



David W. Demming
Certified Financial Planner™
David W. Demming Jr.
Certified Financial Planner™
Karen Bordonaro
Certified Financial Planner™

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DEMMING FINANCIAL SERVICES CORP.

13 New Hudson Road
Aurora, Ohio 44202

Tel: 330 • 562-2122
Toll Free: 877 • 841-2122
Fax: 330 • 562-6086
Email: info@demmingfinancial.com
www.demmingfinancial.com

Client Newsletter

Past market performance is not indicative of future results

Too Rich for a Roth? Not Anymore. That's Going to Change in 2010

Next year, individuals with a modified adjusted gross income of more than \$100,000 will be eligible to convert a traditional IRA to a Roth IRA. The IRS is offering taxpayers a three-year window in 2010 to pay taxes due on a conversion as part of removing the income limits.

Traditional IRAs allow investors to save money tax-deferred with deductible contributions (within certain income limits if either spouse is eligible for a qualified plan at work) until they're ready to begin withdrawals anytime between age 59½ and 70½. Roth IRAs don't allow tax-deductible contributions, but they allow tax-free withdrawal of funds with no mandatory distribution age and allow these assets to pass to heirs tax-free as well. If you leave your savings in the Roth for at least five years and wait until you're 59½ to take withdrawals, you will not pay taxes on the gains.

Remember that when you do a full or partial conversion, you must pay income tax on the amount you are converting. Since you received a tax deduction on your contributions to most traditional IRAs, you must pay the taxes due on those contributions and any gains in your IRA. But, subject to certain restrictions, you won't pay tax when you finally need to withdraw money from a Roth. That's where the silver lining comes in for you, or for your heirs if you pass that money on to them.

The conversion issue is a potentially attractive retirement and estate planning idea for all Americans who want to make sure they maximize the assets they have for themselves and for their heirs on a tax-free basis. And the conversion option isn't available just for traditional IRAs – it can be used for retirement assets held at other employers and 401(k) holdings. But anyone considering such a move – regardless income status – should first review their current retirement asset strategy with us or a tax professional.

Things to consider:

♦ How close is retirement?

If you have more than five years until you plan to withdraw your retirement funds, conversion of traditional IRA assets to a Roth IRA might make sense. The longer the time span where earnings can grow tax deferred, the greater the benefit of being able to withdraw those earnings without paying tax on them.

♦ What will your tax rate be at retirement?

Many people, such as business owners, may be paying taxes now at a fairly low rate. So they might pay higher taxes at retirement. If that's the case, converting to a Roth might make a lot of sense. With Social Security benefits being taxable at certain income levels, Roth IRAs can limit or eliminate such taxes.

♦ A Roth conversion can be expensive:

You'll have to pay taxes on contributions that you previously deducted, as well as taxes on the accumulated earnings. Also, you need to be aware that conversion could push you into a higher tax bracket, especially if you've accumulated sizeable earnings over the years. This is why a conversion needs to be planned with a tax expert. Why? It may trigger the Alternative Minimum Tax (AMT) due to those high earnings.

♦ Know how the conversion window will work:

Keep in mind that 2010 is the actual year you will be able to convert your retirement assets to a Roth, but you'll be able to spread out the tax hit. The Internal Revenue Service has granted taxpayers the option to claim 50 percent of conversion amount as income in 2011 and the remaining 50 percent in 2012. Also, you have to understand that if you choose the conversion period, your tax will be based on your tax bracket for that year. This means swings in income will affect what you pay.

A Primer on Medicare and Medigap Coverage

Despite all the public discussion about health care, very few people under the age of 65 understand the basics of Medicare, the federal health program for seniors and certain disabled individuals, or Medigap, the supplemental private coverage many buy to cover treatment that shortfalls what the federal program doesn't pay.

Even if you have years before you qualify, why focus on Medicare and Medigap now? Because as big changes happen in our health care system, those who understand the programs and products ahead of time will not only be better equipped to plan for their post-retirement health care options, but they'll have a better understanding of these critical federal program changes over time.

Who is eligible for Medicare? More people than you might think. Medicare is available to anyone over the age of 65 who is a U.S. citizen or a permanent legal resident for five continuous years. Yet people under the age of 65 qualify under certain circumstances, including: if they are permanently disabled and have received Social Security disability payments for the last two years, or if they need a kidney transplant, are under dialysis for permanent kidney failure or have Amyotrophic Lateral Sclerosis, also known as Lou Gehrig's disease.

How does Medicare cover expenses? Medicare coverage is divided into three primary parts: Part A, Part B and Part D. And yes, there is a Part C. Here's what each part covers:

- **Part A** is the segment of the program most associated with hospital care. It covers hospital inpatient care, a limited amount of care at some skilled nursing facilities, some specific home health care alternatives and hospice care. Most people are enrolled automatically in Part A when they reach 65 and they get this coverage for free. What's important is that Medicare doesn't cover long-term nursing home expenses, so that's why long-term care planning is necessary for all individuals.
- **Part B** is all about outpatient services. This is the part of the plan that covers doctors' visits, outpatient care and some other medical services that Part A doesn't cover, such as the services of physical and occupational therapists, and other aspects of home health care. You do have to pay a monthly premium for Part B coverage with a deductible – in 2009, the basic premium is \$96.40 per month though it might be higher for some people based on income. By the way, you'll sometimes hear people refer to Part A and Part B coverage as "Original Medicare."
- **Part D** is Medicare's prescription drug coverage. Part D is administered by a number of private insurance companies that operate in various areas of the country, so this requires some shopping on your part to make sure you're getting the right drugs at the right price. Financial assistance might be available if you need it.
- **Part C** is actually the Medicare Advantage Plan, which is an optional plan individuals may choose so they receive their Medicare benefits through private health plans. You'll also hear this plan referred to as Medicare+Choice. These private plans include conventional HMOs and PPOs and are required by law to offer benefits that cover everything that Medicare covers, but they don't have to cover everything exactly as Medicare Part A and B do. There might be some customized options that allow for lower co-payments or lower total out-of-pocket expenses. In simplest language, Medicare Advantage plans blend the benefits of Original Medicare and Medigap plans (more on this below). By law, you can't buy Medigap supplemental insurance if you've chosen Medicare Advantage. However, it's very important to get some expertise on the choice between Original Medicare and Medicare Advantage plans based on your anticipated health needs to make sure the coverage you buy covers what you really need.

