

# THE ADVISOR

*We're watching your nest egg.®*

*For Participants in The Container Store's 401k Program*



## To Roth or Not to Roth... That Is the Question

**By Carl A. Youngdale, AIF®**

*Editor's Note: This article was originally written for the employees of another company who have the option of making Roth 401k contributions. Even though your company does not currently offer this option, we've included this because it also applies to Roth IRA vs. traditional IRA discussions.*

thought about your current situation as well as where you hope to be in the future.

**What is a Roth 401k as compared to a traditional 401k?**

- A traditional 401k has the advantage of lowering your taxable income in the current year, and then allowing your savings to grow tax-deferred until it's withdrawn, usually in retirement. When withdrawing funds in retirement, the distributions are taxed at your then-current tax rate.

*The advantage of a Roth is that the distributions are not taxable. Generally, if you will be in a higher tax bracket when you retire, the Roth is a better choice than a traditional 401k.*

Yes, it's a question, but not as important as some folks might like you to believe. It is definitely not a reason to take a break from your established savings plan while you consider your options. There are advantages to both, and the decision does require some

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## Did You Know...

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Thank you for giving us the opportunity to serve you. Your business is appreciated and your referrals are welcome. Please mention our name to friends and associates who might need our services. We wish you a happy holiday season and a prosperous 2007!

# Check Your Investment I.Q. (Match the Term to the Definition)

- |   |                     |
|---|---------------------|
| A. Correlation                                  | E. Front Running    |
| B. Standard Deviation                           | F. Cherry Picking   |
| C. Roth 401k                                    | G. Ponzi Scheme     |
| D. <a href="http://www.SEC.Gov">www.SEC.Gov</a> | H. Traditional 401k |

\_\_\_\_\_ A promoter guarantees a high rate of return on his “special” investment. The promoter then pays old investors with new investor money. This works as long as new investor money comes in at a greater rate than previous investors liquidating their accounts.

\_\_\_\_\_ The disadvantage of this account is that you will pay more in taxes while you are contributing, which might dissuade you from using it.

\_\_\_\_\_ This account has the advantage of lowering your taxable income in the current year and then allowing your savings to grow tax deferred until it’s withdrawn, usually in retirement. When withdrawing funds in retirement, the distributions are taxed at your then current tax rate.

\_\_\_\_\_ A “Big Shot” money manager says his record of stock picking is fabulous, due to genetics and “market feel”- having learned it from his wise old father. He says he bought Google and Yahoo when they were just starting out.

Then he sold Lucent just before it tanked. He doesn’t mention that he lost more than 80 percent of some of his clients’ money just before they fired him and that most of his clients have lost money over the Big Shot’s career in investing.

\_\_\_\_\_ A good place to check your own retirement numbers would be to use the retirement calculators you can find here.

\_\_\_\_\_ A measure of the volatility of a portfolio or how a portfolio’s returns vary from its mean.

\_\_\_\_\_ Simply tells us if two asset classes move in concert with each other, or if when one zigs, the other zags.

\_\_\_\_\_ An institutional investor sends an email to his aunt in Eastern Europe who buys options before the institutional investor goes into the market and buys a large block of stock that drives the price of the stock up. The aunt then exercises the options and makes a killing, splitting the profit with her nephew.

ANSWERS: G, C, H, F, D, B, A, E.

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# “Yikes– I’ve been had!”

## Con Artists Are Stalking You

**By Robert J. Coopman, Esq.**  
CFS, BCAA, BCE, AIF®

Believe it or not, con artists actually are more effective in scamming people with above-average levels of financial sophistication, according to a new report sponsored by the Investor Education Foundation of the NASD. So, if you believe you could never be swindled, think again. A good scam weaves a sprinkle of facts in with some well-placed fabrications, and voila--intelligent people are elbowing each other trying to open their wallets fast enough to get in on the next sure thing. Here are a few of the “gotchas!” circulating out there:

