

The Goodman Report

Fall 2009



Always Reaching for New Highs

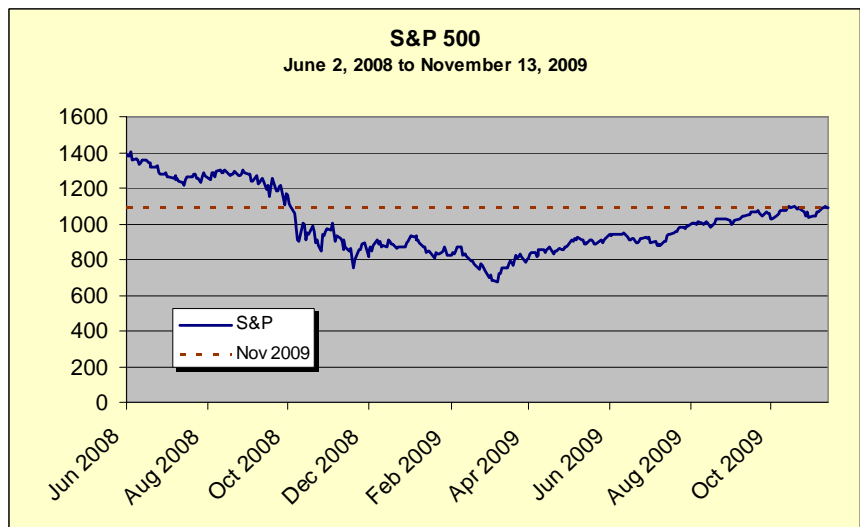
By James Lucas, CPA, CFP®
Executive Vice President, Managing Director

The market volatility of the last 18 months has proven to be gut-wrenching for most investors. Fear continues to creep into investor's minds while watching the daily media frenzy fed into our televisions and radios. However, those feeds declaring future doom and gloom have fallen on deaf ears on Wall Street. From the market lows in March to a year-to-date double-digit gains, the markets continue to defy paranoia. As such, questions now arise whether or not the markets are overvalued.

To gain some perspective, consider how the world watched as some of the largest banking institutions threatened to cripple the monetary system. Governments around the globe stepped in to support monetary and fiscal policies to offset the credit freeze experienced in 2008. The fear generated from these events prompted a mass exodus from equity markets creating the enormous losses of 2008. That same fear prompted the 800 point swings on the DOW as investors tried to make sense of it all.

Today, some industries have experienced declining financial conditions warranting restructure of company balance sheets. Unemployment has surpassed 10%. But despite these woes, trends indicate the worst is behind us. The markets, looking forward as they do, have rebounded to levels close to those in October 2008 (see chart). Thus, the double-digit gains this year, it would seem, not only show confidence for the future but restore the markets back to levels before the panic selling experienced in 2008. Therefore, from a long-term perspective, how can the market be overvalued?

The average annual growth rate for the S&P 500 is 9.4%. This rate takes into account market rallies and crashes. If the markets continue this historical trend then an investor, believing markets are overvalued at one specific point in time, would need the



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Market Update

By Jeanie Weathington, CFP®
Director of Research

Despite a rocky start, 2009 is shaping up to be a much better year than 2008. The S&P 500 Index reached a 12-year low in early March and then rallied for a 17.09% year-to-date return through October. The improvement in the stock market has been driven by improvements in both the economy and investor sentiment.

Home prices have been stabilizing, and sales have been rising at a pace that leaves a 7.3 month supply, the smallest amount since early 2007. Merger and acquisition activity has picked up in recent weeks, supporting optimism about the market as companies

show they are willing and able to make large acquisitions. Corporate earnings announcements have been both positive and negative influences on the market as some companies report strong earnings while others have had to revise downward their earnings prospects.

On the other hand, unemployment is still high (10.2%) and is expected to reach at least ten percent by the end of the year. This will continue to dampen consumer spending, a major driving force of the economy. The upcoming holiday season will be a key gauge of the depth of the economic recovery. Additionally, the housing market has not completely recovered, and the credit markets are not back to full swing.

