

# Capital Financial Planners, LLC

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## Japan's Two Lost Decades: Can It Happen In The U.S.?

**T**wenty years after Japan's "economic miracle" collapsed, the Asian nation still has not recovered its once-vaunted economic clout. Japan's debacle involved a spectacular jump in stock and real estate prices followed by an equally spectacular fall as those bubbles burst, much like the twin "pop" that sent the United States into a recessionary spiral in December 2007.

Does that mean Americans are doomed to spend the next two decades struggling to get their economic lives back? And what lessons can investors learn from the Japanese experience?

**Echoes of a debacle in Japan.** The start of Japan's so-called "lost decade" in 1990—which has stretched to two decades since that phrase was coined to describe Japan's extended economic malaise—was triggered by a period of irrational exuberance in the 1980s. Loose monetary policy fueled a rapid rise in stock and real estate prices. Driven by speculation, leveraged assets, and investing excess, Japanese industrial production rose by 50% during the 1980s, and by 1989 Japanese banks had become the largest in the world. When the bubble burst in 1990 and the economy collapsed, investors belatedly realized that much of the growth had been illusory.

The same thing happened in the United States during the period 2002 to 2007, as "easy money" policies, consumer spending, and foreign investment pushed real estate and stock

prices ever upward—until the bubble burst, sending over-leveraged financial institutions to the brink of bankruptcy and the U.S. economy to the edge of systemic failure. Two years later, the U.S. jobless rate surpassed 10%,



businesses have trouble obtaining credit, and government officials are weighing further intervention in the economy even as the national deficit soars to unprecedented levels.

From an investor's point of view, the story is illustrated vividly by looking at the most-quoted stock market averages in the two countries. Japan's Nikkei average hit an all-time high of 38,957.44 intraday Dec. 29, 1989, then fell off a cliff. In 2009, the Nikkei never exceeded 10,800, and it nearly fell below 7,000 in March. In the United States, the Dow Jones Industrial average soared to a record intraday high of 14,198.10 on Oct. 11, 2007, then plunged as the economy deteriorated, dropping as low as 6,547.05 in March 2009 before rallying back above 10,000 in the last few months of the year.

**Why the U.S. should fare better.** While the similarities between the countries' boom-and-bust debacles are striking, there are also fundamental differences. For instance, the U.S. crisis is unlikely to be as deep and long-lasting as the Japanese downturn largely because the U.S. boom period did not even approach the stupendous

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## Should I Sell When The Market Is Down?

**W**e all know that investments go up and down in value. We also know that it's best to buy low and sell high. But no one can always guess the best time to make a sale.

Whether the market is up or down, each investor should consider their needs and the prospects of an investment before making a sale.

If an investor needs funds for a near-term obligation, choosing which security to sell and the tax impact of a sale must be considered.

Otherwise, before making a sale, an investor should ask, "If I had cash now, would I buy the security I am considering selling?" The next question is, "Do I have a better alternative in mind?"

Some people don't want to sell a security at a loss, as they feel doing so will permanently lock in that loss. However, if the proceeds from the sale are to be reinvested in something that is a prudent fit for the portfolio and is expected to perform better in the future, making the change can be a positive choice.

We appreciate your allowing us to be a part of your decision-making team.

Judy:

# Your 401(k) Choices After A Layoff

If you're one of the millions of people who have received pink slips from their employers during these troubled economic times, things may look bleak. But there's something you can take with you from your old job—your 401(k) account—that could hold the key to better times ahead. Though there's no penalty for leaving your retirement funds where they are, you may be understandably reluctant to entrust the money to your ex-company, continue to pay what may be unreasonably high administrative fees, retain limited investment choices, and risk having uncertain access to your account if you decide to make changes in your investment choices.

So what are the alternatives? Participants in 401(k)s and other employer-sponsored retirement plans can normally choose from among three main options: taking a lump-sum distribution opting for annuity-type payments, or rolling the funds into an IRA or a 401(k) at your new job. There are pros and cons for each possibility.

**1. Lump-sum distribution.** If you're in desperate need of cash, this may be what you have to do. But it has several drawbacks. If you request a lump sum from your

company, it's required to withhold 20% for federal taxes (and sometimes additional state withholdings), and you could owe more than that if you don't deposit the money in an IRA or another 401(k) within 60 days. You'll owe income tax on the amount of the distribution (which might push you into a higher tax bracket), plus you'll likely have to pay a 10% penalty if you haven't reached age 59½, bringing the total tax you pay on the amount received to almost 50%. Finally, of course, you'll be depleting your retirement savings well ahead of schedule.

