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***It isn't that we plan to fail, it's just we fail to plan.***

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# Duane's Capital Ideas

## Strengthening your financial future

September 4, 2009

### Is "Buy and Hold" Dead?

Financial experts have traditionally held that equities belong in a portfolio because, despite involving greater risk than cash or bonds, when held over the long term they offer higher return potential. However, that conventional wisdom has come under fire since the double whammy of the dot-com crash and the credit crunch. If you're wondering whether it's time to revisit the amount you've allocated to stocks, understanding both sides of the argument can help you make a more informed decision.

#### **A challenge to the case for equities**

Much of the discussion in financial circles has centered on two factors. Until last year, the S&P 500 hadn't experienced negative returns over a 10-year period since 1939. However, in 2008 the annualized return on the S&P 500 for the previous 10 years turned negative; as of last December, the S&P's compound annual return for 1999-2008 was -1.38%--less than the 3.22% of U.S. Treasury bills.

Also, a widely discussed article by financial analyst Rob Arnott (*Journal of Indexes*, May/June 2009) argued that rolling over 20-year Treasury bonds and reinvesting the income would have outperformed the S&P 500 for an even longer period, from 1969 to 2009.

#### **Questioning the questions**

Though it's true that stocks have experienced a lot of volatility in the last decade while bonds had an exceptionally good run during the period examined in Arnott's research, it's never been more important to remember that past performance is no guarantee of future results.

Opponents of Arnott's arguments contend that the conditions that produced the cited outperformance by bonds can't be counted on to happen again. Interest rates have declined substantially since the early 1980s, which helped push up bond prices. Not only are Treasury yields relatively low--bond yields move in the opposite direction from prices--but the Federal Reserve is working overtime to try

to keep them that way. That means the conditions that created a favorable environment for bonds may not continue in the future. If and when interest rates and inflation start heading up, they are likely to affect bond prices.

It's also instructive to look at the period just after 1939, the last time the S&P 500's 10-year return was negative. In 1940, the compound annual return for the previous 10 years was 1.8%. A year later it went to 6.43%, and by 1942, it was 9.35%--not far below the overall historical annual average of 9.62% since 1926.

Finally, even though the large-cap S&P 500's 10-year return was negative as of December 2008, the 10-year average for small caps was 6.44% over the same period.

#### **The smart way to buy and hold**

Even if you shouldn't expect stocks always to outperform bonds--and there's no guarantee either way--that simply underscores the value of investing in multiple asset classes. Diversification can't guarantee a profit or insure against a potential loss; not one of the 16 asset classes Arnott discusses had a positive return in September/October 2008. However, the very idea that you can't be sure which type of investment may outperform others should demonstrate diversification's value. What if the asset class you expect to provide higher returns isn't the best performer *during your time frame*?

Investing is rarely black and white. You might decide to have a core holding and be more tactical with a portion of your portfolio. And even if you are firmly in the buy-and-hold camp, that shouldn't be the same as "buy and forget about." Monitor your investments periodically to ensure that they're still appropriate.

*Market data source: Ibbotson SBBI*



**Regardless of your filing status or how much you earn, you'll be able to convert a traditional IRA to a Roth IRA starting in 2010.**

## Roth IRA Conversions in 2010: Goodbye, Income Limits!

With the lure of tax-free distributions, Roth IRAs have become popular retirement savings vehicles since their introduction in 1998. But if you're a high-income taxpayer, chances are you haven't been able to participate in the Roth revolution. Well, that's about to change.

### What are the current rules?

For 2009, if your modified adjusted gross income (MAGI) is greater than \$100,000, you can't convert a traditional IRA to a Roth IRA. This \$100,000 limit applies whether you're single or married filing jointly. And if you file your taxes as married filing separately, you can't make a conversion at all--regardless of your income level.

In addition, your ability to make annual contributions to a Roth IRA depends on your MAGI:

If your federal filing status is:	Your Roth IRA contribution is reduced for 2009 if your MAGI is:	You can't contribute to a Roth IRA in 2009 if your MAGI is:
Single or head of household	\$105,000 but less than \$120,000	\$120,000 or more
Married filing jointly or qualifying widow(er)	\$166,000 but less than \$176,000	\$176,000 or more
Married filing separately	More than \$0 but less than \$10,000	\$10,000 or more

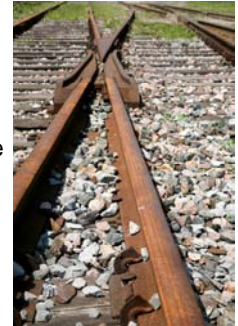
### What is--and isn't--changing

In 2006, the Tax Increase Prevention and Reconciliation Act (TIPRA) became law. TIPRA repeals the \$100,000 income limit for conversions, and allows conversions by taxpayers who are married filing separately, beginning in 2010. This means that regardless of your filing status or how much you earn, you'll be able to convert a traditional IRA to a Roth IRA starting in 2010.

