Investor Insights & Outlook

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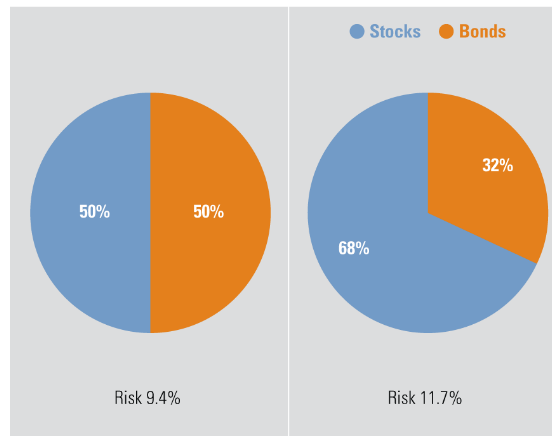
The Importance of Rebalancing

Over time, your asset-allocation policy can veer off track because of market ups and downs. This is illustrated quite clearly in the image below; a strong stock performance can cause a simple 50/50 portfolio mix to become unbalanced over time. After 30 years, what was once a 50% allocation to stocks now sits at 68%—quite a jump. Moreover, not only does the portfolio's allocation change, but the portfolio's risk also changes, rising sharply from 9.4% to 11.7%. If your needs and/or risk tolerance have not changed, your allocation shouldn't either.

But why would anyone want to sell investments that have done great in order to purchase laggards? While rebalancing might seem odd at first, it is all about risk control. If more and more of your total portfolio winds up in one investment, you risk losing a lot should that investment stumble.

Change of Portfolio Allocation:
January 1980–December 2009



Keep in mind that an investment cannot be made directly in an index, and past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. The sale of an investment for the purposes of rebalancing may be subject to taxes. Risk is measured by standard deviation. Standard deviation is a statistical measure of the extent to which returns vary from the expected returns. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest. Stocks are not guaranteed and have been more volatile than bonds.

Source: Stocks—Standard & Poor's 500®, which is an unmanaged group of securities and is considered to be representative of the stock market in general; Bonds—five-year U.S. Government Bond.

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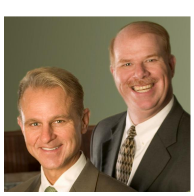

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Advisor's Corner

Charles Blozinski, CFP and Thomas Goodwin, CFP, EA offer their clients the advantage of over 35 years of combined experience in financial services. They work as an interactive team to provide independent, unbiased financial advice in a fee-only environment. Integrity Financial Planners is a registered investment advisor in the State of Oregon.

2010 Roth IRA Conversion: Everyone Welcome

Integrity:

- A Roth IRA conversion is one tax strategy which will protect your retirement assets against tax rates rising in the future. Remember that a conversion must be done by December 31st.

Beginning in 2010, investors of all income levels will be able to convert their traditional IRA assets to Roth assets. For 2009, your adjusted gross income must be $100,000 or less for you to be able to convert, whether you file your tax return as a single or you're part of a married couple filing jointly. So, this is rather large news for those that have been left out of the mix.

It is important to note that those who do elect to make the conversion will have to pay taxes. However, you'll be able to spread the tax hit over the subsequent two years—2011 and 2012. It may be hard to get excited about paying taxes versus letting the assets sit in your traditional IRA and paying taxes later. Traditionally, the calculus about whether to convert from a traditional IRA to a Roth required you to project whether your income would be higher or lower in retirement than it is now, a question that's very difficult to answer if you have more than a few years until retirement. However, many argue that the odds are excellent that tax rates across the board are currently low relative to where they could be in the future. If you share that view (no guarantees here), you'll want to take advantage of every means you can to pay taxes now rather than waiting until later.

With a Roth IRA, you contribute after-tax dollars but qualified withdrawals are tax-free. In a traditional IRA, contributions are tax deductible (there's no deduction for contributing to a Roth), but withdrawals are eventually taxed as ordinary income. The Roth IRA also gives you more flexibility than you'll have with a traditional IRA. Notably, you won't be required to take mandatory distributions from a Roth at age 70 1/2, as is the case with traditional IRA assets. That's a huge boon if you don't expect to need your IRA assets during retirement; you can allow those investments to grow and pass on a greater amount to your heirs.

And while it's never ideal to tap your retirement savings prior to retiring, the Roth is a much better option than a traditional IRA should you need to do so. If you convert to a Roth and five years have elapsed since you made the conversion, you can withdraw the converted amount, plus any additional contributions, prior to age 59 1/2 and you won't have to pay taxes or penalties.

One can find calculators on various reputable financial websites that will aid in your determination of whether to convert or not. In general, the younger you are, the more beneficial a conversion will be. That's because you'll have more years to recoup the tax hit. That's not to say a conversion should automatically be off the table if you're nearing or even in retirement, though. If it's fairly early in your retirement, longevity runs in your family, and you won't need to put your hands on your IRA assets for five years or even more, a conversion may well be worth it because you'll have a good shot at recouping the tax hit.