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Roth IRAs – To Convert or Not To Convert in 2010?

By Wade Egmon, CPA, CFP®
Client Service Manager

You probably know the fundamentals of a Roth IRA conversion – if your income is under a certain limit then you can convert all or a portion of your Traditional IRA and/or qualified plan to a Roth IRA and pay tax at ordinary income tax rates on the converted amount.

Under the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), the income limitation to convert to a Roth IRA is completely removed for 2010 only, allowing all individual taxpayers to take advantage of a conversion. The tax on the conversion can be in one of two ways. The default allows the taxpayer to spread the tax liability equally over the 2011 and 2012 tax years. If the taxpayer chooses, an election can be filed to recognize all conversion income with the 2010 tax return.

The question becomes, is a Roth conversion the right strategy for you? Often, the answer is not clear. First, we must look at the basic benefits and disadvantages of a Roth IRA conversion:

Benefits and Disadvantages of Conversion

Benefits

- The Roth IRA offers tax diversification, that is, a tax-free source of future income.
- Asset growth inside of a Roth IRA is not subject to income taxation.
- Distributions from a Roth IRA: 1) of conversion amounts are income tax and penalty-free if they occur more than 5 years after the conversion date OR after age 59.5. 2) in excess of converted amounts are income tax and penalty-free if they occur more than 5 years after the conversion date AND after age 59.5.
- Owners of a Roth IRA are not subject to required minimum distributions (RMDs).
- Heirs of Roth IRAs are not subject to income tax on distributions, but must take RMDs.
- Unlike Traditional IRAs, a taxpayer can make contributions to a Roth IRA after age 70.5 if his or her income falls under certain limitations.
- Other items may be positively affected in the years after the conversion when distributions are taken, such as taxability of Social Security benefits, AGI-sensitive tax benefits (child or education credits, long-term capital gain rates, personal exemptions, itemized deduction phase-outs, etc).

Disadvantages

- The taxpayer must pay the taxes on the converted amount. The forgone growth of the funds used to pay the tax over time could be significant.
- Changes in tax law concerning the taxability of the Roth IRA could remove some or all of the benefits of and actually double-tax previous conversions, i.e. taxation of Social Security.
- Often the taxpayer would have been in a lower tax bracket during retirement.
- The taxpayer may be tempted to access funds early that are earmarked for retirement.
- Other items may be negatively affected in the year of conversion, such as taxability of Social Security benefits, AGI-sensitive tax benefits (child or education credits, long-term capital gain rates, personal exemptions, itemized deduction phase-outs, etc).

Clearly, there are many issues to take into account when contemplating a conversion, but the impact of paying tax now might be the most significant. Some key factors to consider are listed below.

- Do you have non-retirement assets available to pay the tax on conversion?
- How many years are you from retirement and when will you need access to retirement funds?
- What is your current and expected future tax rate?
- From a tax diversification standpoint, what other types of assets and income will you have in retirement (qualified plans, pension income, rent income, annuities, other types of tax free assets/sources of income, etc)?
- What effect will a conversion have on current and future social security benefits and other AGI-sensitive credits and deductions?
- How will a conversion impact your overall estate plan?

The decision of whether or not to convert to a Roth IRA (and in what amount) is complex and will differ for each individual according to their unique circumstances. As always, Goodman Financial is here to help you with this and many other important decisions affecting your retirement portfolios.



Portfolio Rebalancing

By Ed Roth, CFA, CPA, CFP®. CEBS
Vice-President, Investment Advisory Services

By now, the financial markets have acquired your attention. On a prospective basis, what should a long-term investor do with his/her portfolio?

On the surface it would seem quite apparent that the answer is to "buy low and sell high". It's a simple and logical investment approach, yet so hard to do for many. Investors have been struggling with this strategy for decades. Numerous studies and individual experiences suggest most investors do just the opposite. That is "buy high and sell low" a strategy which results in long-term underperformance for an investment portfolio.