**Real Estate Scam.** Fraud perpetrators often attract investors at free-lunch style events in local restaurants and hotels. For example, invitations often include seminars with alluring titles such as, “Retirement Secrets of the Rich: What Your Accountant and Stockbroker Don’t Want You to Know.” The text on the invite tells you how Jon W. James et al will help invest your IRA funds ... to take advantage of “the booming real estate market...to produce double-digit returns.” What you won’t see in print on the invitation, small or otherwise, is that in the case of the SEC vs. Jon W. James et al, the SEC alleges that Jon W. James took investors’ retirement money, claiming they would make returns of 24 percent through promissory notes and interests

in limited liability companies. The SEC alleges that James used new investor money to pay previous investors. This is known as a “Ponzi Scheme”. James never owned any real estate – it was a complete sham. The probable loss to investors is around \$22 million.

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*Believe it or not, con artists actually are more effective in scamming people with above-average levels of financial sophistication, according to a new report sponsored by the Investor Education Foundation of the NASD.*

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**IPO Scam.** Some New York Big Shots named Jarvis, White, Baptiste, and Latorri (hereinafter NYBS) sold unregistered stock in a company named One Wall Street. NYBS collected \$1.6 million before the SEC filed an emergency enforcement action to stop them. The pitch included the following: (1) One Wall Street would soon conduct an initial public offering, (2) E\*Trade Financial Corporation was negotiating to merge with One Wall Street, (3) One Wall Street would use the investment proceeds for marketing to create exposure for the company, to acquire distressed financial research companies, to expand into international

markets, and to expand the company’s information technology infrastructure. The SEC alleges that each of these statements was false and misleading. Why would 64 investors, mostly senior citizens, fall for this? First, the news touts big earnings for people who get in on the ground floor of an Initial Public Offering. Second, NYBS used name dropping – touting their connections to a successful company - E\*Trade Financial. Third, taking advantage of another company’s misfortune sounds like buying a rare painting at a garage sale. Last, investing in anything “international” this year was considered the road to success! There was something in the scam for everyone.

**Stock Tips Scam.** The SEC charged five individuals with insider trading in connection with Blue Rhino Corporation’s merger announcement. The SEC alleges that a Wachovia registered representative named Michel got a stock tip and purchased \$90,000 of Blue Rhino with his own money, then borrowed \$70,000 from a client and bought more (in violation of Wachovia Securities policies). In addition, the SEC alleges that Michel purchased \$1.2 million of Blue Rhino on behalf of his relatives and customers at Wachovia Securities. Beware of relatives in the securities business offering stock tips or borrowing your money to invest in a hot tip.

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**“Convince Yourself That You Can Beat the Market Without Knowing Anything About It.”**

— From “How to Ruin Your Financial Life” by Ben Stein —

# Discussing Risk As It Pertains to Portfolio Design

**By Jeffrey A. Baumert, AIF®**

Every day, each of us deals with an element of risk in some aspect of life. Webster defines “risk” as: “possibility of loss or injury, to expose to hazard or danger.” In our daily lives, risk comes in many forms-- driving, flying, climbing a ladder, or even crossing the street. We are all pretty adept at managing these types of risk, otherwise that “survival of the fittest” thing would kick in and many of us would be winnowed out before we made it to the other side of the intersection.

However, there are other types of risk that some people are not as aware of, and even less capable of dealing with. One of these less detectable areas of risk concerns your investment portfolio. When it comes to investing, many forms of risk apply, including business risk, market risk, interest rate risk, economic risk, and credit risk.

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*Risk management is one of the primary responsibilities of any portfolio manager – individual or institutional.*

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When analyzing an investment portfolio, one of the primary determinants of risk is standard deviation. Correctly analyzing the standard deviation of a portfolio can tell you a great deal about its level of risk, its effectiveness and appropriateness. How to correctly compare one portfolio to another, or a portfolio to a benchmark, is a separate topic and perhaps the subject of another discussion.

Risk management is one of the primary responsibilities of any portfolio manager – individual or institutional. We manage risk for our clients in two steps. First, we communicate through risk assessment questionnaires, client profile information and personal conversation to help you determine where you fall, personally, and where a particular portfolio falls with respect to risk. Second, we develop risk-adjusted portfolios that address varying levels of acceptable risk from asset preservation to aggressive growth.