Unfortunately, TIPRA does not repeal the income limits for annual Roth contributions. However, depending on your circumstances, beginning in 2010 you may be able to make your annual IRA contribution to a traditional IRA, and then convert that IRA to a Roth. Your financial professional can help you determine if this works for you.

### Convert now, pay later

Normally, when you convert a traditional IRA to a Roth IRA, you're required to include the amount converted--minus any nondeductible contributions you've made--in your gross income in the year you make the conversion.



However, to ease the pain of a potentially large tax hit in 2010, TIPRA includes a special rule for 2010 conversions only: if you convert your traditional IRA to a Roth IRA in 2010, you can report half the income from the conversion in 2011, and the other half in 2012.

For example, assume that in 2010 your sole traditional IRA is worth \$200,000, and you've made \$50,000 of nondeductible contributions. If you convert the entire IRA to a Roth in 2010, \$150,000 will be subject to federal income taxes. If you use the special rule, you can report half of the taxable amount (\$75,000) as income in 2011, and the other half as income in 2012. Alternatively, you can report the entire \$150,000 as income in 2010. (Note: state tax rules may differ.)

(Note that a SEP IRA can also be converted to a Roth IRA, and a SIMPLE IRA can be converted two years after you begin participating in your employer's SIMPLE IRA plan.)

### Is a Roth conversion right for you?

The answer is complicated, and depends on many factors, including your income tax rate, the length of time you can invest the funds without withdrawals, your state's tax laws, and how you'll pay the income taxes due on the conversion.

Even if you decide to convert, whether it makes sense to use the special 2010 deferral rule depends on your individual situation. It may also depend on where you think income tax rates are headed. If you expect rates to be lower in 2010 than in 2011 and/or 2012, deferring the tax hit may not be a good idea. Your financial professional can help you run projections to determine if the special rule is appropriate in your particular case.

## Homeward Bound: Investing in the American Dream



Your home is more than a shelter, it's a sanctuary from the world around you. It's also a daycare center, restaurant, laundry facility, and enter-

tainment complex all rolled into one. And for some, it's a status symbol. But is it an investment?

Just a few years ago, with home prices steadily increasing, the answer might have seemed obvious. But recent double-digit annual declines in housing prices have--not surprisingly--led to a chorus of calls to rethink the way homeownership is viewed. Your home, you might hear, is just a place to live, not an investment. The truth is that even if your primary motivation for owning a home isn't financial, your home qualifies as an investment.

### The profit motive

An investment can be defined as a purchase or an allocation of dollars with the intention of generating income or profit. Certainly, if you purchased your home with the intent of fixing it up and "flipping" it, your home would qualify as an investment under this definition. Even if your primary motivation for buying a home is the enjoyment the home provides, however, your home has characteristics that make it an investment--it generates current "income" and provides potential profit in the form of long-term appreciation.

### Your home generates income

If you didn't own a home, you would be paying rent. If you own your home outright (i.e., you don't have a mortgage), the value of what you would otherwise be paying in rent might be considered a type of "income" that your home generates each and every month.

Similarly, if you have a mortgage, each payment you make is offset by the value of this generated income. For example, let's say that each month you make a mortgage payment of \$2,500. If it would cost you \$2,000 each month to rent a comparable home, the incremental cost of buying rather than renting is \$500. In effect, you're paying \$2,500 each month for your home, but receiving an immediate income benefit of \$2,000 each month.

Another consideration: while rent can increase (or decrease) from year to year, most homeowners (at least those with fixed mortgages)

will make the same monthly payments over the term of their mortgage. And mortgages have a finite term--you'll eventually own your home outright and will continue to benefit from the generated rental income thereafter.

Of course, equating your home to an income-producing asset is more complicated than we're describing here. A detailed analysis might account for factors like home maintenance costs and property taxes, as well as tax breaks associated with homeownership.

