



Trusted Financial Advisors  
**Quaker**  
 Wealth Management, LLC

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As another school year comes to a close, life is getting a bit busier in Moorestown.

Justin is finishing his 2<sup>nd</sup> year of medical school while Stephanie, who just returned from a semester in Spain, is a college senior! She is considering graduate school which means she stays on the payroll a bit more.

Mary Kate had a great year at Wake Forest while Jack rocked Sophomore Rowing at the Prep. Julia just became a teenager (yikes) and Maggie pitched a no-hit inning in softball.

These are the best of times. Enjoy.

John and Dan

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## Roth Conversion(?)

### Roth IRA Conversion - Proceed With Caution

With all the media noise about Roth IRA conversions, it's easy to become confused. We'll help you consider the following:

**1. Beware the hype!** Having spent more than 40 collective years on Wall Street, we're instinctively suspicious when the media and large financial institutions concurrently hype something. Cynics? You bet.

**2. Ouch! Taxes.** If you convert your traditional IRA to a Roth in 2010 you can spread out your tax liability over 2 years. But you'll still have to pay the IRS 100% of the taxes due. As a general rule, we are not fans of voluntarily prepaying taxes.

**3. Don't forget state taxes.** Most investors may not be aware that state income taxes may also apply to conversions.

**4. Feeling generous?** Since IRA assets will normally pass to a charity without a tax liability, paying taxes to convert to a Roth doesn't make sense.

**5. Trap doors.** There may be other dangers lurking. A conversion might bump your tax rate, impact college financial aid, increase taxes on your social security benefit, etc.

A Roth IRA conversion can make a lot of sense especially for younger clients who can pay the taxes with non-IRA funds and who will be in a high tax bracket upon retirement. There may also be estate planning advantages for clients.

But the even the best analysis depends on 2 key factors; future tax rates and the date you go to the Kingdom. Hence, even the best analysis is only speculative.

**Roth conversions are good for some investors but probably not as many as the media might have you believe.** As always, we are happy to answer your questions.

## Dividends(!)

### The Pundits Discover Dividends (Finally)

Recently, all the leading "experts" are extolling the benefits of dividends. Of course the impetus for their new found religion is the current **market correction** and once the market recovers, they will predictably move on to the next discovery.

As members of our client family, you know one of our core investment principles is based on investing in high quality stocks and stock funds that pay dividends. As we like to say, **we like investments that "pay rent"**. This is unwavering.

### Dividend Virtues

The of benefits of dividends are undeniable. Consider this, since 1925, 44% of all stock returns can be attributed to dividends. The long term average annual return for stocks is about 10%. This means that 4.4% is attributed to dividends. Amazing.

There are other virtues. As a group, dividend stocks generally **hold up better in bear markets**. Of course, the reverse is also true. They generally lag other stocks in bull markets. All things considered, they provide for a slightly smoother, though not risk free, ride.

We have experienced at least 4 bear markets. God willing, we hope to service you for many more years (heck, Dan has a 9 year old) and will no doubt see more bear markets. We have personally seen how collecting dividends soothes investor psyche when things look bleak. **Dividends can help buy some patience which is key to creating and preserving wealth.**

We are flattered that others are discovering the virtues of dividends, albeit a bit late.

Thank you for allowing us to serve you.

John and Dan.

## Stock Dividends: An Income Alternative

*"Many dividend-paying stocks represent large established companies that may have significant resources to weather economic hard times."*



Since 2003, when the top federal income tax rate on qualified dividends was reduced, dividends have acquired

renewed respect. When (or if) that tax rate increases (under current law, dividends will once again be taxed as ordinary income in 2011), the long-term demand for high-quality, reliable dividends will likely increase as baby boomers approach retirement and focus on income-producing investments.

### Why consider dividends?

Because they can add to a stock's total return, dividends can be especially important if the market produces relatively low or mediocre returns. According to Standard and Poor's, dividend income has represented roughly one-third of the total return on the S&P 500 since 1926, though that percentage has declined over the last decade. Dividends also may mitigate the impact of a volatile market by at least partly offsetting price fluctuations to even out a portfolio's overall return.

