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INVESTMENT PERSPECTIVE

Third Quarter 2006 Volume 4, Issue 3

The Pension Protection Act of 2006

BY DENNIS C. ROGINSKI

On August 17, 2006, the Pension Protection Act of 2006 (PPA 2006) was signed into law. Discussed in this 900-page document are various changes with various implementation dates. These changes include an easing of the rules for Roth IRA conversions, more favorable distributions from an IRA to a charity, and permission for a non-spouse beneficiary to do a direct transfer from a company plan to an inherited IRA. The PPA 2006 also made permanent the temporary-retirement provisions created by the Economic Growth and Tax Relief Reconciliation Act 2001 (EGTRRA).

If you donate money to charities, you can now use IRA funds without triggering federal income taxes. Beginning immediately, taxpayers who are 70 1/2 years old or older can now donate money from their IRA—up to $100,000 per year—to a qualified charity without generating a tax bill. Normally, this distribution would be taxed as ordinary income, but now the distribution is tax free. Not only is it tax free, but it also counts towards the donor's required minimum distribution for the year. The distribution must be paid directly to the charity, and is effective for the years 2006 and 2007 only.

Beginning immediately, taxpayers who are 70 1/2 years old or older can now donate money from their IRA—up to $100,000 per year—to a qualified charity without generating a tax bill.

Prior to 2007, a non-spouse beneficiary could not inherit a company retirement plan such as a 401(k) and then transfer that balance to an inherited IRA (allowing the account to grow tax deferred over his or her life expectancy). Normally, the account would have to be emptied within five years. (See 2nd quarter 2006 newsletter.) Staring in 2007, the non-spouse beneficiary can transfer the inherited 401(k) to a properly titled inherited IRA and allow the account to grow tax de-

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DID YOU KNOW?

Did you know that in 1896, Charles H. Dow, the first editor of *The Wall Street Journal* and founder of the Dow Jones Company, was credited with first attempting any calculation to represent the market? The representation was called the Dow Jones Industrial Average (DJIA) and started with 12 stocks. In 1916 the number of stocks increased to 20, and in 1928 it increased to 30 stocks, its present number. Do you know the name of the company that was part of the original DJIA and is still part of it today? Find the answer on page four.

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The Ticker Year-to-Date 2006*

- DJIA +8.97%
- NASDAQ +2.41%
- S&P 500 +7.01%
- Russell 2000 +7.78%
- M.S.C.I. EAFE +12.21%
- 10-year Treasury Yield 4.637%

*As of September 30, 2006

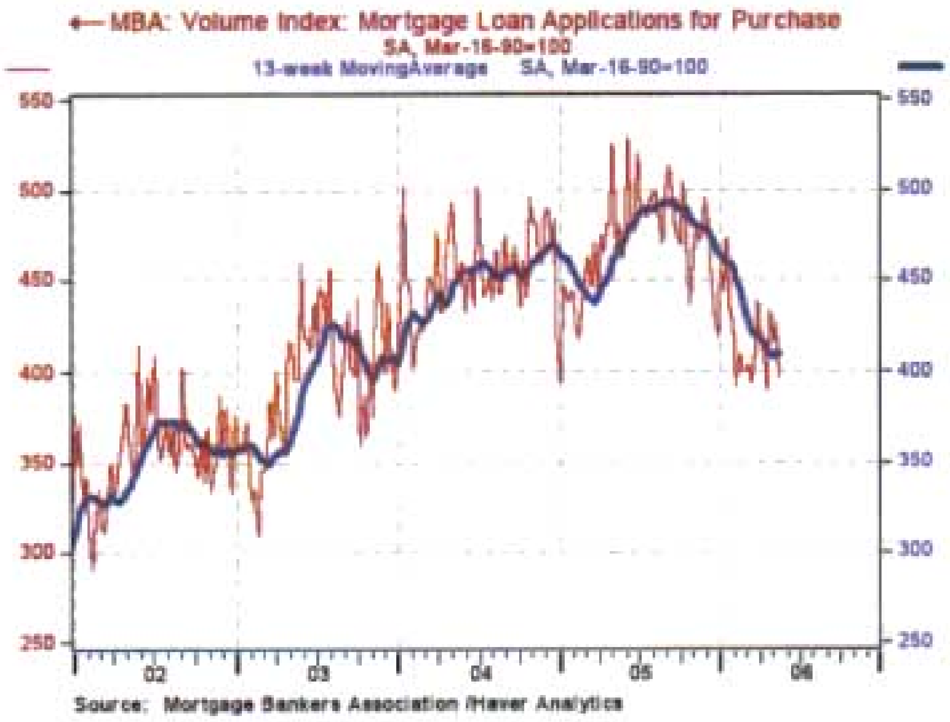
MARKET COMMENTARY

Economic analysis is like a seesaw. Economists talk about activity that is up, but they also temper it with talk of activity that is down. Eventually, the sides change with up moving down and down moving up. (During this shift, the seesaw is level for a brief time.) And not all economists see the seesaw the same. (Say that three times fast!)