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*Obviously, knowing the historical returns of an asset class is important, but just as important for true risk management is the knowledge of asset class correlation and standard deviation.*

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Each portfolio utilizes asset allocation and diversification to mitigate or manage risk as appropriate for a particular risk level. We utilize different asset classes and sub-asset classes to manage a portfolio's overall risk level. It is important to understand certain characteristics of asset classes to build a portfolio that appropriately deals with risk. Simply allocating perhaps 5 percent of a portfolio to 20 different asset classes and sub-asset classes is not necessarily a prudent way to effectively manage risk. Obviously, knowing the historical returns of an asset class is important, but just as important for true risk management is the knowledge

of asset class correlation and standard deviation. Correlation analysis tells us how two asset classes act with respect to each other. Correlation does not imply cause, but simply tells us if two asset classes move in concert with each other, or if when one zigs, the other zags. Standard deviation is a measure of the volatility of a portfolio or how a portfolio's returns vary from its mean.

Ideally, we would find asset classes that have negative correlation (zigs and zags opposite each other), low standard deviation and consistent positive long term returns. That is difficult to do (even more so lately as asset classes have tended toward a greater degree of correlation) since in reality there are very few asset classes that have perfectly negative correlation. There are plenty of asset classes that have positive long term returns, but to simply invest in those with the highest long-term returns would likely put you in a bad position if there were a dramatic market downturn. And most assets with the highest long-term returns tend to have the highest standard deviation. So like a jigsaw puzzle, we combine individual funds to create an effective portfolio. We analyze how the different asset classes and funds we use to represent those classes fit together so as to maximize portfolio return for a given level of volatility (measured by standard deviation). By carefully analyzing correlation and matching asset classes and representative funds that have reasonably low correlations, we can minimize overall portfolio volatility while maximizing the portfolio long term returns.

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To Roth or Not to Roth - Cont. from Page 1

- A Roth 401k does not reduce your taxable income in the current year, but grows tax free. Distributions are tax free as long as you are 59 ½ years old or older, and the distribution is made at least five years after the first contribution. The five-year holding period applies even if you are over 59 ½ years old or are disabled.
- The disadvantage of a Roth is that you will pay more in taxes while you are contributing, which might dissuade you from using it.
- The advantage of a Roth is that the distributions are not taxable. Generally, if you will be in a higher tax bracket when you retire, the Roth is a better choice than a traditional 401k.

### Is there a “big picture” way of looking at this issue before we get into the technicalities?

Yes. You probably want both traditional and Roth.

Let's imagine you are retired and 65 years old, and you want to buy a big-ticket item, perhaps a houseboat. Your kids and grandkids claim they would like to spend at least a month every summer on the houseboat with you. The houseboat I've got in mind would cost \$100,000. So, if you have a Roth 401k with a balance of \$100,000 or more, you just make a withdrawal and buy the boat. Done.

### *You probably want both traditional and Roth.*

If you have a traditional 401k, in addition to the \$50,000 you might draw each year in retirement, you will need to withdraw \$100,000 for the boat plus additional funds to cover the tax bill. If you started this while in one of the lower tax brackets, the additional withdrawal

of \$100,000 + is going to move you up one and maybe even two tax brackets. This might make you pause and put off a fun-filled summer for another year. You can see that you might like to have two pots of money to choose from: one Roth and one traditional. That's the big advantage of a Roth in my view - it gives you a choice later in life.

### So what do you need to know in order to make a decision?

1. You can never convert a traditional 401k to a Roth 401k.
2. There are no income limits on a Roth 401k like a Roth IRA. With a Roth IRA, if you are single and your modified adjusted gross income (MAGI) is more than \$110,000, or if you are married and file jointly and your MAGI is more than \$160,000, you can't contribute to a Roth IRA. The phase-out of allowable contributions begins at \$95,000 and \$150,000 respectively. (2005 limits.)
3. If your company offers matching funds, the company cannot match Roth 401k contributions.
4. Once you retire, you can rollover your Roth 401k to a Roth IRA. The advantage of this is that you are never required to take mandatory minimum distributions at age 70 ½ years old from a Roth IRA like you do from a Roth 401k. FYI: you must take mandatory minimum distributions at 70 ½ from a traditional IRA and, unless you are still working, from a traditional 401k.

