

Roffman Miller Review

A Quarterly Newsletter from Roffman Miller Associates

Stationed overseas during WWII, my father received an interesting letter from home. It was from his mother (my grandmother), and the letter began:

Dear Robert,

Your father is much better since falling off the roof..

Now imagine my father's surprise at those words – he hadn't received a letter in several weeks, had no idea that his father had an accident, and was at this point suddenly unsure whether his father was better *because* of his fall or in spite of it! In much the same way, 2009 has brought us a number of perplexing lead-ins to a story that will continue to unfold in the years ahead. Among them,

The savings rate in the U.S. has increased dramatically

This is a good thing, right? For decades, Americans have been derided for having the lowest savings rate among the developed countries, but now that we seem to be interested in saving again, we are being chastised for being so frugal. Our government would like us to open our wallets and spend again.

The banks are not lending to struggling businesses

Correct me if I'm wrong here, but isn't lending to weak borrowers at the root of the economic crisis we've been experiencing? The government is encouraging banks to make more loans despite the questionable economic recovery.

The Fed has put a curse on cash

Short term bond and money market rates are near zero, forcing many to seek out riskier assets that they feel will provide an acceptable level of return. This could be just the nature of the markets, or it could be a strategic move by the Fed and Treasury to get our savings out of low-return vehicles and instead get them invested in stocks and bonds which will provide the capital that companies need to grow and pull us out of recession.

**Congratulations Roffman Miller
Associates
2009 FIVE STAR Wealth Manager!**

We like to think that excellent customer service is a big part of who we are and just one of the ways we try to distinguish ourselves from other advisors. But don't take our word for it... check out the November issue of Philadelphia Magazine for a special recognition of two of our team members! Look for the 2009 FIVE STAR Wealth Manager award section to find out more.



The third quarter was generous to investors, with a 15.6% total return for the S&P500. For the six month period ending September 30, the S&P is up over 32% - its best two-quarter return in thirty-five years. During this time period, there were plenty of negative economic reports, but as Mark Frombach points out on the following page, it is difficult to determine if and when the economy has begun to turn. The examples above are only three of the sometimes contradictory data that we need to consider in our investment decisions.

As we approach the end of 2009, there will be countless predictions for next year, including severe pullbacks in the market, inflation, deflation, Santa Claus rallies, etc. If you ask me, though, I think the market is doing much better since it fell off the roof.

-Peter Miller

Trends

By Mark Frombach



I read a lot. During the day, I consume data and news articles in large volume. At night, on the weekend, and on my daily train rides to and from the city, I digest a lot of print by other writers who have opinions about the economy, the markets, geopolitics – anything that would affect the investment portfolio which is my livelihood. Often I wonder if, as a person who is required to form and communicate a ‘market opinion’, reading other peoples’ opinions is disruptive or even ‘cheating.’ In the end, I have resolved the conflict by understanding that my own opinion is stuck most of the time in my own head, and the writers and editorialists I read sometimes touch on the same feelings and put my own thoughts into words. As no one has seemed to corner the market on being right all the time, I believe I will continue to absorb as much outside opinion as I can. And, even if I end up on the other side of the opinion spectrum, at least I can see what all the other investors are being told (which is indeed important).

A few years back, I read a piece by the well-known newsletter author Dick Davis about trends. Perhaps it was no more than a simple expansion of an old market adage, “the trend is your friend,” but this article put words to some of the sentiment I had been trying to express through my research:

It is difficult for investors to predict change

Lots of people see change coming, but what is especially difficult is to predict *when* it will occur. Why? Market trends in force seem to have a self-perpetuating momentum, even if they appear to have run longer than fundamentally acceptable. Think back to the late ‘90s, when P/E ratios continued to expand well beyond historical averages and many speculated that the end was imminent. Alan Greenspan, in fact, tossed out the phrase that we all remember, “irrational exuberance.” That was in 1996, yet the market continued to rise dramatically for another three years. I’m sure we all thought \$100/bbl oil was absurd.. and then it rose to \$147. At some point in between, Goldman Sachs predicted \$200/bbl oil, but as we know the trend eventually changed and Goldman was forced to reevaluate the situation and assign a new price target.

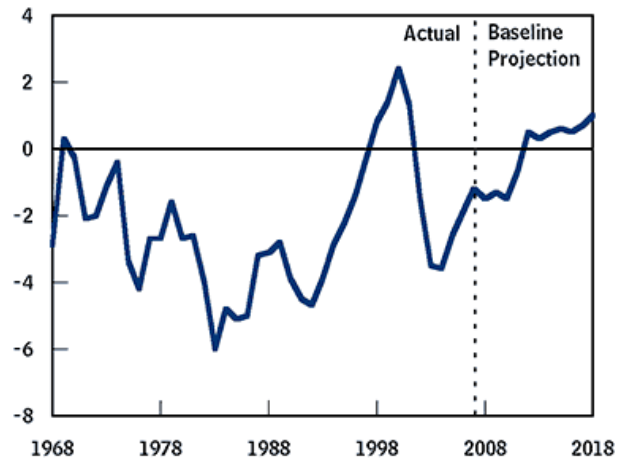
No major trend goes straight up

Whatever the reason, there are always corrections and counter trends, some quite long, along the way.

