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## K & S Winter 2010 Financial Fitness Newsletter "Step By Step"

**Financial Market Commentary-** Wharton Business School Professor Jeremy Siegel believes that the longest and deepest economic contraction since the Great Depression ended last summer. He believes the following:

- the economic recovery will extend into 2011 and will be stronger than most forecasters expect,
- consumer spending will be subdued for the first part of the year
- investment will increase as firms find themselves with record-high cash balances
- the extreme inventory liquidation that occurred in 2009 will reverse itself by the middle of 2010 as firms rebuild inventories and retail sales pick up,
- the housing market should also show some life as the inventory of unsold houses finally dwindles to a manageable size
- the Federal Reserve will be forced to raise interest rates much sooner than most forecasters now expect
- stocks should fare better than bonds if interest rates rise
- stocks should perform well in 2010 rising 10 to 12% by year end
- the dollar will be stronger than most believe, especially against the euro,
- as the Fed raises interest rates, dollar denominated assets will become more attractive
- the emerging economies will be strong and their currencies will rise relative to the dollar and stocks in these countries should also register double digit gains in 2010.

In summary, Professor Siegel feels improving economic trends should continue throughout 2010. He theorizes that this will cause the Federal Reserve to raise interest rates, which will at first unsettle U.S. stocks and bonds. However, strong economic growth should lead to a good year for the equity markets in 2010.

**Risk Management Strategy-** There are different ways to manage investment portfolio risk. **Asset allocation** is a process in which a portion of an individual's capital is invested in stocks and a portion is invested in bonds. In this manner, risk is managed by adjusting the mixture of stocks and bonds. Since stocks have historically had higher risk and return than bonds, those who are more focused on growth may wish to invest a larger percentage of their assets in stocks. Conversely, more conservative income oriented investors may wish to invest their assets in bonds or less volatile higher dividend paying stocks. **Diversification** is the concept of spreading assets across different securities and asset classes in an attempt to reduce risk by not concentrating investments in a few securities or **asset classes**.

Examples of securities would be an individual XYZ Electric Company bond or an ABC Beverage Company stock. Examples of asset classes would be U.S. Small Company stocks, corporate bonds or International Large Company stocks. An important element of the risk management discussion is understanding sub-category risk. Typically with fixed income securities, the higher the **safety rating** and the shorter the **maturity**, the lower the risk and return. With stocks, normally larger companies that pay steady, above average dividends tend to be much less volatile than smaller companies that have lower **dividend yields**. For additional costs beyond investment management fees, insurance companies offer various forms of portfolio coverage. Another way to protect against a loss in portfolio value is to employ **options contracts** to hedge against investment risk. We advise investors to manage risk through the following **process**:

1. Be aware of the risk/reward characteristics of differing allocations of stocks and bonds.



2. Choose an asset allocation mix that meets your investment goals, objectives and comfort level.
3. Monitor your asset mix.
4. Periodically re-balance your mix of assets when they are driven out of alignment by forces of the financial markets.

Asset allocation seeks to maximize the performance of your investment portfolio using diversification and disciplined investing. However, using an asset allocation methodology does not guarantee greater, or more consistent returns, or against loss; rather it is a method used to manage risk. Your investment objectives, time horizon and risk tolerance will drive your asset allocation and help you determine the right balance for you.

**Timing the Stock Market**- If you ever contemplate whether to move your assets in and out of the stock market, our advice is to avoid this activity because the odds of achieving success may be stacked against you. Studies have shown that the majority of stock market returns during a calendar year occur in around three and a half weeks. Good luck trying to determine when those days are going to happen. According to FactSet and Standard & Poor's, if you invested \$10,000 in the S&P 500 during the period from March 31, 1984 to March 31, 2009, if you stayed invested your investment grew to \$50,126. If you missed the 10 best days your investment grew to \$24,188 or your average annual return declined from 6.66% to 3.60%. If you missed the 30 best days your average annual return declined further to -.07%. Even further compelling in the case against attempting to try to time the stock market is the fact that six of the 10 best days occurred within 10 days of the worst. In many instances we subscribe to the philosophy that is summed up in the following quote: "**Patience is also a form of action.**" Auguste Rodin

**IRA Roth Conversion**- Normally investors who have adjusted gross income of more than \$100,000 are excluded from converting assets from a traditional IRA to a Roth IRA. Beginning on January 1, 2010 Roth conversions will be open to all. Here are some key points to keep in mind when considering a conversion:

**1. A major benefit of investing in a Roth IRA is that balances are tax free for accumulation and distributions for both account owners and beneficiaries.**

2. If you convert in 2010, you can pay the tax in 2010 or you can elect to spread the tax liability over the next two years, 2011 and 2012.

