

Perspectives

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What Do Your Children Know About Building Wealth?

When you were 20 or 25, what was your level of financial literacy? What would you like to have known at 18, 25, or 35? What did you think of when the nightly news mentioned Wall Street or the Federal Reserve? Did you even care about those things at that time?

Few young adults fully understand how wealth can be built. That's a shame. Decades from now, many will wish they had started planning to amass wealth earlier in life. How can you encourage your children to start that process?

Help them start before they turn 18. If your child is a minor, there are still several ways she or he can get a head start on growing wealth. Besides the basic move of opening a savings account, it is possible for your child to open a Roth IRA. The IRS sets no minimum age limit for IRA contributions; if your son or daughter has earned income from a job and filed taxes, he or she can open a Roth or traditional IRA with your assistance and contribute to it. Your child may also buy a government bond with your help, or buy equity shares or make a direct stock purchase via a guardian account or custodial account.^{1,2,3}

Encourage them to set life and financial goals. Why not? It is not far-fetched if your teen wants to become a millionaire; given inflation over time, we may need to be millionaires down the road. Even if your son or daughter simply sets a life goal – for example, to start a business someday or to graduate from a prestigious university – he or she will start to think about what that will take financially.

Wean them off plastic. As your children become young adults, the great lesson is a simple one – spend less than what you make.

If they have to go into big debt, it better be for education's sake and not for comparatively frivolous reasons. Remind them that it is possible to pay off debt and plan to build wealth at the same time.

Look back over your life for a moment. What shaped you more – the material things you bought when you were 18 or 21, or the experiences you had when you were 18 or 21?

Convey that it is not what you own, but what you do that counts. Hopefully, your son or daughter will start investing early – and sensibly. Some young investors like the thrill of day trading – of looking for the next hot stock that will be the talk of Wall Street. It is better for your son or daughter to learn principles of diversification from the start (and not retrospectively). Getting rich slowly is not a bad idea. Investing seriously means staying invested through market cycles.

Remind them of the power of compounding. If your child opens an IRA or 401(k) before age 30, that does so much in terms of retirement savings potential. Yet few young adults focus on these retirement savings tools. The tax information service CCH took a poll in 2007 and found that just 4% of employees aged 25 and younger were maxing out retirement plans. That same year, Charles Schwab conducted a survey and learned that only 40% of adults aged 26-40 were contributing to an IRA.⁴

Looking back, what did you wish you had known? Today is as good as any day to let your son or daughter know about some investment and asset-building principles. At first glance, it may seem boring to them – but making money sure isn't. The more they know now, the more years they have on their side to grow wealth.*

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Citations.

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³ investopedia.com/ask/answers/06/underagebrokerageaccount.asp [1/30/08]

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Roth IRA Conversions for 2010

A unique opportunity for IRA owners.

In 2010, anyone may convert a traditional IRA to a Roth IRA. No income limits will stand in the way of the conversion! Should you do it? Here's why it may (or may not) make sense for you to go Roth next year.

Why you might want to consider it. A Roth IRA permits tax-free growth *and* tax-free income distributions in retirement (assuming you are age 59½ or older and have held your Roth account for five years or longer). You can contribute to a Roth IRA after age 70½, without having to take mandatory withdrawals. While contributions to a Roth IRA aren't tax-deductible, the younger you are, the more attractive a Roth IRA may seem.²

However, older investors have reasons to go Roth as well – especially if they don't really need to withdraw IRA assets. Under present tax law, converting an untapped traditional IRA to a Roth will shrink the size of your taxable estate, and careful estate planning could foster decades of tax-free growth for those IRA assets.³

Currently, if you name your spouse as the beneficiary of your Roth IRA, your spouse can treat the inherited IRA as his or her own after you die and forego withdrawals. So those Roth IRA assets can keep compounding untaxed across the rest of your spouse's life.

If your spouse then names a son or daughter as a beneficiary, that heir has the choice to make minimum withdrawals according to his or her life expectancy, all while the assets continue to compound tax-free. Currently, withdrawals from an inherited Roth IRA are not subject to income tax.³

Why you may want to think twice about it. The IRS regards a traditional IRA-to-Roth IRA conversion as a distribution from a traditional IRA – a taxable event.⁴ You'll need to pay taxes on the entire amount of the conversion. Do you have the money to do that?

Keep in mind, however: with the market down, many IRA values are lower than they have been for years. That translates to paying less tax on gains. It is also worth remembering that tax rates could increase in the years ahead – another reason why now may be a good time to convert.

Why you might want to fund a Roth IRA this year. *In 2009, any withdrawals from a traditional IRA can be used to fund a Roth IRA.*⁵ Interesting. Why is this so?

In years past, mandatory withdrawals from a traditional IRA typically couldn't be deposited into a Roth IRA. But the federal government has suspended mandatory IRA withdrawals for 2009.⁶ Any IRA withdrawals made in 2009 are thereby elective withdrawals. So, if your adjusted gross income (AGI) is \$100,000 or less, you have an option to fund a Roth IRA with a withdrawal from a traditional IRA – at least through the end of 2009.⁵

In 2009, you can fund a Roth IRA with after-tax contributions to a 401(k), 403(b) or 457 retirement savings plan. This year, you can take those contributions and convert them to a Roth IRA tax-free, provided your AGI is \$100,000 or less. More good news: there is no limit to the conversion amount.¹

A potential tax break for those who convert in 2010. If you do a Roth conversion during 2010, you can choose to divide the taxes on the conversion between your 2011 and 2012 federal returns.⁷

Be sure to consult your 1st Global Financial Advisor before you convert. This is a very good idea before you arrange any rollover or transfer of your IRA assets. In any year, you should fully understand the potential tax impact of a Roth conversion on your finances and your estate. Also, remember that while the income limit on Roth IRA conversions will go away in 2010, the income limits on Roth IRA *contributions* still apply next year and for the foreseeable future.^{7,*}

Citations.

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