What about Medigap? So-called "Medigap" coverage is supplemental coverage that's available for people who opt to be covered under Original Medicare – Part A and B coverage. You buy Medigap insurance from a private insurer, and your primary goal is to determine whether that supplementary coverage actually pays for the things you know you'll need that Medicare doesn't cover. You do have to pay a monthly premium for this coverage. And again, if you choose Medicare Advantage (Part C) coverage, you're not allowed to buy Medigap coverage.

To compare Medicare and Medigap coverage, visit the [Medicare Personal Plan Finder](#) on the Medicare.gov website.

When do I enroll for Medicare? You have a six-month window to enroll for Medicare that starts three months before your 65th birthday and ends three months after. As mentioned above, if you're already receiving Social Security at age 65, you'll automatically be enrolled in Part A, but if not and you enroll more than three months after your 65th, you may be subject to a late enrollment penalty.

By the way, what's Medicaid? This is the name for the federal program – and corresponding state programs – that pick up health care costs for indigent children and adults. Unless you're below the poverty line or you spend out your assets in your senior years, this won't be part of the discussion.

Dear Clients:

As 2009 comes to a close, the global markets have rebounded significantly from the first quarter lows, although unemployment continues to tick upward, tempering enthusiasm. After a negative start to the year, the markets have rewarded our patience and diligence when allowing managers to put capital to work during this tumultuous period. The first quarter was one of the worst on record, with the next two quarters rising cumulatively over 50% for many indices. Tempered expectations should continue from here as the initial bounce has been robust and is unlikely to continue unabated without some bumps along the way to a sustained recovery.

Today there is much to be thankful for as we look to say goodbye to 2009. The economic environment is healing slowly, and – although not official yet as we write this – it appears that one of the great recessions of post World War II more than likely ended as we entered the second half of 2009. Although the year is not fully completed, it would suggest that we have ended one of the worst, if not the worst, 10-year rolling domestic market returns on record.

Unequivocally, pessimism is pervasive in many individual's attitudes. Certainly, the most negatively impacted industries such as auto, steel, housing and banking reflect the difficult times we are enduring. We have seen historical events that have somewhat paralleled this. The best example we can cite is the previous stagnant economic decade of the 1970s, which had been viewed as the worst decade for stock market performance since World War II. The 1970s were a period where we had high inflation, high taxes, high unemployment, but also some of the lowest equity valuations that we had seen in 30-40 years. However, that pessimism did not continue to translate into below-average returns in the subsequent period. In fact, we then were followed by two decades that were among the highest rewarding in modern economic history. As investors became more complacent and assumptive with those now higher return expectations, they viewed that period as a "right of spring" so to speak to expect even higher returns. That's true whether one is describing stock market returns or real estate returns.

As we have seen, events taking place during the 2000s translated into dramatically lower returns. In fact, there is a strong probability that the 2000s may well have superseded the ineptitude of the 1929-1939 years. As markets close on 12/31, we will be able to make a definitive call as to how 1929-1939, which provided a positive return of about 1% annualized a year, compares with the 1999-2009 returns for the major indices such as the S&P 500 or the Dow Jones Industrials.

Although we are not suggesting that we can predict future returns, a contrarian viewpoint would be to believe that higher-than-average returns over the next decade could follow the most recent anemic one. Many well respected investors to whom we entrust capital certainly are not predicting Armageddon, but do espouse a cautious optimism that the global financial system has weathered a storm and a slow economic recovery may be afoot. They tend to be in a camp expecting below average returns in most asset classes for the foreseeable future. Only time and experience will prove either prediction accurate.

We do have a lot to be thankful for. There are not the attractive distressed valuations that we saw six months ago, but if we are at the beginning of an economic recovery, which traditionally lasts 60-70 months and portends returns in excess of 100% cumulatively, we may have more blue skies in the forecast.

Happy holidays and let's look forward to a happier New Year.

Best wishes,

David W. Demming, CFP®

REMINDERS...

- ◆ **IT IS IMPORTANT TO SAVE STATEMENTS FROM YOUR INVESTMENTS.**
When an investment is fully or partially sold, all the statements – from the initial purchase to the final sale – are needed to calculate cost basis for tax purposes.

Keep ALL YEAR-END statements from mutual fund companies; quarterly statements may be discarded once the cumulative year-end statement is received.

Keep ALL QUARTERLY and/or MONTHLY statements from clearing or brokerage firms (i.e., First Clearing Corp.) Clearing firms do not issue year-end cumulative statements, so ALL statements, monthly and/or quarterly, should be saved.

- ◆ Remember to send us copies of your 2009 W-2s, 1099-Rs, and 401(k) statements.
- ◆ **Thinking of refinancing? Need a new mortgage? Now may be a good time. Contact John Pazicni of Certified Mortgage Financing at (440)974-9721.**

ADDRESS CORRECTION REQUESTED

Denning Financial Services Corp.
13 New Hudson Rd.
Aurora, OH 44202