

BEYOND THE HORIZON

4th Quarter, 2009 Issue

MARKET OUTLOOK

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Since our last “Market Outlook” report three months ago, the equity markets have continued to recover, gaining nearly 32% and 54%, respectively, for the Dow and S&P 500 indices since their lows on March 9, 2009. As we have pointed out in the past, it is not uncommon to see rebounds of this magnitude off a bear market low.

There are several reasons for the rebound. Typically, the deeper the recession, the stronger the recovery and vice-versa, and this recession has been one of the worst. But for the past several months, economic indicators have been improving. Banks are healthier, the housing market has improved somewhat, and we have realized GDP growth for the third quarter, albeit slow growth. This is most likely a result of government spending and inventory restocking. Historically, stock markets respond well to government spending. With only 19% (latest report) of the stimulus spent thus far, the markets should continue to rebound as more of it is spent. Corporate earnings reports for the second quarter have been positive, primarily due to cost-cutting measures, and corporate balance sheets are stronger than they have been during the past four recessions. The consumer is spending once again. Back-to-school sales were stronger than expected which usually correlate to Holiday sales. The U.S. consumer also responded well to the Cash-For-Clunkers program and First-Time Homebuyers tax credit. While spending, they also managed to reduce their credit by a record amount in July. Oil prices at \$70-\$80 per barrel also bode well for the economy. Temporary unemployment, a leading indicator, is starting to turn around. Remember, unemployment usually peaks six months **after** the end of a recession.

There are, however, a lot of anti-growth forces at work affecting the long-term outlook. Home foreclosures continue. The government program to help homebuyers with foreclosures has only reached approximately 9% of those who are struggling. Nearly one in four houses are below water (whereby the homeowner owes more on the property than what it’s worth). There is no pent-up demand for houses and cars coming out of this recession to help fuel a recovery. There is also a potential problem looming on the horizon in the commercial real estate market. Some worry about inflation, but we should be more worried about fighting off the current threat of deflation. We recently heard an analogy regarding inflation and deflation that paints a very clear picture. (Deflation is a decrease in the price of goods and services, whereas inflation is an increase in them. Deflation erodes the value of our assets whereas inflation erodes our

purchasing power.) Think of deflation as a fire to your home and inflation as the water used to put it out. It would be better to have water damage to our home (i.e. inflation) rather than have our house burn down (deflation). That's why we need the Government stimulus package and/or spending to boost the economy. So for now, we don't see the risk of inflation in the near term picture. One important part of the recovery equation remaining is our need for jobs growth. Lastly, taxes will most likely rise in the future, which won't be good for economy. Last month, during a speech at Trustmont Group's Compliance Conference, Linda Duessel, Equity Market Strategist and Senior Portfolio Manager for Federated Investors, equated our current economic picture to be more like 2002 than 1982. She feels the economy and markets will continue to be "a go until taxes go up or interest rates rise".

The general consensus is that equities have the potential to see gains of an additional 15%-20% over the near term. Valuations of companies in the U.S. and abroad have declined along with the markets. As of 12/31/08, the price-to-earnings (P-E) ratio for nearly every regional index was well below its 5- and 10-year average. Earlier, we recommended that clients reduce their exposure to overseas holdings because we felt the U.S. would fare better than the rest of the world during the downturn. In 2008, U.S. equities performed better than all other regions with the exception of Japan. Moving forward, however, we anticipate that to be different. The U.S. is expected to drop to the middle of the GDP pack with countries like China, India and Brazil taking the lead. Therefore, we are now recommending a heavier weighting overseas and to those companies who will continue to benefit from "the China effect". Additionally, investors who remain heavily invested in cash or short-term bonds should consider taking action. Those seeking the safe haven of Treasuries should be leery. We don't anticipate any further appreciation in Treasuries and many short-term bond funds. Mortgage rates will likely increase next year since the Government, who has been the primary buyer of these loans, will slow their pace. We do, however, continue to see opportunities for some corporate and emerging market bonds. Many corporates still offer attractive yields. Emerging market debt is attractive because these countries are stronger and have implemented strong fiscal monetary policies.

Sources: "What about the China effect?" and "U.S. consumer credit down" posted on MarketWatch.com 10/1/09 and 9/8/09, respectively; 2008 Review/2009 Outlook published by American Funds; Investment News published 9/7/09; Linda Duessel, Federated Investors; BusinessWeek 8/17/09.

Disclaimer: The opinions expressed herein do not necessarily reflect those of Trustmont Financial Group/Trustmont Advisory Group.

THANK YOU FOR YOUR FEEDBACK

In our last newsletter, we included a survey for our clients to complete and return to us. We thank the many of you who responded. As always, your feedback and opinions are important to us. The survey was another way to determine if we are communicating effectively with our clients. We felt it was a successful project with a favorable outcome.