### Potential for appreciation

When you purchase a home (and you may own several over the course of a lifetime), getting the best value for your money is usually a concern. Although you may not purchase a home with the intent of flipping it for a profit in the short term, you probably expect that your home will appreciate over the long term. The future value of your home is important, whether you hope to sell your home some day, or intend to leave your home to your children.

In addition to expecting your home to appreciate in value over the long term, if you have a mortgage, you probably anticipate building wealth through equity as you pay down the mortgage. With each mortgage payment you make, more and more money (equity) is potentially available to you to use toward future goals or to serve as a financial safety net in retirement.

That's not to say that a home is necessarily the most *efficient* way to accumulate wealth. Depending on where you live, and how long you intend to reside in your home, you might come out ahead financially by renting and investing the dollars you save by doing so. The point is, that as bleak as the current housing market is, over the long term, you probably view your home as a relatively safe vehicle for wealth accumulation. As with any investment, that expectation may or may not be reflected in actual performance over time.

### The bottom line

Your home is likely your single largest investment asset, playing a critical role in the overall accumulation of wealth during your lifetime. But, as is the case with all investments, whether owning a home is the most efficient allocation of your dollars depends in part on your expectations and tolerance for risk.

**Since 1987, when the Case-Shiller index of 10 major cities begins, it's risen from an index value of 63 to 151. Annual return: Just 4.1% per year. During that period, according to the Bureau of Labor Statistics, consumer prices rose by 3% a year. Net result: Home prices produced a real return of just 1.15% a year over inflation over that time.**

**Brett Arends, Is Your Home a Good Investment? WSJ, May 27, 2009.**



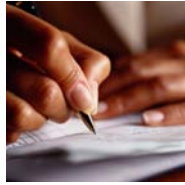


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## Ask the Experts



### What health insurance options do college students have?

There are basically two ways to insure your child's health while at college: through your family health plan or a health plan provided by the school.

Most family health plans allow a child to continue to be covered by the family plan if the child is your dependent (check the policy for specific age limits and requirements) and is a full-time college student. But be sure to check whether coverage is available for doctors and medical services provided on or near campus. Some plans, such as health maintenance organizations (HMOs), may offer full coverage only if provided by doctors or at facilities within the HMO network. Full benefits may not be available for care provided by doctors or at facilities outside the particular HMO network. However, other types of plans may offer full coverage for almost any type of care provided by most doctors or at nearly all hospitals.

If your child isn't covered by your family health plan because he or she has reached the

maximum age stated in the policy to be covered as a dependent, or is not a full-time student, the Consolidated Omnibus Budget Reconciliation Act (COBRA) may allow your child to continue to be covered by your plan on an individual basis. The benefits of your health insurance plan are available to your child for up to 36 months, but often at an additional cost.

Your child may also obtain health insurance through the school. Many colleges offer low-cost health plans for students that may even be less expensive than continuing coverage through your family plan. These plans are usually not as comprehensive as family plans, but provide benefits for most urgent or serious injuries or illnesses. Plans differ from one college to the next. Also, check the applicable laws of the state where the college is located. Those laws may impact the level of coverage available and the cost of coverage.

### Can a student's health insurance be cancelled during a medically necessary leave of absence?

Generally, no. In 2008, President Bush signed into law H.R. 2851, known as "Michelle's Law." It ensures that a child covered under a health insurance plan as a dependent and full-time college student will continue to be covered during a medically necessary leave of absence from school due to a serious medical condition.

The law is named in memory of Michelle Morse who, while a full-time college student, was diagnosed with cancer. Against her doctor's wishes, she opted to continue her studies on a full-time basis while undergoing treatment so she could remain covered under her health insurance plan.

While Michelle's Law does not require health insurance plans to provide coverage to dependents, it does mandate that plans offering such coverage allow students like Michelle Morse to take a medically necessary leave of absence from college without losing their dependent status under their health insurance plan. The determination of a "medically

necessary" leave of absence is made by the student's treating doctor.

Under the law, the coverage must be extended for the earlier of one year from the date of the student's medically necessary leave of absence or the date the coverage would have otherwise ended based on specific policy provisions. The law applies not only to public and private two- and four-year colleges, but also to many occupational education and postsecondary vocational schools.

The law becomes effective for insured and self-insured health plans on the first day of their plan year beginning on or after October 9, 2009. For calendar year plans, this means the effective date is January 1, 2010.

Michelle's Law applies to individual health insurance plans in the same manner as it applies to group health plans. And if a parent or employer changes medical plans, any new plan must continue the dependent student's coverage under the new plan.