

WEALTH Management

THIRD QUARTER 2009



**First National
Wealth Management**

A Division of First National Bank of Chester County



Roth Conversions

With asset values low, some owners of traditional IRAs may be wondering whether this might be a good time to convert their accounts to Roth IRA status. There is a significant tax cost associated with the transaction, because the full amount of the conversion is taxable at ordinary income tax rates. The benefit that makes the price worth paying is the potential for tax-free growth in all the years following the conversion, coupled with freedom from the required minimum distribution rules.

But what happens if the account does not grow after the conversion? What happens if it actually falls in value? For a limited period of time, the taxpayer is allowed a change of heart and can negate the conversion.

The conversion "do-over"

Here's a fictitious example, one tied to recent financial market experience. Fred converted

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Estate planning strategies

GRATs

The Grantor Retained Annuity Trust (GRAT) has been getting quite a bit of attention from estate planners recently. The reason is that low market interest rates create a window of opportunity for passing assets to heirs without incurring much, if any, estate or gift tax.

The GRAT is established for a set number of years. During the term of the trust, the grantor is paid an annuity, a fixed dollar amount, every year. When the trust terminates, the assets left in the trust pass to the grantor's heirs. A gift tax, due when a GRAT is funded, is imposed upon the actuarial value of what the heirs will receive when the trust terminates. Estate

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So...Where Are We Now?



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Earlier this year the low yield of 2.20% in the ten-year U.S. Treasury note and the low of 676.53 on the S&P 500 Index were both driven by fear. During the second quarter, we saw a strong upward move of 15.93% in the stock market, although it is still 42.7% below the 2007 high. The rally in stocks may be due to a combination of short covering and rebalancing back into equities as investors who were underweight feared missing the rally. U.S. Treasury yields moved up to more normal levels at 3.50%, with corporate bonds outperforming, indicating less concern about corporate credit quality.

The question remains: Are we witnessing a new bull market in stocks or a cyclical (short-term) bull market correction in a secular (long-term) bear market? Let's first look at the positive factors impacting the markets. Since the failure of Lehman Brothers, the U.S. government has provided liquidity to the credit markets and stimulus

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Where are we? . . . CONTINUED

to help the economy and stabilize investor confidence. Also, many investors have been underweight in equities, and there's a lot of cash in money market funds that may still need to be invested. Finally, the large drop earlier this year caused stocks to be oversold, so a correction from those levels would not be unusual. These are all positive for the short term, but may not lead to a sustained recovery.

When we look out over the longer term, we see some clouds. As we mentioned in our last commentary, consumers have taken on too much debt relative to their assets—particularly in housing. The savings rate has moved sharply higher to 7%, as consumers save and pay down debt. We also are witnessing a shift in demographics as baby-boomers move toward retirement, which may involve downsizing and spending down their retirement savings. These lead to a slower economy and fewer dollars available for new investment. Government spending may be short-term positive, but higher deficits can have a long-term dampening impact on the economy. Another concern is the weakness of financial institutions, both here and abroad.

Many pundits are expressing concern about inflation. As the government continues to print money, there is the potential for future inflation. But history teaches us that the bursting of a credit bubble tends to be deflationary. Although the government has been increasing the money supply, these dollars have not been flowing into the economy, but have been held as excess reserves at depository institutions. We are not seeing an increase in credit demand, which would indicate that spending for large-ticket items remains weak.



Image courtesy of Swann Galleries, Inc.

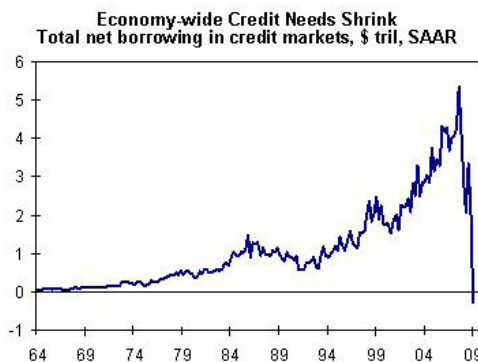
only two colors, conveys the joy of the toy through three “characters”—actually only one design element—that not only play with the yo-yo but also embody it. Heads, eyeballs and yo-yos merge, and even the letters dance.

The poster has been described as a “rare and wonderful gem of advertising.” It sold at a recent Swann Galleries auction of posters for \$8,400.

COLLECTORS CORNER

Duncan Yo-Yo (1930), poster by Raymond Gid (1905-2000). The years 1910-1945 have been dubbed the “golden age of posters” because posters were so widely used then for so many different purposes—selling goods and services, promoting political viewpoints, supporting war efforts—and often employed “modernist” techniques, particularly Art Deco ones, to achieve their sponsors’ goals.

Gid’s work here is a rare example of a successful attempt to mix humor with the normally severe Art Deco style. Duncan yo-yos hit the market in 1929 and quickly became quite popular. The poster, using



We continue to be conservative in our asset allocation and continue to overweight bonds relative to a neutral position in equities. We feel that diversification is important as we move through the sum-

mer months and test the staying power of the current stock rally. We patiently look to improved economic data for a clearer picture of the future stability and growth of the economy. ■

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Or call 484-881-4080 if you'd like to schedule an appointment to discuss your investments.



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