### What personal factors should you consider?

1. The fact that you don't know what the future tax rates will be is definitely significant. If dealing with this unknown makes you uncomfortable, or if you fear that tax rates might rise, this might be reason enough to settle the issue in favor of the Roth.

2. If you have a good idea that you will live on 50 percent less than you do while working, the traditional is probably the better way to go because the tax savings now will be greater than the tax savings later.
3. If, for whatever reason, you have scads of money to spare, contribute to both a traditional and Roth 401k.
4. If it's touch-and-go every month but you want to contribute, you should stick with your current traditional 401k. Contributions to a Roth 401k don't reduce your taxable income, so you will feel a bigger pinch in your wallet or pocketbook when contributing to a Roth.

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*A good place to check your own numbers would be to go to the calculators for retirement and other issues on the SEC website.*

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### Could you give a few examples based on age?

Yes, but keep in mind that everyone should do their own analysis-- these are opinions, not rules. A good place to check your own numbers would be to go to the calculators for retirement and other issues on the SEC website. (<http://www.sec.gov/investor/tools.shtml>)

### What if I'm twenty-something and in a low tax bracket?

If you are young, in a lower tax bracket, and are in a profession where you expect to earn more in the future (and thus are fairly certain you will end up in a higher tax bracket), you would want to contribute to a Roth 401k. In this case, the current tax burden will be light compared to later in life.

(Continued on Page 6)

*To Roth or Not to Roth - Cont. from Page 5*

### **What if I'm thirty-something and making good money?**

If you seem to have excess cash around that would otherwise have been wasted on whiskey, beer, wine or (insert your own vice here), then it would probably be better to contribute to a Roth 401k.

### **What if I'm forty-something, making good money, the kids are preparing for college, and my expenses exceed my income a few months a year?**

If you, like many folks in this economy, have taken pay cuts or are just treading water financially, it probably makes more sense to just "keep on keeping on" contributing to your traditional 401k. You will save more on your taxes and have more in your pocket to cover your regular expenses. If you do this, you should revisit this option somewhere down the road when your fortune or disposition is looking brighter.

### **What if I'm fifty-something and in a high tax bracket?**

If you are currently in a high tax bracket and in retirement plan on withdrawing an amount equal to 50 to 60 percent of your current income (assuming that will put you in a lower tax bracket), then it would make sense to elect the traditional 401k. You'll have more money invested, and when you take it out, the government will get a smaller bite.

### **What if I'm weaving and ducking through life and really can't categorize myself?**

If you still have no clear feeling about what you should do, you could view it like this:

Adopt a Zen or Feng Shui approach. Heat up the room, lie down on your mat, stretch and breathe deeply. Then, try to create even balances in your traditional and Roth 401k's so that you will have a choice when you take withdrawals. During retirement, when you need a lot of money for a big purchase, it might be

better to draw that money out of a Roth and avoid taxes. In another year, you might not need much money because you are living on a sailboat and wind is cheap. You've also decided that it's fun to cook all your meals and fish a lot. In that case, it might be better to draw the minimal distribution from a traditional IRA because you would be in a low tax bracket.

### **Will income taxes go up in the future?**


People who claim to know this should take a minute and tell the CIA where Osama bin Laden is hiding or tell the environmentalists whether Global Warming is reversible.

### **Can I change my mind?**

Yes. You might decide to change your allocation to 100 percent Roth. If it seems too difficult to make it on the reduced current income, you can change back to traditional. There might be a month delay for the change to take effect depending on your pay cycle and the account custodian. You may have the option of dividing your contributions, say 50 percent to Roth and 50 percent to traditional.