It's important to recognize that there is a buyer and a seller to all security transactions. In today's market environment, this raises a quandary for sellers; why are people buying in this market environment? For many, it's much easier to perceive the need to sell, because they do not want or can not tolerate any more losses. However, the answer may reside in the concept of *Portfolio Rebalancing*.

Whether you have been a buyer, seller or taken no action recently, consider a few questions:

- 1.) Have my long-term investment goals changed?
 - if yes, now is the time to redefine them, before moving on to #2
 - if no, move on to #2
- 2.) Do I have established risk tolerance and asset allocation strategies?
 - if yes, move on to #3
 - if no, now is the time to establish both before moving on to #3
- 3.) Have I rebalanced my investment portfolio in accordance with my responses to #1 and #2?
 - if yes, then it is likely you are investing in accordance with your risk tolerance and long-term investment goals
 - if no, why not? Revisiting #1 and #2 may provide insights for the reasons.

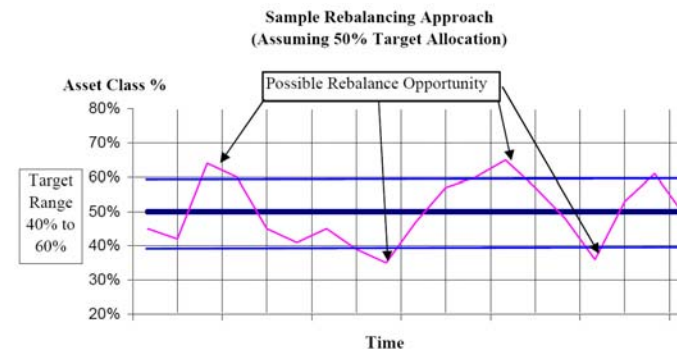
For many, the answer to the first question is no, with retirement savings being the most common goal. In any case, it is essential that your long-term goals are understood, reasonable and unambiguous given your facts and circumstances. This includes both you and your advisor.

Typically, the second question is misunderstood, unknown, ignored or the response is not clearly explained. It is not advisable to take investment actions until your Risk Tolerance and Asset Allocation strategies are apparent. Again, this includes both you and your advisor. There is not a single right or wrong answer, it's a subjective conclusion which is reflective of you. It's about having an understanding and reaching an agreement on these issues. In doing so, long-term target ranges for cash, fixed income and equities are established.

Assuming you have successfully addressed the first two questions; the final question centers on implementing investment strategies

for your portfolio. This includes the practice of *Portfolio Rebalancing* which is a built-in asset allocation mechanism based on your long-term investment goals and risk tolerance. It can be used during up and down markets. Should your equities fall below a designated target range, buying is indicated. Alternatively, should your equities exceed target ranges, selling is indicated thereby allowing you to harvest likely gains.

Of course, this is not an arbitrary process. The appropriate due diligence is necessary to identify specific holdings to purchase or sell. Also, sometimes target boundaries are not crossed, but research compels an investment action be taken anyway. Similarly,

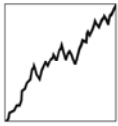


the other asset classes (cash and fixed income) can be cared for in much the same way. *Portfolio Rebalancing* facilitates diversification, another cornerstone of investing.

By using *Portfolio Rebalancing*, your portfolio's asset allocation is in alignment with your risk tolerance and long-term investment goals, whether buying or selling is taking place. Even so, when it is time to implement *Portfolio Rebalancing*, investors may encounter some emotional discomfort. Why? In a climate of generally rising equity markets, obligatory selling may cause an investor to feel that additional gains will be missed. Conversely, in a climate of generally falling equity markets, obligatory buying may cause an investor to feel they will be purchasing additional losses. No one knows the future and market timing is not a sound investment policy. On the other hand, by having a strategic investment plan that includes *Portfolio Rebalancing* the likelihood of long-term investment success improves.

One would not rebalance daily because of transaction costs. However, either on a periodic basis (perhaps quarterly or semi-annually) or through regular review of pre-defined target ranges, investment actions can be initiated.

