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Money Matter\$



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A new change for the 2007 tax year—is it a benefit to you?

By Harry Maurer

Wonderful News: A new tax law allows *anyone* to convert assets from a traditional IRA to a Roth IRA beginning in 2010, *regardless of income*. This means:

- Your investments can grow tax-free forever, and distributions will be tax-free.
- You will not have to take minimum distributions from your IRA after 70 ½.
- Your heirs won't have to pay tax on the Roth they inherit from you.

Whoopee! The IRS loves you. Or do they?

Words can be seductive. If you do this, then what's it going to cost you?

A conversion will trigger a taxable event. Since the contributions you made to your traditional IRA were not taxed, the amount you convert will be. Where will you get the cash to pay the tax?

Ugh! The IRS simply wants to increase its tax revenues. Maybe you shouldn't convert.

So what would my trusted investment advisor recommend I do, given the pros and cons? The answer: It depends!

Let's look at a couple of extreme situations:

Situation 1 (Do it!) - Suppose in 2009 you sold your primary residence, after having lived in it for at least two years; and suppose that you use the tax-free capital gains for your 2009-10 living expenses while you start your own business, which will not create any taxable income in 2010. Then it would most likely make sense to convert all or part of your traditional IRA into a Roth.

Why? Because you will owe taxes only on the converted amount, as that will be your only significant taxable income in 2010. And, you get to keep all the profits in the Roth IRA tax-free.

Situation 2 (Don't do it!) - Suppose you have \$340,000 in adjusted gross income for 2010. That would put you in the highest federal tax bracket of 35%. To do a conversion, you'd need

to pay the IRS 35% of the amount you convert (in addition to any state tax). Even though your Roth distributions will ultimately be tax-free, it's unlikely that, when you begin taking distributions, you would be in a higher tax bracket than you are this year. In this case it **WOULD NOT** make sense to do the conversion.

As you can see, **each situation is different.** You need to sit down with a trusted tax advisor and answer some questions for yourself.

- Is my current tax rate low enough to justify a conversion?
- What tax rate do I anticipate when I expect to take distributions?
- When I begin taking distributions, will I be living in a high tax state like Oregon or a no income tax state like Washington?
- Can I afford to pay the conversion taxes with money held outside of my IRA?
- Instead of converting, would I be better off investing my excess cash in a non-qualified account?
- Can I go without the money I convert for at least five years?
- Do I want to pay taxes now, so that my heirs won't need to pay taxes later?
- Have I thought about the consequences of my decisions?

Whichever way you go, remember this:

- If you fail to convert by December 31st, you've missed out on your opportunity to convert in the current year.
- If you do convert by December 31st and later wish you had not, you have until October 15th of the following year to undo your conversion without paying any tax or penalty.

Conclusion: Lots of people have lots of opinions. **Only those opinions that take into account your personal circumstances and objectives can have any value.**

Check out our **updated website** at www.sommersfinancial.com

3 Year Average Annual Returns

- Dow Jones Industrial 30 Average : 8.6 %
- Standard & Poor's 500 Index: 11.4 %
- NASDAQ Composite Index: 8.8 %
- Russell 2000 Small Company Index: 16.3 %
- Sommers Financial Management's "MODEL 25" PORTFOLIO (see next page for an update): 20.9 %

Sommers Financial Management's "MODEL 25" PORTFOLIO Update

The major market indices (Dow Jones Industrials and S&P 500) are at five year highs, and the model portfolio has struggled for the past six months, primarily due to our concentration in homebuilders, energy, and basic materials companies. But looking back over the past 6 months, the market is at the same point it was in May—and after dropping at the beginning of summer—has just recently returned to the highs of the year. **Fortunately, client accounts have fared much better than the model over the past six months**, as we avoid concentration in any one sector as part of our diversification strategy.

The formula used in creating the model is currently being tweaked, tested, and will have slight modifications before the January newsletter. With these small changes we aim to reverse the trend of the past 6 months and get back to our historical market-beating ways. Expect to see a few more incoming (maybe familiar) and outgoing names than usual in next quarter's update. Up, up, and away!

OUTGOING stocks from the portfolio during the third quarter of 2006 include:

- **Q Logic**—We enjoyed a 12% rise since purchasing this one back in October of '05.
- **Dow Chemical**—Down 9% since entering the portfolio—benefiting from lower oil prices, but not enough.
- **Taiwan Semiconductor**—Up 21% since purchasing this one back in the third quarter of 2004, and still hanging close at #27.
- **First Marblehead**—Wow! A 180% return in one year with this holding. At \$70/share, it is no longer a screaming bargain. "What a run" is right!
- **Hooray**—The roller coaster ride comes to an end, with us exiting smarting from a 29% loss in this stock.
- **K-Swiss**—We locked in an 11% gain with this shoe-maker this time around.

<u>Company Name</u>	<u>Symbol</u>	<u>SFM Rank</u>	<u>% Gain/(Loss) since purchased</u>
Actions Semiconductor	ACTS	5	18.0
Aspreva Pharma	ASPV	8	(5.2)
Biovail	BVF	16	5.9
Citigroup	C	17	1.2
CompuCredit	CCRT	18	(21.3)
China National Offshore	CEO	12	8.6
Calamos Management	CLMS	23	(7.5)
DR Horton	DHI	22	(17.4)
Syneron Medical	ELOS	4	7.5
EnSCO International	ESV	19	4.0
Eagle Materials	EXP	14	(12.8)
Freeport McMoRan	FCX	3	(2.3)
Grey Wolf	GW	10	(3.6)
Interdigital Comm.	IDCC	6	4.6
Ipsco	IPS	20	(6.3)
Moody's	MCO	7	5.4
Nabors Industries	NBR	24	4.8
NetEase.com	NTES	21	(25.1)
NVR, Inc.	NVR	2	35.6
OMI Corp	OMM	11	(10.2)
Southern Copper	PCU	9	65.7
Patterson Energy	PTEN	1	(16.0)
PetroChina	PTR	15	12.8
Sunoco	SUN	25	6.6
Virpharma	VPHM	13	(34.2)

- **Toll Brothers**—Homebuilders have seen a sharp decline in new orders, and this company was not as bubble-proof as Robert Toll proclaimed. We exit with a 25% loss.

INCOMING stocks to the portfolio this quarter include:

- **Biovail**—A specialty pharmaceutical company responsible for manufacturing Wellbutrin.
- **EnSCO International**—a Dallas, Texas based offshore oil and gas driller, with a forward P/E of 6.4.
- **Freeport McMoRan**—A copper producer with mines in Indonesia—projected to grow their earnings 2.5 times the pace of Southern Copper.
- **Interdigital Communications**—This company is involved in the wireless semiconductor industry.
- **Nabors**—A Bermuda based land driller for oil and natural gas, trading at 6.1 times earnings.
- **OMI Corp**—OMI transports oil and gas on tanker ships across the globe.
- **Sunoco**—Sunoco rounds out our new energy holdings in the portfolio, and is a refiner and marketer of petroleum products. It trades at 8 times next year's earnings.

Returns for our Model Portfolio versus the S&P 500 Index

	<u>Model Portfolio</u>	<u>S&P 500</u>
Three Months	-5.0 %	5.2 %
One Year	1.3 %	8.7 %
Three Year Annual Avg.	20.9 %	11.4 %
Annual ROR Since Inception	25.7 %	11.4 %