



# Financial Matters

We help clients to maximize their financial well-being through education, communication and service that exceeds expectations.

Spring 2010

## Special points of interest:

- Join us on May 21st for an open house at our new location.
- 2010 Retirement Plan limits are unchanged from 2009.
- Estate and generation-skipping transfer taxes are

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## Is a Roth IRA Conversion Right for You?

Thinking about converting to a Roth Individual Retirement Account (IRA)?

For 2010, the Roth IRA rules have become more lenient and many IRA owners can convert their traditional IRAs to Roth IRAs. Prior to doing this, one important question to ask yourself is, how long can you keep your money in a Roth IRA?

Here are some other factors and strategies that will help you now and in the future.

**Non-deductible contributions** – Income limits prevent many people from making tax-deductible contributions to a traditional retirement account. However, if you act before April 15, 2010, you can contribute to a non-deductible traditional IRA, in anticipation of converting that traditional IRA later in 2010. In 2009, the maximum permitted contribution to a non-deductible IRA was \$5,000, or \$6,000 if you were 50 or older at year-end.

By starting now and making another contribution soon in 2010, you can effectively convert two years worth of contributions to a Roth IRA in 2010. Be careful: You will still have to pay taxes unless that is the only IRA you have. That is because of a little known rule called the “Pro-Rata Rule.”



The IRS says when calculating the taxable and non-taxable amounts of a conversion, all of your traditional IRAs, including SEP and Simple IRAs, must be included. Here’s the bottom line: You cannot just withdraw or convert the non-deductible fund and pay no income tax, even if the non-deductible IRA contributions were kept in a separate IRA. Any year you make non-deductible contributions, you must file Form 8606 (Continued on page 3)

## The Psychology of Investing

Studies show that 15 percent of the time when we feel that we are absolutely, positively right about something, we’re actually wrong. That’s overconfidence, one of many behavioral flaws that can be financially dangerous for investors.

The emerging field of behavioral finance studies our irrational investment decisions. Ultimately it may give us insight

into “irrational” market swings.

One example of financial decision-making swayed by emotion is the “disposition effect”: When investors sell stocks from their portfolio, they tend to sell winners and hang on to losers.

“It’s very natural why people do that,” says Daniel (Continued on page 2)

## The Psychology of Investing (cont'd.)

Kahneman, who received the Nobel Laureate in Economics for his pioneering work in behavioral finance. “If you sell a stock that is currently worth more than you paid for it, then you pat yourself on the shoulder for a successful investment. When you cut your losses on the stock, in contrast, you have to accept punishment right now for having made a choice that didn't turn out well. It is not surprising that people prefer rewarding themselves than punishing themselves.”

According to Kahneman, one of investors' biggest mistakes is "narrow framing," or looking at investment problems in isolation from the whole portfolio. "People should be educated to ask for advice about the big picture and always consider a particular decision in the context of their overall situation and objectives," says Kahneman.

John Nofsinger, author of “Investment Madness: How Psychology Affects Your

Investing and What to Do About It” and “Investment Blunders of the Rich and Famous,” says investors' missteps fall into two categories.

Overconfidence. Nofsinger agrees with Kahneman that many people exaggerate their ability to pick winners and their control over the market. They hang onto losing stocks or funds because they can't admit mistakes. “The overconfidence bias causes you to trade too much and take too much risk,” says Nofsinger. “As a consequence, you pay too much in commissions and taxes, and you're susceptible to big losses.”



Terrance Odean, associate professor at the University of California, found that men are particularly prone to overconfidence, which hurts their returns. Men trade 45 percent more often than women but earn returns that are 1.4 percent less. Among single people, men trade 67 percent more often but earn returns that are 2.3 percent less than women.

Emotion. Fear and greed, rather than rational facts, rule many investment decisions. Worse, says Nofsinger, is an

## What Do You Know About Citrus X Paradisi? Quiz

Citrus X Paradisi was called the forbidden fruit when it was discovered in the mid-1700s in Barbados and Jamaica. Today, we know it as the grapefruit!

