SMITH HAYES Financial Services

Third Quarter 2009
Volume 1, Issue 4

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Dow Jones Industrial Average Index Posts Best Third Quarter Return Since 1939

Clint Rushing, CFA

In a continuation of a trend first witnessed during the second quarter of this year, U.S. equity markets continued their ascent during the third quarter of 2009 as several key economic indicators became more favorable during the latest three-month period.

In terms of the specifics from the third quarter, the Dow Jones Industrial Average gained 15.0% most recently, ending the month of September at a reading of 9,712.28. According to The Wall Street Journal, this represented the Dow's best quarterly performance since the fourth quarter of 1998, and represented the best third quarter performance since 1939.

Meanwhile, the widely followed S&P 500 Index also posted a gain of 15.0% during the third quarter of 2009, ending the month of September at a reading of 1057.08. On a year-to-date basis, the S&P 500 has gained 17.0% relative to the end of 2008.

S&P 500 Performance: Trailing Four Quarter Basis

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U.S. Economy Continues To Show Signs of Improvement During Third Quarter…

Clint Rushing, CFA

One of the key factors that allowed the U.S. equity market to post solid gains during the third quarter of 2009 was the fact that several widely followed economic indicators continued to show signs of improvement during the most recently ended three-month period of 2009.

The improvement was visible in several sectors of the U.S. economy, including in regard to manufacturing activity, the supply of existing homes for sale, as well as in regard to the number of people filing for first time unemployment benefits.

In regard to the housing market, trends across the U.S. continued to show signs of modest improvement, and this was especially true in regard to the supply of existing homes for sale across the country. At the end of August, the National Association of Realtors reported that unsold inventory totals during August were 16.4% lower than a year ago in regard to existing homes.

Secondly, manufacturing activity exhibited meaningful signs of improvement during the third quarter as measured by the ISM Manufacturing Index. During the month of August, the index increased to 52.9. A reading above 50.0 indicates expansion within the manufacturing sector. Going forward, investors and economists will be looking for additional evidence that the recent improvements are indeed, sustainable in nature as we head into the fourth quarter of 2009 and into 2010.

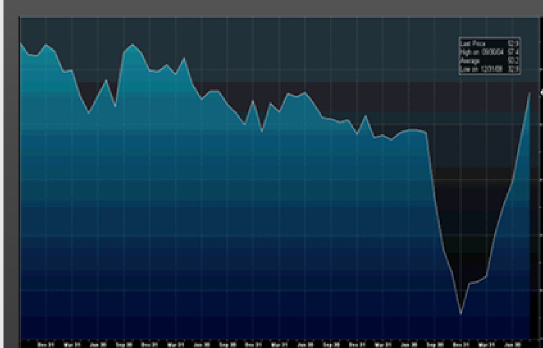
Finally, while the unemployment rate continued to move higher during the third quarter of 2009, there were several signs within the U.S. labor market that indicate the worst of the job losses may be behind us at this point in the economic cycle. First, weekly initial unemployment claims have been trending down during the past several months, as corporate layoff announcements have eased relative to the first part of 2009. Secondly, demand for temporary employment services has been increasing in certain regions of the country, which is a positive sign for an eventual upturn in terms of companies hiring full-time workers.

U.S equity prices rebounded by a notable amount during the second quarter of 2009, and one of the key drivers behind the increase in stock prices was related to more encouraging economic news.

Existing Homes, Months Inventory, 2004-Present

Source: Bloomberg Chart

ISM Manufacturing Index, 2004-Present



Source: Bloomberg Chart

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Roth Conversion 2010: What You Need to Know

Jeff Ziemba, Omaha

The Roth IRA is a very meaningful way to save for retirement. You save with after-tax dollars and withdraw them tax-free in retirement[1]. For many high income investors, however, gross income limits prevent them from taking advantage of this retirement vehicle. Are you one of them? If so, mark your calendar for January 1, 2010. When the crystal ball drops, the income limits that exclude certain individuals from converting IRA assets to a Roth IRA will disappear (Note: income limits will still apply on contributions).

What are the details of this conversion opportunity?

Starting in 2010, investors that have historically exceeded the income limit will be able to convert Traditional IRA money to a Roth IRA as part of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA). Prior to this legislation, only investors (single or joint filers) with modified adjusted gross income below $100,000 could convert Traditional IRA and pre-tax 401(k) money to a Roth IRA. This legislation only applies to *conversions*. Income limits will still apply when it comes to *contributing* to a Roth IRA, regardless of whether you convert a portion of your assets to the Roth.

What are the consequences of converting to a Roth IRA?

You position yourself and your heirs for tax-free income upon withdrawal (estate taxes may still apply). For those that choose to convert assets to the Roth, you will have to pay taxes on the taxable portion of the account balance. You can elect to pay the bill in one of two ways: pay it all in 2010 or spread the liability over two years in 2011 and 2012.

Please note that you cannot choose to convert only the portion of an account that you've already paid taxes on. For example, if you have a $150,000 cumulative Rollover IRA (with pre-tax money) and build on it with another $25,000 of after-tax money, you'd owe taxes on 91% of the $25,000 because the tax bill is calculated proportionately based on the total amount of your IRA accounts. Consult with your tax advisor before converting.

Who should convert?

Fundamentally speaking, if you anticipate that your tax bracket will be the same or higher when you withdraw money, you might consider the Roth Conversion. The assets you pull out will not be taxed. For that reason, it's important to consider your investment time horizon. Lastly, it is generally better to pay the conversion tax with funds that are not withdrawn from an IRA or other retirement account – you could generate more tax.