Many experts also look at dividends as a relatively reliable indicator of a company's financial health. Investors have become more conscious in recent years of the value of dependable data as a basis for investment decisions, and dividend payments aren't easily restated. Because dividends are one sign of a company's financial health, boards of directors generally are reluctant to send investors a negative message by cutting dividends.

Also, many dividend-paying stocks represent large established companies that may have significant resources to weather economic hard times, which could be helpful if you're relying on those dividends to help pay living expenses.

Finally, dividends become even more valuable if they're reinvested rather than used to supply income. A dividend that's used to purchase more of the company's stock means you'll receive a proportionally greater share of the company's earnings the next time dividends are paid, which in turn means a larger dividend payment to be reinvested (assuming the company continues to do well and the dividend rate remains the same).

### Look before you leap

Investing in dividend-paying stocks isn't as simple as just picking the highest yield. If you're investing for income, consider whether the company's cash flow can sustain its dividend. Dividends on common stock are paid at the discretion of the company's board of directors, and there's no guarantee they won't be cut.

Also, some companies choose to use corporate profits to buy back company shares. That may increase the value of existing shares, but it sometimes takes the place of instituting or raising dividends.

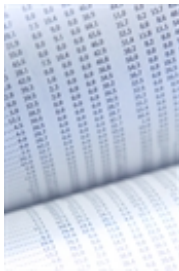
If you're interested in a dividend-focused investing style, look for terms such as "equity income," "dividend income," or "growth and income." Also, some exchange-traded funds (ETFs) track an index that's comprised of dividend-paying stocks, or that's based on dividend yield. Be sure to check the prospectus for information about expenses, fees, and potential risks, and consider them carefully before you invest.

### All dividends are not alike

Some dividends, such as those paid by real estate investment trusts (REITs) and master limited partnerships, don't qualify for the same maximum federal income tax rate as qualified dividends, and a portion may be taxed as ordinary income. Also, the 15% maximum rate is scheduled to expire at the end of 2010, and there is no guarantee dividends will continue to receive favorable tax treatment.

The 15% rate applies to qualified dividends (those paid by a U.S. or qualified foreign corporation). Also, you must have held the stock for more than 60 days during a 121-day period (60 days before and 61 days after the stock's ex-dividend date). Form 1099-DIV, which reports your annual dividend and interest income for tax accounting purposes, will indicate whether a dividend is qualified or not.

Be aware that some so-called dividends actually are considered interest for tax purposes. These include dividends from deposits or share accounts at cooperative banks, credit unions, federal savings and loan associations, and mutual savings banks.



## Rolling GRATs Are Rockin'

A grantor retained annuity trust (GRAT) is an irrevocable trust into which you make a one-time transfer of property and from which you receive a fixed amount annually for a specified number of years (the annuity period). At the end of the annuity period, the payments to you stop, and any property remaining in the trust passes to the persons you've named in the trust document as the remainder beneficiaries (e.g., your children) or the property can remain in trust for their benefit.

A GRAT is generally used to transfer rapidly appreciating (or high income-producing) property to heirs with the main goal of transferring, free from federal gift tax, a portion of any appreciation in (or income earned by) the trust property during the annuity period.

Because a GRAT is an irrevocable trust, when you transfer property to the GRAT, you're making a taxable gift to the remainder beneficiaries. The value of the gift is discounted because of your retained interest. The amount of the discount is calculated using IRS valuation tables that assume the property in the trust will realize a certain rate of return during the annuity period. This assumed rate of return is known as the Section 7520 rate, discount rate, or hurdle rate. If the property in the trust grows more than the IRS assumed rate of return, any excess growth will pass to the remainder beneficiaries gift tax free.

The catch to this strategy is that you must outlive the annuity period. If you die before the annuity period expires, the value of the property in the trust on the date of your death will be included in your estate for estate tax purposes. This, however, merely puts you in the same position you would have been in had you not used the GRAT (except for the costs to create and maintain the trust).

GRATs are typically created with a long term (5, 10, or 20 years), especially when the Section 7520 rate is low. The longer the term, the more growth that can potentially be removed from an estate. However, the longer the term, the greater the risk that you'll die during the trust term and that all of the GRAT assets will end up back in your estate.