**2. Annuity-type payments.** With this option, you're still on the hook for tax payments and a possible early withdrawal penalty, but at least the tax liability will be spread out over the years you receive payments. Typically, the amount you get is calculated according to your life expectancy or the joint life

expectancies of you and your spouse. If you choose, payments may continue until the death of the second spouse.

**3. Rollover.** This has obvious advantages. Not only will you have more investment choices, but the transfer—to a traditional IRA or to another employer plan at your new job—isn't taxed, and your money can continue to compound on a tax-deferred basis until you make withdrawals during

retirement. Just be sure to complete the rollover within 60 days of taking the money from your old 401(k), and keep in mind that your former employer will still automatically withhold 20% of your balance. To avoid that levy, which you can't recoup until you file your tax return, arrange for a trustee-to-trustee transfer directly from your old account to the new one. Best of all, this option helps your money keep to its appointed task—saving for a secure retirement. ●



## Quiz: The Rules Of Roth IRA Conversions

Roth IRA conversions aren't off limits to six-figure earners anymore. Starting in 2010, you can convert a traditional IRA to a Roth regardless of your income. Previously, such conversions were permitted only in a year in which your adjusted gross income (AGI) didn't exceed \$100,000.

Why would you want to convert to a Roth? It's a good idea for many retirement savers. Unlike withdrawals from a traditional IRA, which are taxed as income, "qualified distributions" from a Roth that has been established for at least five years are tax-free. And whereas a traditional IRA forces you to take taxable distributions during retirement, a Roth

IRA has no mandatory withdrawals.

Of course, there's no such thing as a free lunch. You must pay tax at ordinary income tax rates on the amount you convert from a traditional IRA to a Roth.

How well do you know the rules? Test your knowledge with these questions.

1. When are contributions to a Roth IRA tax-deductible?

- a) Only when your AGI is less than \$100,000
- b) Only when you don't have a traditional IRA
- c) Only when you itemize deductions on your tax return
- d) Never

2. The regular annual contribution limit

for a Roth IRA is:

- a) \$2,000
- b) \$5,000
- c) \$6,500
- d) Unlimited

3. A Roth distribution is not a qualified distribution if it's made:

- a) because of death or disability
- b) after reaching age 59½
- c) to pay first-time homebuyer expenses
- d) to pay higher education expenses

4. When can you contribute to a converted Roth IRA?

- a) Only when you don't have a traditional IRA
- b) Only when your AGI doesn't exceed an annual limit
- c) Only when you're disabled
- d) Never

# Roth IRA Conversion & Estate Planning

**B**y now, you've probably been inundated with media stories and ads touting the benefits of Roth IRA conversions, which are now open to everyone, regardless of income. Roth IRAs are known for their ability to deliver tax-free income during retirement. But a Roth may realize some of its most significant advantages after your retirement has ended. When the future of the estate tax finally gets resolved, converting a traditional IRA to a Roth will likely reduce any estate taxes your heirs may owe. And it will definitely cut their income tax bill on distributions from inherited IRAs.

Qualified distributions from a Roth IRA that has been established for at least five years are completely exempt from income tax. You're eligible to receive this tax-free income once you reach age 59½, and qualified distributions are also possible in case of death or disability or to pay first-time homebuyer expenses (up to a lifetime limit of \$10,000). Another plus is that with a Roth IRA, there's no rule requiring distributions that must begin for holders of traditional IRAs after age 70½. So if you don't need the money, investment gains in your account can continue to compound indefinitely without being eroded by taxes.

You will have to pay income tax on the portion of a Roth IRA conversion

representing tax-deductible contributions and earnings, and it's best to cover that liability with funds from outside your IRAs. But converting to a Roth is usually worth it for retirees looking to preserve a nest egg for their heirs.

Before 2010, you weren't allowed to convert a traditional IRA to a Roth in a year in which your adjusted gross income (AGI) exceeded \$100,000. But the Tax Increase Prevention and Reconciliation Act of 2005 eliminated this dollar cap for conversions after 2009. Also, if you convert your retirement account in 2010, you can spread the income from the conversion over two years and pay your resulting tax liability in 2011 and 2012.

When you convert to a Roth IRA, you're effectively prepaying income tax for your heirs without using up the annual gift tax exclusion or your estate tax exemption. You can then use those valuable provisions to shelter other transfers from possible taxes. At the same time, you're able to reduce the size of your taxable estate—by paying the tax due on the conversion—and that could provide further tax savings, depending on what happens to the federal estate tax.