CHANGES COMING FOR ROTH IRA CONVERSIONS

Beginning in 2010, the income restriction that prevents many taxpayers from converting existing funds that are tax-deferred into the tax-free Roth IRA will be removed. (Currently, taxpayers with modified adjusted gross income greater than \$100,000 cannot do a conversion.) The new rule also allows the income that results from the conversion to be reported entirely in 2010 or in equal installments over a two-year period (in 2011 and 2012). The income limitations for making new contributions to a Roth, however, will remain the same. Currently, that limit is \$105,000 of income for singles and \$166,000 for marrieds. These individuals can, however, make a contribution to a non-deductible Traditional IRA then later convert it to a Roth.

The major factor affecting the decision of whether or not to convert tax-deferred accounts to a tax-free Roth is the marginal tax bracket in the year of conversion versus the expected marginal tax bracket in the withdrawal years later, which will likely be in retirement years. If your tax bracket now when you would convert is the same or lower than it will be in retirement, you may want to consider a conversion. However, if your tax bracket in retirement is expected to be lower, then you would not want to convert.

There are other factors to consider as well. Roth IRAs do not require minimum distributions to begin at age 70-1/2 as do tax-deferred retirement accounts such as IRAs and 401(k)s. Owning Roth IRAs also gives you tax diversification. Most taxpayers have substantially more funds in tax-deferred accounts that will eventually be taxed. By converting some of these to a Roth, the taxpayer reduces the imbalance and risk that Congress might raise tax brackets in the future. Beneficiary considerations are another. Conversion may be favored where the tax bracket for the beneficiaries is higher. Lastly, consider conversions prior to collecting Social Security benefits. A Roth conversion increases taxable income in the conversion year. This may increase the taxable portion of Social Security benefits.

If you have questions or would like to learn more about Roth IRAs or conversions to Roths, please consult your tax advisor or call our office.

Sources: Financial Planning Association's Virtual Learning Center, "Roth Conversions in 2010 and Beyond".

WHAT SHOULD YOU DO WITH YOUR RETIREMENT PLAN WHEN YOU LEAVE AN EMPLOYER?

Regardless of the circumstances for leaving an employer, you often have the choice of whether or not to leave your retirement plan (i.e. 401(k), 403(b) or pension) in the employer's plan or roll it over into an IRA. The latter is referred to as a Direct Rollover. Here are the advantages of executing a Direct Rollover into an IRA:

- The monies in the IRA will continue to grow tax-deferred until withdrawn.
- You expand your investment choices beyond the employer's plan option(s).
- You control your money instead of being restricted by plan rules or restrictions.
- You can consolidate multiple retirement accounts.
- You can make your own contributions to the IRA as long as you continue to receive earned income.

Conversely, there are a few disadvantages to leaving the employer's plan for the IRA. They are:

- The investments in an IRA may incur higher investment expenses.
- An employer-sponsored retirement plan provides spousal protection in that a spouse cannot be removed as the primary beneficiary without his/her consent. Though the same is true with an IRA account, enforcement by the custodian may not be guaranteed. *(For further explanation, please consult your attorney.)*

As always, the best course of action depends on the client's circumstances, the rules of the existing employer retirement plan, and the investment options available in both the employer plan and the Rollover IRA. For further discussion on this issue, please consult your tax advisor or call our office.

INVESTMENT CORNER

When we think of the different types of investment vehicles available today, we often think of CDs, annuities, mutual funds, stocks, bonds, and possibly real estate. But we often overlook certain types of life insurance policies. That is why we will again highlight the "MoneyGuard Reserve" policy, first featured in our 2nd Quarter 2009 issue. The MoneyGuard Reserve, offered by Lincoln Financial Life, is a life insurance policy that can be suitable for certain clients as another investment vehicle for their savings. The policy is flexible because it can:

- Help you pay for long-term care if you need it
- Help protect retirement income from the risk of long-term care expenses
- Provide an income tax-free death benefit to your heirs if you don't need long-term care
- Offer a money-back guarantee

Let's take a look at the following example. A female client, who is age 65 and a non-smoker, invests \$65,000 into the MoneyGuard Reserve. For her investments, she gets the following benefits:

- A tax-free death benefit of up to \$108,000 for her heirs, OR
- Reimbursement for up to \$324,000 of long-term care expenses (for \$4,500 per month for as long as six years), OR a
- Money-back guarantee of \$65,000 (less any withdrawals) should she ever cancel the policy

If you have questions, would like to learn more, or would like to receive an illustration of benefits on the MoneyGuard Reserve, please call our office.

Highlighting this product in no way implies that it is suitable for everyone. Policy benefits are based on age, smoking status and overall health. FOR AN ILLUSTRATION OR MORE INFORMATION ON THIS OR OTHER SIMILAR PRODUCTS, PLEASE CALL OUR OFFICE.

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