Needless to say, it would be in your best interest to speak with you financial advisor, or even a tax specialist, on the topic to make sure you're thinking through all of the variables. Once the decision has been made to convert, your investment provider/advisor should be able to walk you through the forms you will need to fill out. Lastly, if you convert your IRA from a traditional to a Roth, you needn't change your investments—you're changing the tax treatment of those investments, not the investments themselves. Finally, be mindful of the deadlines related to conversions. Whereas you have until April 15 to make an IRA contribution, the conversion will need to be done by December 31 to count for that tax year.

The 2010 Financial Reform Explained

In the wake of what is quickly becoming known as "the worst financial crisis since the Great Depression," the global economy is still slowly rebuilding. In the U.S., the government realized that it needed to take action to prevent a similar crisis, and on July 21, after a yearlong struggle, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act (also known as the Wall Street Reform Act) into law. Here are some of the most important provisions of this bill:

Consumer Protection: The law creates the Consumer Financial Protection Bureau, a new independent watchdog agency tasked with ensuring that U.S. consumers have access to clear, accurate, and timely information about financial contracts such as loans, mortgages, and credit cards. The agency will also protect consumers from hidden fees (small-type footnotes beware!) and abusive or deceptive practices.

Financial Stability: We've all probably heard the phrase "too big to fail" too often. Financial powerhouses like Bear Stearns and Washington Mutual went bankrupt and almost brought the whole system tumbling down with them, dissolving the economic security of millions in the process. Another new group, the Financial Stability Oversight Council, has been created to see these situations coming. It will monitor large, complex financial firms in order to identify and quickly address problems that could potentially snowball. Increasingly strict rules will be enforced for capital, leverage, liquidity, risk management, and other requirements. Banks and their affiliates will have restrictions on investments in hedge funds and private equity funds.

Financial System Regulation: Since "no one saw it coming" and "it wasn't our responsibility," from now on clear lines of responsibility will be defined and shared between the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, and the Federal Reserve as to which agency is supervising which type of bank. A new Office of Credit Rating Agencies will be created as part of the SEC, with the mission to implement new rules for credit rating agencies, such as stronger internal controls, requirements to make key findings public, and penalties for biased ratings.

Transparency and Accountability: Derivatives have long ceased to be simple risk-management tools and have instead become speculative vehicles that enable traders to make enormous bets with no regulatory oversight. The new law now gives the SEC the authority to regulate derivatives, both over-the-counter ones and other types. Companies that sell products like the now-infamous mortgage-backed securities are required to retain at least 5% of the credit risk instead of passing it all over to investors. Hedge funds, which used to operate in their own money-filled bubbles and could not be bothered to register with the SEC, are now required to register and to provide the information necessary to assess their contribution to systemic risk.

Executive Compensation: You're the CEO, you do all the work, you take all the risks—it's only fair that you should be paid billions while the rest of us settle for less because, hey, the economy is in a crisis. However, saying that Wall Street's compensation system has been way out of control is an understatement: think about Merrill Lynch ex-CEO John Thain's $87,000 area rug, or former head of Wachovia Robert Steel's $225 million in golden-parachute (executive severance package) money. To step away from this system, the financial reform law will give shareholders the right to vote on executive pay. Public companies will be required to set policies to take back executive compensation if financial statements are shown to have been tampered with or made inaccurate, and executive compensation will be determined by taking the company's stock performance over a five-year period into account.

These are just a few highlights, but the impact on institutions, financial advisors, and investors should be significant. Overall, the provisions in this bill look great on paper, but the real challenge lies in putting all these good intentions into practice.

TIPS to Inflation Proof Your Portfolio

Integrity:

- Since 2009, Integrity has added TIPS to the fixed income section of our diversified portfolios. We feel that TIPS provide a hedge against future rises in inflation.

When signs of inflation creep into the economy, investors seek to protect their portfolios by turning to defensive market sectors (utilities, health care). But certain fixed-income investments, like Treasury inflation-protected securities, or TIPS, can be just as useful.

The interest rate does not change over the life of TIPS, but the underlying principal rises and falls with changes in the inflation rate. So the amount an investor will receive as income also changes. At maturity, you either receive the adjusted principal or the original principal, whichever is larger. The table singles out those years since 1990 when inflation was 3.0% (its long-term average) or higher and shows how TIPS fared. Out of the seven years illustrated in the table, TIPS outperformed inflation in five of them—and by a considerable margin.

TIPS Performance During Inflationary Periods: 1990–2009

Year	Inflation	TIPS
1990	6.1	23.9
1991	3.1	–13.7
1996	3.3	7.2
2000	3.4	13.2
2004	3.3	8.5
2005	3.4	2.8
2007	4.1	11.6

This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Past performance is no guarantee of future results. TIPS carry individual and unique risks.

Inflation-protected bond portfolios primarily invest in fixed-income securities that increase coupon and/or principal payments at the rate of inflation. These bonds can be issued by any organization, but the U.S. Treasury is currently the largest issuer of these types of securities. Most of these portfolios buy bonds with intermediate- to long-term maturities.

Source: TIPS are represented by the Ibbotson Associates TIPS Index. Inflation is represented by the Consumer Price Index.

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