiving paper confirms and statements to switch to the electronic one. This seems to us to be a good deal.

The dollar and emerging market bonds. The third quarter that just ended was, as you know, quite favorable for our investments, building on the recovery that began in March. In the last couple of weeks, economic reports have been less favorable than those of the recent months. Given the very extensive rally, markets are somewhat vulnerable. We retain large holdings in US bonds; we might well sell some of those, if we do have a bout of stock market selling, so as to buy more equities. We continue to be fairly bullish about the long-term prospects for equities, particularly those of the emerging economies of Latin America and Asia.



We recently made some changes in our portfolios of foreign currencies and bonds. The dollar's long-term decline was interrupted in the financial crisis last year: The dollar (and US treasury bonds) rallied very sharply from July through March, as virtually every other investment asset in the world plunged in value. Since March, as it has become clear that the world is not coming to an end, the dollar has resumed its decline, as the nearby graph shows, while other investment assets have begun to recover from their losses.

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Having sold our previous foreign currency positions in the spring and summer of 2008, we began to buy currencies again in March of this year as the crisis was subsiding. We purchased euros, the Canadian and Australian dollars, and the British pound. (We invest in these via exchange-traded funds, which are, in effect, money market funds denominated in those currencies.) We recently sold the British pound position and invested in a closed-end fund that holds bonds issued by governments and companies in the developing world. Our expectation is that the growing financial strength and foreign reserves of developing countries will cause their currencies to rise in value against the dollar.

This rationale is related to that of our equity investments in the emerging economies, which we have written about frequently in the last several years, including in the letter from two weeks ago. The developing economies across Asia and Latin America are increasing their share of the world's economic pie. At the same time, their finances are improving markedly. Their stocks, their bonds, and their currencies are increasing in value. With this recent investment, we have continued our process of increasing our investments in these dynamic investment markets. This investment will increase in dollar terms as the US dollar weakens; it pays a large dividend as it collects interest on the underlying bonds in the portfolio.

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