How do I know if the Roth Conversion is right for me?

Before you make the decision to convert a portion or all of your pre-tax IRA or 401(k) savings to a Roth IRA, it is important that you consider your tax situation, time horizon, and retirement income possibilities. To help you evaluate your options, it is critical that you consult your tax advisor.

[1] Qualified distributions are not included in your gross income if you have met the five year aging requirement and are 59 ½ or older. Consult your tax advisor before converting any IRA assets.

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Caution! Higher Taxes Ahead

Jake McKee, Omaha

At every year end, investors should strongly consider discussing various tax-saving alternatives with their adviser, CPA, and tax attorney. This year may be even more important as future tax changes loom. With the Republican tax cuts set to expire in 2011, this year and next could be a great opportunity for investors to improve their tax situations.

There is great speculation as to where this administration and Congress will direct our tax code, but I think it is safe to say that taxes are going up based on proposals put forth thus far. Probably the best indicator is what is known as the "Green Book" which lays out the Obama administration's tax agenda.

Below is a short list of items that may be most important and applicable to our investors.

- **Capital Gains & Qualifying Dividends** – Depending on the tax bracket, the capital gains tax may change in a meaningful way in 2011. The worst of it will be born by upper income tax payers, where the Democrats would like to raise this from 15% currently, to 20%. If investors expect to find themselves in these brackets, it may be wise to realize capital gains in 2009 and 2010 while this tax remains at the lower level. In addition, it may be beneficial to realize any losses that investors may have over the last several quarters as well. By doing this and to the extent capital gains are offset, taxpayers may reduce their taxable income up to $3,000 per year. Furthermore, realized capital losses not used may be carried forward and hence may become a 20% asset in 2011 and beyond, to offset future capital gains taxed at higher rate.
    - For taxpayers in 0%, 10% and 15% bracket, they will continue to have capital gains at 0%.
    - The 25% and 28% brackets appear likely to maintain their 15% rate.

- **Overall Tax Rates –** As I mentioned, the Republican tax cuts are set to expire, but what does this really mean. The 10%, 15%, 25%, and 28% rates will be maintained for the most part, but the higher rates of 36% and 39.6% will be reinstated for individuals with incomes over $200,000 and married couples filing jointly with incomes over $250,000. Now Obama is not proposing that the current tax rates expire sooner than 2011, so there should be 2009 and 2010 to plan ahead and implement changes. High income earners may consider emphasizing the importance of tax consequences in their investment strategy. Investment products have many different tax characteristics and to this end, there are several possible solutions that may have meaningful advantages. These may include, but are not limited to, municipal bonds, tax-managed mutual funds, or individually managed investment portfolios.

The future is still uncertain as to how taxes will change, but it is easy to speculate that they will be on the increase. Everyone will feel the pinch in some way; I just mentioned the federal income tax. Lest we forget all the other taxes we may pay, Medicare, social security, unemployment, property tax, state income tax, gas tax, wheel tax, insurance premium tax, sales tax, the list goes on. Because tax accounts for so much of an individual's financial situation, we have always encouraged clients to discuss possible solutions and do some planning that may make the tax sting a little less onerous. Over a long period of time, these little changes can become a fairly meaningful number.

The "Green Book" is a lengthy document that I did not discuss in detail above and also represents proposals and not law. The accuracy and completeness of rules and regulations are not guaranteed by me or SMITH HAYES, but put forth to stimulate thought on tax matters. Furthermore, SMITH HAYES Investment Consultants do not purport to give tax advice, as that should be reserved for your CPA or tax attorney. Notwithstanding, we encourage good relationships and open lines of communication between clients, investment consultants, accountants, and attorneys to ensure the appropriate solutions are executed for our clients.

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SMITH HAYES Client Appreciation Event

Starting in January 2010, the $100,000 income limit for a Roth conversion goes away. This is one of the rules surrounding ROTH IRA conversions that are changing and these changes could be very important to you and your financial future.

To help you understand what these changes are and how they may affect you, SMITH HAYES is sponsoring a Client Education Event on this important topic. We are holding this event in the following locations:

OMAHA
Scott Conference Center
6450 Pine Street
Tuesday, Nov. 10, 2009
5:30 p.m.-6:30 p.m.

LINCOLN
Champions Club
707 Stadium Drive
Thursday, Nov. 12, 2009
5:00 p.m. – 6:00 p.m.

Our guest presenters are Ken Kluck, CPA, Senior Partner, McDermott & Miller CPAs (Omaha) and Jan Labenz, CPA, of Labenz & Associates (Lincoln.)

We encourage you to take advantage of this opportunity to learn about the 2010 Roth IRA conversions. Please feel free to attend the event that is most convenient for you. Seating is limited, so to reserve your spot, please contact Lori at lmoss@smithhayes.com or 1-800-279-7437.

SMITH HAYES Action Team Update

On Saturday, August 1st, fifteen SMITH HAYES employees laced up their sneakers and headed to downtown Omaha to participate in the 18th Annual Juvenile Diabetes Research Foundation's Walk to

Cure Diabetes. The Juvenile Diabetes Research Foundation (JDRF) is the leading charitable funder and advocate of type 1 (juvenile) diabetes research worldwide. The mission of JDRF is to find a cure for diabetes and its complications through the support of research. This year's walk raised over $1.1 million for diabetes research!

On July 31st, SMITH HAYES sponsored a youth and women's fast pitch softball tournament. The event raised over $2,000 for the Juvenile Diabetes Research Foundation.

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