Why don't all investors rebalance their portfolios? It may be their tendency to buy high and sell low or they do not have an established risk tolerance or asset allocation strategy. And there may be emotional behaviors that run contrary to an investor's stated risk tolerance or long-term goals. *Portfolio Rebalancing* is an effective investment strategy. Investors understand that their portfolio is being managed in accordance with their risk tolerance and long-term investment goals. Things do change and this requires a periodic consideration of the questions above and communication with your advisor.



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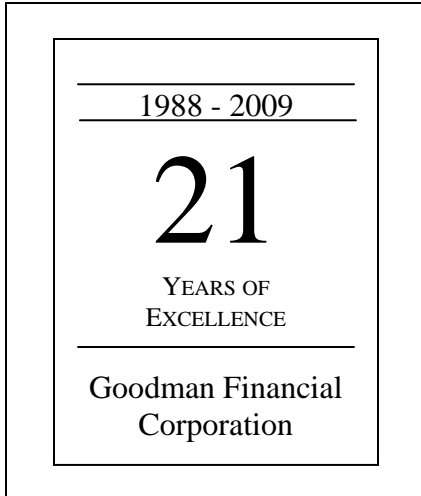
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keen ability to perfectly time entry and exit points in the market.

The dynamics of the current economic environment will continue to support volatility in the markets. However, three factors will provide for market appreciation—corporate profits, cash reserves, and investor sentiment. Corporate profits are meeting and exceeding analyst expectations. Companies have huge amounts of cash in reserve. That cash will undoubtedly fuel merger and acquisition activity over the next couple of years. And, just as companies will take advantage of opportunities in the market, investors will once again increase stock and bond positions in their portfolios to benefit from returns generated by the improving global environment.

Goodman Financial recognizes and monitors these events and trends. We manage diversified portfolios with patience and diligence knowing that short-term decisions often negatively impact long-term results. We seek to find and take advantage of opportunities in the market regardless of index levels. As economic activity increases and markets appreciate, one might question whether or not the markets are overvalued. If history is any indication, then each market cycle will always reach for a new high.



Office Update

By Paul Brill

Executive Vice President, Director of Operations

Goodman Financial is pleased to announce the addition of two professionals to its staff. James S. Lucas, CPA, CFP®, has joined as Executive Vice President, Managing Director. He will advise clients on investment strategy and oversee firm level initiatives. Wade D. Egmon, CPA, CFP®, has joined as Client Service Manager. He brings extensive tax and financial planning experience to service our clients' needs.

Be sure to visit the company's new website at www.goodmanfinancial.com. Newsletters, current and past, as well as special research reports will be available in the Publications & Media section. You may now call us Toll Free at 877-599-1778 or locally at 713-599-1777.

Goodman Financial has begun airing radio spots on 740AM (KTRH). If you miss the ads on the radio, you may also listen to them on the website in the Publications & Media section.

Growing Through Referrals

Goodman Financial Corporation has grown over the past 21 years through client referrals. The highest compliment we can receive is the referral of your friends, family, and business associates. We believe they will appreciate the suggestion. Thank you for the trust you place in our hands.

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That being said, the market does tend to recover before the general economy. As the stock market gains momentum, consumer confidence and optimism will improve. This will increase spending and flow through to corporate earnings, helping with an economic recovery.

At its November meeting, the Fed indicated that the economy was in recovery. It kept the Fed rate unchanged at 0-0.25% and said it would keep rates low for some time. The Fed also announced plans to wind down some of its programs used during the height of the crisis, such as purchases of mortgage-backed securities and Treasuries. Additionally, the first-time home buyer's credit was extended. While these steps show that the Fed is prepared to systematically withdraw its support, investors are concerned about how the economy will do without government help. This concern will most likely lead to some down days as the market readjusts to post-stimulus conditions.

Oil prices have been hovering around the \$75-\$80 a barrel range. Prices rise due to signs that the economy is recovering and will lead to increased demand or due to fears about supply, such as the tensions with Iran over its nuclear program and missile testing. Prices drop when pessimism shows up about the economy or the political issues surrounding suppliers are resolved. The uncertainty of the economic recovery will most likely keep oil prices trading in today's moderate range.