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THE 'OTHER' GOLDEN RULE:  
 THOSE WITH THE GOLD RULE.



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# Money Matter\$



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## Investing in Real Estate with funds from your Traditional IRA By Adam Sommers

**“FINDING A GREAT SHORT SELL IS EASY—ALL YOU NEED TO DO IS GET HOLD OF A LIST OF A BROKERAGE FIRM’S FAVORITE “BUY” RECOMMENDATIONS.”**

“An investment advisor whose portfolio skyrockets in value during bull markets isn’t necessarily a good bet. Only if the same advisor is able to hold onto those gains during bear markets does he become worthy of your consideration.”

**“THE FIRST RULE OF INVESTING IS NOT TO LOSE PRINCIPAL. THE SECOND RULE IS NOT TO FORGET THE FIRST.”**

“In seeking investments, opportunities rather than security should be the driving force. After all, a boat in the harbor is safe, but in time its bottom will rot.”

—Excerpts from “Money Doesn’t Grow on Trees,” by Breck Speed and Mark Dutton

### Stock Profile – Taiwan Semiconductor (TSM)

Taiwan Semiconductor recently hit #1 on our list of most fundamentally attractive stocks. It is a large company (\$9 billion in sales and over 22,000 employees worldwide) with a dividend yield of 2.8%, and is growing profitably.

The company is based in Taiwan and engages in manufacturing, selling, packaging, testing, and computer-aided designing of various integrated circuits and other semiconductor devices, as well as manufacturing masks. It offers a range of wafer fabrication processes, and the company’s semiconductor products include logic, mixed-signal, memory, CMOS image sensor, and high voltage semiconductors. The company also offers a range of design services and multiproject wafers processing services. TSM serves primarily fabless semiconductor companies and integrated device manufacturers.

Taiwan Semiconductor’s Notable Statistics	
Market Capitalization	\$ 57 Billion
5 Yr. Annual Growth Projection	25 %
SFM’s Price / Earnings Ratio	15.1
SFM’s Calculated ‘Payback Ratio’	13 %
3 year Average Return on Equity	18 %
Net Profit Margin	23 %
Debt / Assets Ratio	0.13
Current Ratio	6.34

With real estate in general being a terrific investment over the last 5 years, many clients have been asking if they can spice up their normally mundane IRA portfolios by purchasing real property in their IRA. Over the past 50 years appreciation on real estate has averaged around 6% annually. However, in addition to appreciation, the ability of investment property to generate income increases the returns on real estate investments, bringing the results closer in line with returns achieved by more traditional IRA investment choices such as stocks, bonds and mutual funds.

IRS Publication 590, Individual Retirement Arrangements, does not label the purchase of real estate as a “Prohibited Transaction”; however, there are some intricacies that must be considered.

The easiest and most common way to invest in real estate within your IRA is to purchase publicly held real estate investment trusts (REITs), mutual funds and exchange-traded funds focused on real estate, or publicly held corporations and limited partnerships that specialize in real estate and/or property management.

#### Am I permitted to invest in commercial or residential property in my community with IRA funds?

You can definitely purchase local real estate to hold in your IRA, but there are a few items you need to consider before purchasing the house next door. All IRA investments must have a custodian or trustee that keeps track of the investments and reports any deposits or withdrawals to the IRS – and most major brokerage firms — TD Ameritrade included — and banks do not allow private real estate holdings in the IRAs that they administer – meaning you must seek out an IRA administrator that permits private real estate transactions. Since real estate holdings in IRAs are less common and may cause additional IRS reporting, management and service fees are often higher than those levied by traditional banks and brokerages when utilizing an IRA trustee/custodian that specializes in real estate.

#### Can I purchase my primary residence with funds from my IRA?

IRS Publication 590 prohibits “selling property to” your IRA, hence it can’t purchase your existing primary residence from you. It also does not allow you to invest in property for personal use (present or future), nor can it be used for the benefit of a family member or business associate. Time shares are also prohibited – the IRA investment must be a true “investment property” – not a second or vacation home.

#### What are the drawbacks of using my IRA to invest in real estate?

In addition to the possibility of higher than normal administration fees, gains you earn on the property are taxed at ordinary income tax rates of up to 35% when you withdraw money from your IRA, while long-term capital gains (assets held for more than 12 months) currently generate federal taxes at a maximum rate of only 15%. Additionally, the often overlooked – but possibly most important – advantage of real estate investing is the concept of leverage, or the use of low-interest, outside financing with a minimum amount of your capital employed. You need to be aware that you probably must purchase the property outright with your IRA dollars, as most banks will not lend money to purchase real estate through an IRA. Another tax-disadvantage to consider is that depreciation and other expenses for the property can not be deducted on your income tax return due to the property being held in a tax-sheltered account. Finally, when you reach age 70½ and must take “Required Minimum Distributions” from your IRA, it may necessitate the sale of the property at an inopportune time or price if other liquid assets are not available in your IRA.