". . . the Achilles heel of the economy is the housing sector and the collateral damage that could ensue."

What one economist might view as down, another might not see as down at all.

The economic analysis of the third quarter, and its affect on the upcoming fourth quarter, is no different. **For the "up" side:** production of business equipment is showing gains; business construction is the strongest it has been in five years; U.S. exports, while still at a deficit, are slowly closing the gap; companies in the S&P 500 have had 17 consecutive quarters of double-digit operating profit growth; energy prices are retreating; and corporations have bucket-loads of cash showing on their balance sheets. **For the "down" side:** it's the housing market. It doesn't seem right. With the majority on the "up" side, how can the one item (housing market) outweigh them all? Dr. Quincy Krosby in *The Hartford Market Commentary* said, ". . . the Achilles heel of the economy is the housing sector and the collateral damage that could ensue." When housing prices were rising at a fast clip, Mortgage Equity Withdrawals (MEW) totaled $800 billion. Half of this was used for consumer spending. Homeowners felt confident about borrowing due to their substantial increase in net worth. Now that housing prices, on average, are declining, MEWs are slowing. With this slowing is talk of the housing



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If you followed these recommendations, your return was 2.06%, as of September 30, 2006, based on the Russell 1000 growth index.

INVESTMENT ADVICE FOR EVERY GENERATION

At the end of 2005, large-cap growth was being recommended as the asset class to be in for 2006. I'm unsure if these recommendations were based on actual valuation levels or the fact that large-cap growth—based on nine asset groups—was second to last in the years 2000 through 2004 and third to last in 2005 (based on total return). Was it time for large-cap growth to be the top performer? If you followed these recommendations, your return was 2.06%, as of September 30, 2006, based on the Russell 1000 growth index. Unfortunately, this asset class is second to last among the nine, and once again, this is a case against trying to time the market. As I mentioned in this year's second quarter newsletter, it's very difficult to time the market, and it's highly improbable that this can be done successfully year after year. However, this does bode well for asset allocation, which means putting a certain percentage of your "investable" funds into each asset class and realigning those funds back to your original percentages every one, two, or three years. Past studies have shown that this technique has generated higher returns than trying to time the market. Not only that, it has proven to be less risky (based on standard deviation). Would you like to learn more about asset allocation and rebalancing? Give us a call.

We offer a free consultation lasting about an hour.

THE PENSION PROTECTION ACT OF 2006

(CONTINUED FROM PAGE 1)

The PPA 2006 also allows tax refunds to be deposited automatically into an IRA. Since the average tax refund is approximately $2,400, this is an excellent saving device.

ferred, withdrawing only the required minimum distribution (RMD) each year. This tax law change could add millions of dollars to the total amount being withdrawn. Even though the new federal law will allow this, the plan document must specify that a direct transfer is allowed. This type of transfer has always been required, and the new law will not change this. Check your company plan for details.

The PPA 2006 made it a little easier to convert a company plan to a Roth IRA. Beginning in 2008, you will no longer need to roll the company funds over to a traditional IRA and then convert to a Roth IRA. The new law will eliminate the first step. Funds from a company plan can be directly converted to a Roth IRA. This will also eliminate some pro-rata rules between pre-tax funds and after-tax funds. Of course, you will still be required to pay the tax at conversion and must still qualify based on income limits, but this income requirement will be eliminated in 2010. Then, even the rich will be able to convert.

The PPA 2006 also allows tax refunds to be deposited automatically into an IRA. Since the average tax refund is approximately $2,400, this is an excellent saving device. Saving this much extra in your 401 (k) could possibly double your retirement funds. This may be an excellent savings technique, since the common theme of PPA 2006 is that retirement security is mainly your responsibility. Congress came to this conclusion—and now the ball is in your court.

MARKET COMMENTARY

(CONTINUED FROM PAGE 2)

bubble bursting. Whatever it's called, there is a definite weakness in housing demand and activity. As of July, new-home sales were down 21.6%, and existing-home sales were down 11.4%. The Office of Federal Housing Enterprise Oversight (OFHEO) reported that in June, housing prices decelerated to 10.1% from last year. I agree with Richard Berner, economist for Morgan Stanley, who thinks housing activity and prices will drop further for the remainder of the year and continue dropping through 2007, although not as significantly. In addition, he states that housing prices are also determined geographically. For instance, Detroit's housing activity will slow at a greater pace because of its weak local economy, namely the auto industry. Conversely, the housing demand in the Gulf region is strong due to the destruction of so many homes by Hurricane Katrina.

But overall, the housing market is weak throughout most of the country, and this weakness is likely to depress economic growth. It trickles down to residential construction, mortgage finance companies, and real estate brokerage jobs, to name a few. And loss of jobs, whether it's yours or your neighbor's, shakes consumer confidence. With this, consumers tend to tighten their money belts and spend less. But American consumers, who contribute

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70% to the overall economy, are a creative lot and full of surprises. So with the fading of one sector, another sector takes its place. Which sector will be next?