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Seasonal Musings

January 2009

Musings In This Issue

**A Silver Lining
The Madoff Affair and
Trust
Signs of Life Under the
Surface**

Hi Paul,

Welcome to another issue of "Seasonal Musings", the e-newsletter from Five Seasons Financial Planning LLC (FSFP). In this issue, we'll be discussing converting IRAs to Roths, lessons from the Madoff scandal, and of course, recent market developments. As usual, if there are financial planning or investment topics you'd like us to cover in future issues, please drop us a line.

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A Silver Lining

Start Planning for 2010 IRA-to-Roth Conversions

As I've [written before](#), the tax code is due to change next year to allow anyone, regardless of income, to convert their IRAs to Roths. This will provide a previously unavailable opportunity to those of you who are high income earners to:

- diversify yourselves from a tax perspective. You will


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then have the option in the future to tap different types of accounts (taxable, IRA, and Roth) for retirement income depending on your financial objectives and circumstances, and on the state of the tax code.

- take advantage of the depressed value of your IRAs (and possibly of your retirement plans).

When you convert, your IRA balance (less any previous after-tax contributions) will be taxable as ordinary income. In this respect, smaller account balances are better since they result in smaller tax bills. In effect, you will then be "freezing" your IRAs at low levels for tax purposes, never having to pay taxes on any future withdrawals no matter how much the account subsequently grows (barring any changes to the tax treatment of Roths).

- defer and spread the income tax bill from conversion. IRA converters in 2010 alone will have the option to spread the ensuing tax bill over 2011 and 2012.

- forever avoid having to take required minimum distributions (RMDs) from retirement accounts you convert (again barring any changes to the tax treatment of Roths). Roth accounts (unlike IRAs and 401(k)'s) are not subject to RMD rules. This makes Roths ideal to plan to pass on to the next generation, who can take lifetime tax-free distributions.

The precipitous decline in both asset values and interest rates has increased the attraction of all kinds of strategies combining estate planning with retirement income generation. IRA conversions are but one simple example. Take advantage of the silver linings in these dark clouds.

The Madoff Affair and Trust

It's amazing how difficult economic times and restrictive financial conditions bring to light the excesses of the preceding boom times. When the tech bubble burst earlier this decade, the Worldcom and Enron schemes were unearthed. This time around, we have the Madoff fiasco and many other Ponzi schemes surfacing around the country. It brings to mind the Buffett quote about a receding tide exposing who's been swimming naked.

The unfortunate result of these shenanigans is that we as employees, as investors, as constituents, and as clients then begin to question the trust we have placed in our employers, financial markets, regulators and advisors. Obviously, I'm most concerned with the state

of the client-advisor relationship. So, what was it about the Madoff situation that should have raised alarm bells for clients and prospective clients?

1. Ineffective Checks and Balances. It should have been clear that Madoff's firm serving as custodian for the client accounts of his investment advisory business provided an opportunity for abuse. In effect, by controlling his clients' custodian, he could have their trade confirmations and monthly statements say whatever served his purposes.

In our case, TD Ameritrade and Fidelity serve as custodians for client accounts under our management. We are independent from them and vice versa, and therefore they serve as an objective third party to provide literal confirmation of what's going on in client accounts. (Surprisingly, I read recently that about 10% of investment advisory firms also serve as their clients' custodians.)

2. Vague Responses. Many Madoff clients report that employees were vague or evasive in handling queries about their accounts. When an investment advisory firm, with a fiduciary obligation to its clients, can't effectively explain account transactions, this should raise legitimate concerns.

3. Lack of Transparency. At least a few prospective Madoff clients became suspicious when the firm's principals couldn't adequately explain their investment strategies, their investment philosophy, or their choice of investment vehicles.

A healthy client-advisor relationship depends a great deal on trust. Clients trust us to be forthright stewards of their financial affairs, and we in turn trust our clients to keep us updated on life developments that may have a bearing on their finances.

That's why we find it solid practice management to lay out these expectations and responsibilities in advance in the Investment Policy Statement customized for each client, and to reinforce them in an ongoing manner in periodic review meetings. As in any healthy relationship, consistent two-way communication is a key to building and maintaining trust.

Signs of Life Under the Surface

One of the most disheartening aspects about the second half of '08 was that diversification, to a large degree, failed to ease the pain of the bear market in stocks. With the driving force in the markets being hedge fund liquidations and mutual fund redemptions

(basically motivated sellers with little regard of price) correlations between asset classes other than cash and Treasuries tended to 1.

Since about the middle of December, though, things have changed for the better in this regard. While stocks have basically been stuck in the mud since then, there have been considerable signs of improvement on the fixed-income side of the ledger. Municipals, corporates, mortgages, leveraged bank loans, TIPS, and even junk bonds have put in a solid performance in the last 6 weeks.

This development is a necessary pre-condition to a stock market rally. Whether it's a sufficient pre-condition, we can only hope.

Five Seasons Financial Planning LLC is a Fee-Only investment advisory firm registered with the state of Utah. Five Seasons offers comprehensive wealth management, as well as investment counseling and financial planning services. To view past issues of "Seasonal Musings", click [here](#).

One of the benefits of working with a Fee-Only investment advisory firm is full disclosure. To receive a copy of our Form ADV, which details a variety of information about Five Seasons, or our Privacy Policy, please use the contact information below.

Best wishes,

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