### What is a rolling GRAT?

A spinoff of the GRAT is a strategy known as a "rolling GRAT." A rolling GRAT is actually a series of GRATs with short terms (i.e., 2 to 5 years). For example, say you establish an initial GRAT (GRAT 1) for a term of 2 years. At the end of Year 1, you receive your first annuity payment, and with that payment you fund a

second GRAT. When GRAT 1 terminates at the end of Year 2, you take your second annuity payment and fund a third GRAT. Any assets remaining in GRAT 1 are excess returns that are distributed to the beneficiaries. Depending on how the GRAT is initially funded, excess returns on GRAT assets may consist of interest, dividends, and any market increase (appreciation) in the value of the assets. The creation of subsequent GRATs can go on for as long as you want.

### The benefits of rolling GRATs

The main purpose of the rolling GRAT is to maximize return and minimize risk.

One benefit is that if one GRAT loses money or the growth of trust assets fails to surpass the Section 7520 rate, you can start over with another GRAT. Rolling GRATs are typically funded with specific stocks or asset classes. This segregation of assets can be an investment hedge, for example, to help prevent losses, if any, on one stock from offsetting gains on other stocks.

Additionally, you can reduce the risk of having all of the GRAT assets included in your estate because of an early death. If, for example, you die 5 years into an arrangement as described above, any excess returns from 3 of the GRATs would have been removed from your estate.

Further, assets from the rolling GRAT strategy are distributed to the beneficiaries earlier than with a long-term GRAT. With a 10-year GRAT, for example, assets are distributed only at the end of the 10-year period. With a series of 2-year rolling GRATs, some assets start to become available to the beneficiaries after the second year.

Finally, you can stop creating the GRATs whenever you want to. For instance, you may feel that you have gifted enough already or that you need to focus instead on rebuilding your wealth due to poor market performance.

### The drawbacks

The use of rolling GRATs assumes that you do not need the annuity payments for other purposes.

Additionally, there is a risk that the Section 7520 rate may increase and keep increasing after the first year. Whereas a long-term GRAT can lock in a low initial Section 7520 rate for the entire GRAT term, rolling GRATs may be subject to fluctuating Section 7520 rates.

You'll need an attorney to draft the GRAT documents.



*"A rolling GRAT is actually a series of GRATs with short terms (i.e., 2 to 5 years)."*





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## Ask the Experts



### How have stocks performed after a recession?

Mark Twain said it best: "History doesn't repeat itself; at best it sometimes rhymes." Past performance is no guarantee of future results, and history can be

an uncertain guide in terms of what might happen with stocks this time around as the economy begins to stagger out of a recession.

That said, it's fascinating to look at how various subsegments of the stock market have behaved relative to one another. Particularly interesting is the comparison between the performance of small-cap stocks and that of large caps after each of the last six recessions. In each case, small caps led the way out of those downturns. During the 12 months after the recession came to an end, as declared by the National Bureau of Economic Research (NBER), small caps beat large caps every time.

The average difference over the six recovery periods was 14.5%. In some cases, the difference was dramatic; in others, small caps were barely ahead. Here are the percentages by which small caps beat the S&P 500\*:

- December 1970-November 1971: 1.3%
- April 1975-March 1976: 23.2%
- August 1980-July 1981: 28.4%
- December 1982-November 1983: 14.4%
- April 1991-March 1992: 14.8%
- December 2002-November 2003: 5.2%

Will history rhyme this time? It's hard to say. Many economists feel the current recession ended sometime in summer 2009. Small-cap stocks have certainly done well since then, but some experts feel large caps are best equipped to navigate a credit crisis. However, until the NBER retroactively declares an official end to this recession, there's no way to know for sure. And don't forget that small caps historically have involved greater risk from market fluctuation, so a double-dip downturn could hit them hardest.

\*Percentages calculated based on data from Ibbotson SBBI *Market Results for Stocks, Bonds, Bills, and Inflation* for small company stocks and the S&P 500 Composite Index.