We all like to look for the best returns in our investment portfolios, and real estate has been a big winner in recent years. If you decide to pursue purchasing real estate in your IRA, be sure to seek out guidance from a trusted professional, as your options need to be weighed based on your personal situation.

### 3 Year Average Annual Returns

- Dow Jones Industrial 30 Average : 9.5 %
- Standard & Poor’s 500 Index: 10.6 %
- NASDAQ Composite Index: 9.0 %
- Russell 2000 Small Company Index: 13.6 %
- SFM’s MODEL 25 PORTFOLIO: 22.7 %

(see inside the newsletter for a detailed update of the Model Portfolio)

## Sommers Financial Management's AGGRESSIVE Stock Portfolio

Company Name	Risk Grade	P/E Ratio	Growth Rate	Expected Return
Alum. Corp of China	D	4.8	14%	37%
<b>Actions Semiconductor</b>	A	7.2	19%	37%
American Eagle Outfitters	C	12.0	15%	11%
Aspreva Pharmaceuticals	B	5.3	5%	37%
BJ Services	C	10.9	21%	15%
<b>China National Offshore</b>	B+	11.9	21%	15%
<b>Cherokee</b>	C	11.5	12%	8%
Syneron Medical	C	15.2	16%	9%
Enesco International	D	8.2	30%	18%
Eagle Materials	D	12.6	26%	15%
Freeport McMoRan	D	10.6	37%	12%
<b>First Marblehead</b>	B+	8.2	36%	20%
Grant Prideco	D	11.8	20%	11%
Lam Research	C	11.4	19%	15%
Maxim Integrated	B+	21.7	19%	10%
NetEase	B	15.4	13%	12%
NVR	D	11.2	10%	13%
OptionsExpress	D	14.8	20%	8%
Southern Copper	C	10.1	5%	9%
Patterson Energy	C	10.1	7%	16%
True Religion	C	13.4	24%	11%
<b>Taiwan Semiconductor</b>	A+	15.1	25%	13%
Tessera Technologies	B	23.5	31%	8%
Unit Corp	D	18.7	22%	16%
Virpharma	D	13.6	19%	18%

*The Aggressive Stock Portfolio* is made up of the 25 best prospects for total return over the next 3-5 years. This list includes more small companies, and more companies that do not pay dividends than our other two portfolios.

We have displayed four pieces of data that seem especially appropriate for an aggressive portfolio. As you can see, the risk grades for some of the holdings are below average, due to the aggressive nature of the stocks. However, the average P/E ratio is only 12.4 due to our value-based investment philosophy. You will not see companies trading at 50 times earnings in any of our portfolios, as we purchase businesses for our clients as owners, not traders.

The growth rate of companies in this aggressive portfolio measures an average of 19%, calculated as the consensus average of all analysts who cover the company for the estimated growth in earnings (profit) over the next five years. The "Expected Return" (avg. 15.8%) is SFM's "payback yield", which is the single most important metric we use when analyzing a business to purchase.

## Sommers Financial Management's Conservative INCOME Stock Portfolio

Company Name	Risk Grade	P/E Ratio	Div. Yield	Ret. on Equity
<b>Actions Semiconductor</b>	A	7.2	0%	51.8%
Bank of America	A+	7.3	4.6%	12.9%
BP, Plc	A	10.1	3.4%	22.9%
Anheiser Busch	A	15.8	2.3%	62.0%
Citigroup	A+	7.7	4.2%	17.6%
<b>China National Offshore</b>	B+	11.5	2.9%	29.7%
<b>Cherokee</b>	C	16.8	8.2%	83.6%
Colgate-Palmolive	A	16.7	2.2%	111.4%
Dow Chemical	A-	11.8	3.8%	24.9%
<b>First Marblehead</b>	B+	8.2	1.6%	37.0%
General Electric	A	13.8	2.9%	25.4%
GlaxoSmithkline	A	17.8	3.7%	10.6%
Johnson & Johnson	A+	14.4	2.7%	26.4%
Coca Cola	A+	18.9	2.6%	31.5%
Linear Technology	A	20.1	2.0%	19.8%
Altria	A+	13.4	3.9%	53.6%
National City Corp	B+	8.8	4.7%	16.7%
Pepsi	A+	17.7	2.3%	32.3%
Pfizer	A+	11.2	4.5%	20.3%
Proctor & Gamble	A+	16.0	2.3%	25.2%
<b>Taiwan Semiconductor</b>	A+	15.1	2.8%	17.8%
US Bancorp	A	9.4	4.9%	19.9%
US Tobacco	A+	13.7	4.5%	1803%
Verizon	A	14.3	3.9%	16.1%
Washington Mutual	A	8.0	5.2%	11.7%

*The Conservative Income Stock Portfolio* is made up of the 25 least volatile, highest yielding, reasonably valued companies on our screen.