1. Grapefruit are believed to be an accidental hybrid of which two fruits?

- A. Limes and oranges
- B. Lemons and oranges
- C. Pummelos and grapes
- D. Pummelos and oranges

2. Grapefruit peel is:

- A. An important source of pectin
- B. Squeezed and the oil is used for soft drink flavoring
- C. A source of flavoring for tonic water and bitter chocolate
- D. Combined with dried pulp and used

as cattle feed

E. All of the above

3. Why was this fruit nicknamed grapefruit?

- A. It is the color of wild grapes
- B. It is the shape of a large grape
- C. It is a hybrid of a grape and a pummelo
- D. It grows in bunches

4. A grapefruit is what percentage juice?

- A. 25%
- B. 50%

(Continued on Page 4)

## Is a Roth IRA Conversion Right for You? (cont'd.)

which details the non-taxable portion of your IRA.

**Recharacterization** – A recharacterization will undo a Roth conversion. It has been called the "do over option," which can be exercised any time before the due date of your income tax return for the year of the conversion, including extensions.

Recharacterizations for 2010 can be made through October 15, 2011. One of the most common reasons to reverse a conversion is that the portfolio's value has declined after the conversion to a Roth IRA.

First, establish a new Roth IRA to hold each year's conversion amount separate from any of your existing Roth IRAs. This will make it easier to identify the funds being recharacterized. If the funds are commingled, the recharacterization process can become more complicated.

Next, consider establishing multiple Roth IRA accounts if you are converting a large amount of money. If you have multiple asset classes in one Roth IRA, the tax effect of losses and gains are proportional to the account. But, if you maintain multiple Roth IRAs, each with a single asset class (examples: US Large Cap, Domestic Small Caps, Foreign Stocks, Emerging Market Stocks, Commodities, etc.) you can pick and choose recharacterizations to take advantage of the tax break.

For example, let's assume you have \$500,000 in your retirement account. You decide to convert \$100,000 and set up four accounts, \$25,000 in each account. You can keep the best performers as Roth IRAs and recharacterize the laggards back to traditional IRAs.

However, there is another strategy to consider in this situation. "Instead, convert \$500,000 to five separate accounts of

Still, the multiple Roth IRAs don't have to remain segregated forever. Once the converted Roth IRAs are beyond the recharacterization deadline, they can be merged into one account.

**Tax Bracket Strategy** – What tax bracket were you in for 2009 and where will you be in the year of the conversion?

In choosing the "optimum" amount to convert to a Roth IRA, you would most likely convert an amount that would be taxed at a rate equal to or less than your projected future tax rate. For example, if you are in the lowest tax bracket, your strategy may require a series of partial conversions each year to remain in the 15% federal tax bracket.

Be aware: various deductions and credits, such as medical expenses and the child tax credit, may be impacted. Parents of students may find that increasing adjusted gross income will reduce their eligibility for college financial aid and scholarships.

Another important tax consideration is that you must make sure you have funds available in a non-retirement account to pay the taxes that will be due on conversion.

It is important to work with your tax adviser to evaluate all the results of a Roth IRA conversion and see if they will differ if the conversion is shifted from one year to another.

If you are eligible, the advantage of converting for the tax year of 2009 is that tax rates are known. The big uncertainty is what will tax rates be in the future? That is why many taxpayers will pay the tax in 2010 as opposed to splitting the income tax on the conversion between 2011 and 2012 tax years.

For those who are not eligible to convert for 2009, you should convert early in 2010.

*"The most important thing in life is to stop saying 'I wish' and start saying 'I will.' Consider nothing impossible, then treat possibilities as probabilities."*

*~David  
Copperfield  
Magician*

*“Things don’t go wrong and break your heart so you can become bitter and give up. They happen to break you down and build you up so you can be all that you were intended to be”*

—Charles  
“Tremendous”  
Jones



## What Do You Know About Citrus X Paradisi? Answers

- 1D. Pummelos and oranges
- 2E. All of the above
- 3D. It grows in bunches
- 4c. A grapefruit is 75% juice

*The O'Meara Financial Group, Inc. is committed to maximizing our clients' financial well-being through education, communication and service that exceeds expectations. We provide personalized wealth planning and investment management services for individual investors and corporate retirement plans.*



Margaret O'Meara, CFP<sup>®</sup>, AIFA<sup>™</sup>  
O'Meara Financial Group, Inc.  
One Harding Road, Suite 104  
Red Bank, NJ 07701  
732-224-9900  
momeara@omearafinancial.com  
www.omearafinancial.com