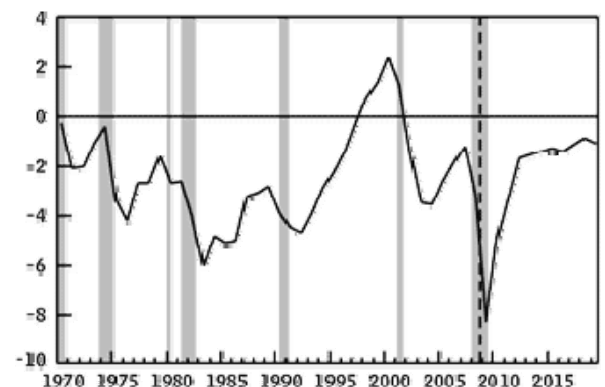
Market downtrends typically don’t last as long as up trends

Here, the ‘durability principle’ is less likely to apply. In my opinion, two factors are in play: first, most people want to see their lives constantly improve. People want more stuff, better stuff, and to do more things. They typically need to work harder, earn more, and spend more to satisfy these needs, and these all drive the economy and markets upward. I refer to this phenomenon as ‘life having an upward bias.’ So, conversely, we really don’t like going backwards – making less, giving up our vacations or grande lattes – and collectively we seem to be willing to dig in and fight hard to turn around a bad situation. This past year, in fact, we saw the U.S. leadership throw the kitchen sink at our economy in an effort to turn it around again.

Today we are in the unenviable position of trying to determine if the economic trend (recession) has indeed been reversed and if we can invest with the confidence that the major crisis is behind us. The rate of growth of unemployment has slowed, a classic sign of a turn. Likewise home prices have seemed to stabilize over the past several months, another sign. But trends, by definition, are not made of short-term data. They are sometimes as difficult to see (e.g. credit bubble) as they are to see changing (e.g. credit bubble bursting). Our challenge at Roffman Miller now, maybe more than at any time during our existence, is to ensure that we incorporate this level of uncertainty in the execution of our portfolio strategy in order to strive for the best return on your investments. For that reason, I encourage you to meet with us soon and discuss the current market risks and how we are addressing them.



These charts depict the actual and projected budget deficits of the United States as a percentage of GDP (above zero = surplus, below zero = deficit). Notice that in the chart above, from 2008, the projected trend is for a surplus in coming years. Fast forward to 2009’s projections, below, and the next ten years does not look as bright. Even the Congressional Budget Office, who produced these charts, has trouble looking forward at trends.



Fixed Income Corner

By Ryan Crooks



There is a common misconception among individual investors that they are somehow losing money when buying bonds priced above par value (\$100), or \$1,000 per bond. Consequently, they avoid buying them because of what seems like fuzzy math. This same aversion creates opportunities for the rest of us. For bonds with similar maturities, premium bonds offer higher current income, lower price volatility and in most cases higher total return or yield-to-maturity (YTM). The example below demonstrates these facts.

	Premium Bond	Par Bond
Maturity	5yrs	5yrs
Coupon	5.5	3.5
YTM	3.50%	3.50%
Price	\$10,910	\$10,000
Current Yield	5.04%	3.505
Annual Income	\$550	\$350
Total Income	\$2,750	\$1,750
less premium	\$910	\$0
Net Income	\$1,840	\$1,750

Despite the higher price paid for the premium bond, investors still receive higher current income from their purchase than they would have by purchasing the par bond. Accordingly, it is the higher current income or return of principle that gives the premium bond lower duration and therefore lower *price volatility* over the life of the bond. Investors also need to realize that the premium paid is not lost but merely returned to them through the higher coupon payments. Finally, keep in mind the example below assumes the bonds are purchased at the same yield which most often is not the case in reality. Because of the investor confusion surrounding premium bonds, they can most often be purchased with additional yield relative to the 'par' bond.

Although there are other nuances to purchasing premium bonds, I think we have demonstrated here the opportunity that is available in premium bonds and why we feel they are an integral part of client portfolios.

Changes to the Dow Jones Industrial Average

On June 8, 2009, GM and Citigroup were replaced by The Travelers Companies and Cisco Systems.