3. If you convert, your assets must remain in the account for 5 years and until you reach age 59 1/2 before you can access the funds without the 10% pre-mature withdrawal penalty.

4. Conversions can be more effective if taxes are paid with after-tax assets, since this will allow the full account balance to grow until it is withdrawn.

**5. Conversions make the most sense for individuals who are currently in a lower tax bracket who will be in a higher tax bracket when they plan to receive distributions.**

6. Any non-taxed assets converted are not subject to ordinary income taxes.

7. You have to add up all of your balances from all of your IRA's to determine what percentage of your assets are pre and after-tax. The tax on your conversion is calculated by aggregating all of your IRAs.

8. You have until October 15 of the year following the conversion to report it. In summary, analyzing whether a conversion is beneficial to you involves many factors and assumptions including pre- and post retirement tax brackets and rates of return, withdrawal rates, life expectancy, and estate tax rates. We welcome the opportunity to work with and your tax professional to carefully consider the factors and aid you in this important decision.

**Heart Smart**- Learning how to prevent heart disease may help you save your life. Cardiovascular disease is the leading cause of death among adult men and women in the United States. Current research shows that Americans on average are overweight, physically inactive, and eating a diet that is too high in calories,



sodium, fat, and sugar. According to the American Heart Association (AHA), Cardiovascular disease and strokes are expected to cost the United States more than \$500 billion this year, an increase of nearly six percent over 2009. Risk-factor management and maintaining health through prevention is infinitely cheaper than management and treating illness. To improve cardiovascular health Americans must start making healthier lifestyle choices. When you have a clearer picture of your personal risk profile, you can take a more active role in making heart-healthy changes. The following is an explanation of risk factors:

A. Blood pressure- Levels that are consistently above 120/80 increases the heart's workload, which in turn causes the heart to thicken and stiffen prematurely. This can increase your risk of heart attack, stroke and kidney failure.

B. Cholesterol- As blood cholesterol rises, so does risk of heart disease. It is recommended that total cholesterol be less than 200. LDL or "bad" cholesterol, should be less than 160, 130 and 100 if you have low, intermediate or high risk for heart disease respectively. HDL or "good" cholesterol yields some protection against heart disease. For women, the goal is an HDL level of 40 or higher; for men, 50 or higher. Triglyceride is a specific fat found in the blood. The desired level for both sexes is a number less than 150.

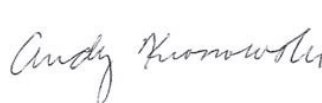
C. Age-The risk of heart disease increases as you get older. This is especially true for women who have a precipitous spike in heart disease after menopause.

D. Gender- Men are more at risk of heart disease than women but women are more at risk of dying from a heart attack. This can be explained by the fact that women have smaller arteries. And the fact that women tend to seek help later than men by two hours on average when significant damage has already done.

Motivation- Jimmy Valvano was a well known basketball coach at North Carolina State University. In 1983, on a last second shot, his team upset the heavily favored Houston Cougars in the Men's NCAA tournament championship game. The victory would come to signify the pinnacle of his colorful and entertaining coaching career. In the early 1990's while battling terminal cancer, he decided that during the last few months of his life that he would create opportunity out of the adversity. He founded the **Jimmy "V" cancer research foundation**. This endeavor would prove to have a far greater impact on the world than his coaching achievements ever did. What is unique about the foundation is that contributions fund grants that are awarded directly to research scientists. In this way donors are assured that most of their donations are applied toward the charitable cause while minimizing administrative costs.

We hope that those of you who experienced the February blizzards are warm and safe. We continue to advise investors to be balanced, globally diversified and income focused. We believe that the road in front of us over the next few years is going to be tedious and bumpy. We are cautiously optimistic that the stock market is going to struggle through a series of higher highs and higher lows as the stock market inches back toward the 12,000 level on the Dow Jones Industrial Average over the next few years.

Sincerely,



Andrew Krosnowski



& Melissa Scott