The holdings in this portfolio received the highest grades for investment risk, as there is traditionally less risk of loss when investing in stocks of large, established, low-priced, dividend paying companies.

The average dividend yield of stocks in this portfolio is 3.4, twice the S&P 500 Index's 1.7%. The average return on equity over the past three years for companies in this portfolio is over 33%, indicating consistent, high-quality earnings for the shareholders—which they pay out in the form of dividends. The average SFM calculated P/E ratio is a mere 13.

This portfolio is consisted of companies that are good long-term holdings in an equity allocation (one piece of the pie) for clients nearing or at the retirement stage of their life.

## Sommers Financial Management's ORIGINAL "Model 25" Stock Portfolio

Company Name	Value Grade	Cash Flow	Risk Grade	Market Cap
Alum. Corp of China	A+	C	D	Mid
<b>Actions Semiconductor</b>	A+	A+	A	Micro
American Eagle Outfitters	A-	A-	C	Mid
Aspreva Pharmaceuticals	A+	A+	B	Micro
Bank of America	A	B-	A+	Mega
<b>China National Offshore</b>	A+	A	B+	Large
<b>Cherokee</b>	A	A+	C	Micro
ConocoPhillips	A	D	B+	Mega
Dow Chemical	B+	D	A-	Large
Freeport McMoRan Copper	A+	A	D	Large
<b>First Marblehead</b>	A+	A+	B+	Small
Johnson & Johnson	C	B	A+	Mega
Linear Technology	C	A	A	Mid
Altria	C	B	A+	Mega
Maxim Integrated	C	A-	B+	Mid
NetEase	B	A+	B	Small
Southern Copper	B-	A+	C	Large
Pfizer	C	B	A+	Mega
Patterson Energy	A-	B+	C	Mid
PetroChina	B+	C	B	Mega
Qualcomm	C	A	A-	Large
<b>Taiwan Semiconductor</b>	A	A-	A+	Large
Texas Instruments	B	B+	A	Large
US Bancorp	B+	B	A	Large
US Tobacco	B-	A	A+	Mid

### Outgoing:

- Analog Devices
- BP
- Citigroup
- Chevron
- Graco
- Home Depot
- 3M

### Incoming:

- American Eagle
- Dow Chemical
- Freeport McMoRan
- Altria
- Patterson Energy
- Qualcomm
- Texas Instruments

## Commentary and Ramblings

By Adam Sommers

As most of you know by now, TD Ameritrade is the new incarnation of the old Ameritrade merged with the former TD Waterhouse. Since last April, our preferred (up until now, at least) custodial brokerage has been experiencing growing pains as Ameritrade tried swallowing a firm equal in size in one gulp. The resulting customer service level, technology integration problems, and inundation of our clients with mail have been unacceptable—and getting worse—in recent months. The custodial broker we recommend to our clients is a partnership crucial to our business, so I wanted to let you know that we are *considering* suggesting our clients move the assets we manage from TD Ameritrade to Fidelity.

I have received feedback from clients in regard to TD Ameritrade's over-exuberant mailings, the delays with the money market checking changeover, statement misinformation, and the new commission structure (if you don't have \$500,000 and want to receive statements in the mail, it costs you more per transaction as of 5/15/07). I would like to ask each of our clients for feedback with respect to a change of custodial brokers. There are pros and cons to weigh in any decision of this magnitude, and I'd like to hear both the positives and negatives you see in Sommers Financial continuing to utilize the services of TD Ameritrade.

I also would like to suggest that anyone with questions should feel free to call me and I'll try to convey the reasoning behind our displeasure with TD Ameritrade (e.g. one hour hold times), and how we have narrowed our alternatives down to Fidelity.

The biggest drawback for our clients if we move to Fidelity would be that the transaction costs are slightly higher than TD, most notably for option contract trades. We know that cost is an important factor when evaluating financial services—as it should be—and want to convey to you that a move of this kind won't be recommended lightly.

Please send us your comments/complaints/suggestions—as our focus is on you, the client.

### Returns of SFM Portfolios versus the S&P 500 Index

	S&P 500 Index	SFM Model	SFM Aggressive	SFM Conservative
Three Month Return	5.8 %	8.9 %	9.1 %	6.2 %
Twelve Month Return	18.4 %	14.3 %	NA	NA
Three Year Average Annual	10.6 %	22.7 %	NA	NA
Four Year Average Annual	13.6 %	26.5 %	NA	NA
Annual ROR Since Inception	12.7 %	30.2 %	NA	NA