Those who inherit a traditional IRA normally must empty the account—and pay income tax on the distributions—within five years or over their life

expectancies. And though a Roth still requires heirs to make withdrawals spread out over their lifetimes, there will be no income tax for them to pay. That can result in substantial benefits even if a Roth account is established too late for its original owner to enjoy much of its bounty.

Consider the case of John, Jane, and their daughter, Mary. John converts his traditional IRA to a Roth in 2010 when he's 65. He names Jane as the sole beneficiary of the Roth, and when he dies at age 73, she is 70. Based on IRS tables, Jane's remaining life expectancy is 17 years. As a spouse, Jane can choose to treat the Roth IRA as her own and isn't required to take distributions. She designates Mary as sole beneficiary, and when Jane passes away at age 87, Mary inherits the Roth IRA. She's 55, and tax rules require her to take annual payments from the account that she could spread over her life expectancy of 30 years.

What has this accomplished? John lived for eight years after converting his traditional IRA to a Roth. Jane then had access to the account's tax-free income for 17 years, and Mary had the account for another 30 years. That's a total of 55 years for a Roth IRA established by 65-year-old John. Converting to a Roth creates a tax-free annuity for your heirs that should last well beyond your life expectancy.

To get these benefits, Roth IRA accounts must be properly titled and have the appropriate beneficiary designations. And after an account holder's death, nonspouse beneficiaries must begin required (but tax-free) distributions from the account by December 31 of the following year. Miss that deadline and the account will have to be liquidated within five years.

Tax laws are never written in stone, and future changes could reduce the effectiveness of this technique for maximizing tax benefits for your heirs. But for now, at least, a Roth conversion provides substantial estate planning benefits. If you'd like to explore whether it would make sense to convert your traditional IRA, please call to set up an appointment. ●

5. After 2010, contributions to a traditional IRA:

- a) will be subject to the old income limits for Roth contributions
- b) will no longer be subject to mandatory distributions
- c) will be eligible for conversion to a Roth IRA
- d) will be taxable

6. The tax on a Roth conversion in 2010:

- a) must be paid in full in 2010
- b) must be paid in full in 2011
- c) can be divided between 2011 and 2012
- d) can be postponed indefinitely

7. What is the age limit for Roth IRA contributions?

- a) 21
- b) 59½
- c) 70½
- d) There is none

8. When can you undo a Roth IRA conversion?

- a) Within one year
- b) By your tax return due date
- c) If your AGI is less than \$100,000
- d) Never

9. A Roth conversion is valued for tax purposes on:

- a) the date of conversion
- b) your tax return due date
- c) the last day of the prior year
- d) the first day of this year

10. How often are Roth conversions allowed?

- a) Only one per month
- b) Only one per year
- c) Once in a lifetime
- d) Unlimited

Answers: 1-d, 2-b, 3-d, 4-b, 5-c, 6-c, 7-d, 8-b, 9-a, 10-d

## Japan's Lost Decades

*(Continued from page 1)*

price increases seen in 1980s Japan. During the 1990s, Japanese real estate lost an average two-thirds of its value. In contrast, U.S. real estate prices are expected to fall 30% to 40%, although some areas, including Las Vegas, Phoenix, and Miami, have seen steeper declines.

Moreover, the U.S. economic structure is more open and fluid than that of Japan, where banks and major industries had a tendency to sweep problems under the rug. In the United States, major banks have quickly (with the push of the government) written off billions in bad debt in an attempt to get a recovery going without unnecessary delay.

But the most basic difference between Japan in 1990 and the United States today lies in the speed in which interest rates were lowered. American economists, most notably current U.S. Federal Reserve Chairman Ben Bernanke, have criticized Japan's central bank for failing to reduce interest rates quickly enough during the early 1990s, with the delay spawning rampant, long-lasting deflation. Eager to avoid that mistake, the Fed has taken several steps to cut interest rates and keep money flowing. And both the Bush and Obama administrations have pumped billions of dollars into the U.S.



economy in the form of corporate bailouts and economic stimulus plans.

Even though the crisis in the United States seems unlikely to mirror the Japanese experience, it's impossible to know what will happen to stocks, real estate, commodities, and currencies in the near term. That's why we advise you to continue

protecting yourself from the vicissitudes of the stock market and the world economy by remaining broadly diversified in your investments. That's the best way to ensure you are in a good position to benefit when the economy starts coming back to life. ●

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