The Dow Jones Industrial Average was created by Charles Dow to gauge the performance of the industrial sector within the American economy. Mr. Dow's original stock index was comprised of 11 companies outlined in 1884. Today, with 30 'component' companies, the Dow's movement continues to be influenced not only by corporate performance, but also by domestic and foreign political events (war, terrorism), global economics (e.g. the 'Great Recession'), as well as outliers such as natural disasters. And if that isn't interesting enough, take a look at some of the related changes to the index components:

- March 1997, Travelers Group replaces Texaco in the DJIA.
- October 1998, DJIA component Travelers Group changes its name to Citigroup (Citigroup later spun off Travelers)
- 1999 SBC replaces Chevron
- 2001 Chevron merges with Texaco
- 2004 AT&T removed from index
- 2005 SBC buys AT&T and changes its name to AT&T
- 2008 Chevron joins the DJIA (again, bringing Texaco back with it)
- 2009 Travelers replaces Citigroup

Natural Resources and Energy – a 'Hot Topic' Throughout History

- **4.5 billion years ago** – Sun formed
 - **65 to 230 million years ago** Dinosaurs rule – fossil fuels formed
 - **500,000 B.C.** – Peking man starts using fire
 - **5,500 B.C.** – Copper first smelted
 - **3,500 B.C.** Invention of the sail – Egypt
 - **1,000 B.C.** Coal first used – China
 - **65 B.C.** First Windmills - Greece
 - **100 A.D.** Petroleum first used as fuel - Rome
 - **1013** Natural gas wells drilled in China
 - **1180** First coal mine - England
 - **1747** Franklin experiments with electricity
 - **1769** Steam engine invented
 - **1809** Gas streetlights installed in London
 - **1816** internal combustion engine invented
 - **1845** Whale oil prices reach \$1.30/gallon
 - **1878** First hydroelectric dam – Niagara Falls
 - **1905** First auto service station – St Louis
 - **1913** First geothermal plant – Italy
 - **1960** First nuclear power plant – Massachusetts
 - **1973** Arab oil embargo
 - **1980** First solar cell power plant – Utah
 - **2007** China begins importing coal to fuel growth
 - **2008** Gasoline briefly at \$4.00/gallon then falls to \$1.50
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Good to know:

- The IRS will now allow parents to adjust their 529 investments *twice* in 2009, instead of the usual onetime switch. This means parents who may have reacted to the markets earlier in the year will have a second chance to keep their plan on track.
- Look for past issues of our newsletter online at www.roffmanmiller.com
- We hope we are meeting all of your expectations and that you are satisfied with our service. If you are, pass along our names to others who you feel can also benefit from our services (e.g. friends, family, co-workers). They might like to join us for one of our *Lunch & Learn* sessions where they can hear about our investment strategy and determine if it's right for them. Call or email us for more details.

2010 Roth IRA Conversions

By Susan Arnold

The income limits for Roth IRA Conversions go away starting in 2010. This may be good news for some people who are thinking of converting their tax-deferred traditional IRAs to tax-free Roth IRAs, but take your time and look closely at the changes and the impact that a conversion has from a tax standpoint. Remember, the IRS allowed this change which actually *accelerates* the collection of income taxes that might have otherwise been deferred for years.

Whether you file as an individual or married filing joint, there is no modified adjusted gross income (MAGI) limit.

Through 2009, if your individual MAGI is over \$120,000 you cannot convert to a Roth IRA. For joint filers, the cutoff is \$176,000. Effective January 1, 2010, the federal government is permanently dropping the income limit that prevented many from converting.

When you convert to a Roth IRA in 2010, you will have the option of spreading out the tax due.

If you convert in 2010, the IRS has granted a onetime option of claiming 50% of the conversion amount as income in 2011 and the remaining 50% in 2012. This is a potential benefit **only** if your tax rate doesn't rise significantly in 2011 and 2012; we can be almost certain that there will be higher tax rates in those future years for top earners.

How you determine the portion of your conversion that should be tax free isn't how the IRS determines it.

There are rules to determining the percentage of any conversion that may be tax free. The IRS's pro-rata rule says you must first take the balance of your Traditional IRA (or, if you have more than one Traditional IRA, the **combined** balances) and then divide any nondeductible contributions by that balance. That gives you the percentage of any conversion that is tax free. In short, you cannot cherry-pick the assets you convert.

If you fit this profile, it might make sense to convert to a Roth IRA:

- You think you will be in the same or in a higher tax bracket in retirement
- You have a long time horizon
- You don't ever foresee needing this money and you want to leave the IRA to heirs
- You have enough money outside the IRA to pay the taxes upon conversion

The bottom line is that just because you are now eligible to convert to a Roth doesn't mean you should. In the right circumstance though, converting to a Roth IRA can have significant potential benefits. Each situation needs to be evaluated on a case-by-case basis; if you are interested in pursuing this further, we will take a close look at your situation and, if it makes sense, help you convert your IRA. Remember, as your financial advisor, we are your partner in your financial decisions. We look forward to discussing your individual case and helping you make the most informed decision.



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