### **What if I'm in a position to maximize my contributions?**

If you plan to maximize your retirement savings for 2006, one good option would be to save \$15,000 (or \$20,000 if you are 50 years old or older) in your traditional 401k at work and save \$4,000 (or \$5,000 if you are 50 years old or older) in your Roth IRA provided you are under the income limits of \$95,000 for singles and \$150,000 for married filing jointly. Remember, there are a number of different ways to piece this puzzle together depending on your personal circumstances.

If you would like to discuss the Roth vs. traditional issue further, or if you'd like to discuss our investment management services, please do not hesitate to call our office at (888) 644-7757. 

*Con Artist Stalking You - Cont. from Page 3*

Payphones Leaseback Scam. The SEC encourages investors to read their "Cyberspace" Alert before purchasing any investment product over the Internet. The payphone leaseback scam was hyped over the Internet and sold by insurance agents. A company named ETS sold unregistered securities in the form of investment contracts and promoted a massive fraudulent scheme that raised in excess of \$300 million from more than 10,000 investors. According to the SEC, "The investments involved the sale of payphones, which

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*Beware of relatives in the securities business offering stock tips or borrowing your money to invest in a hot tip.*

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were leased back from the investors in exchange for a fixed rate of return." In fact, the investment program was a Ponzi scheme. The main perpetrator, Charles E. Edwards, was sentenced to 13 years incarceration and ordered to pay restitution of \$320,397,837.

Foreclosure Scam. So long as the real estate market was sizzling hot, real estate scams were operating under the radar. With new investor money coming in the front door, previous investors were either paid off or given misleading financial statements. Atlanta-based Pinnacle Development Partners, LLC solicited investors with offers of 25 percent returns in 60 days. Pinnacle claimed that it was flipping foreclosed properties by refurbishing them and then selling them at big profits for investors. In October 2006, the SEC alleged that, in fact, without disclosure to investors, Pinnacle itself purchased property from third parties

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Con Artist Stalking You - Cont. from Page 6

and sold it to its investor partnerships at high mark-ups. The exorbitant returns promised to investors were generated by the respective partnership selling the property to other investor partnerships controlled by Pinnacle. Pinnacle collected more than \$30 million. Now in receivership, Pinnacle investors are still awaiting their money. A month earlier, in September 2006, when state regulators first began investigating, a Pinnacle spokesperson told the Atlanta Journal-Constitution, "We get an influx of phone calls every day from potential partners who want to partner with us...It gets really, really busy."

Stock mutual funds don't get many headlines. Bond mutual funds get even fewer headlines. And that's a good thing. 🍎

Discussing Risk...Portfolio Design - Cont. from Page 4

By managing portfolios in this manner, we manage risk for our clients as effectively as possible. We cannot insulate you from risk. Even stuffing dollars in your mattress does not shield you from risk – you lose purchasing power. But prudently allowing for certain risks in an attempt to mitigate others is the effective way to manage overall risk. We continually monitor the capital markets and refine our asset allocation models over time to ensure that our clients have portfolios that allow for the management of risk as it exists currently and will reasonable exist into the foreseeable future. Risk relationships do change. As I mentioned earlier, we have seen a greater degree of correlation of asset classes which tends to increase overall portfolio volatility. But on the other hand, we have also seen a reduction of

volatility across all asset classes which tends to decrease overall portfolio volatility. We will continue to evaluate the capital markets and prudently adjust our investment portfolios to ensure that risk levels are appropriately managed.

Choosing funds is only one part of the investment management process. Properly monitoring and evaluating portfolio risk is another. Performing one task without adequately performing the other is only doing part of the job and can lead to unexpected investment results – perhaps unexpected results of the ugly variety. We utilize a comprehensive investment management process incorporating two levels of evaluation and multiple investment managers to ensure that our clients receive the best risk-adjusted portfolios available. 🍎

## Our Managed 401k Program

For an annual fee of \$360, we will manage your Container Store 401k. This includes maintaining your account in one of our four Model Portfolios, making any changes throughout the year, and when appropriate, rebalancing your portfolio for you. With a disciplined, long-term investment strategy that has been successful for the past century, we feel this is a prudent way to manage your retirement assets while keeping your fees low. To sign up, please go to our website. Fill out the online form, and click the submit button to send your subscription request to us.

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