TARHEEL ADVISORS, LLC
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2010 Investment Outlook

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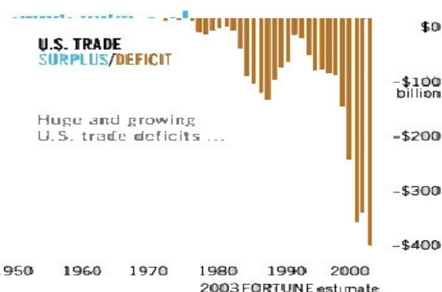
As 2009 closes it not only ends our fiscal year, but also a decade of incredible market turbulence. The Dow Jones Industrial Average closed December 31, 1999 at 11,497.12, and after one recession, one near depression, and two "recoveries" later, we find ourselves within earshot of this figure.

Now that 2010 is upon us, it is time for Tarheel Advisors to submit our investment outlook for the upcoming year. In creating this outlook, a great amount of time has been devoted to understanding the reasons for the economic collapse that has occurred over the past 3 years. To fully understand this wild decade of market fluctuations we need to start 40 years in the past.

Back Drop—Global trade and currency was backed in some shape or form by gold for centuries up until the 1970's. At that time, Nixon discontinued the practice of allowing US Dollars to be exchanged for gold reserves, and the world's many currencies moved onto a floating rate system instead of having their value pegged to a gold standard. As many remember, gold skyrocketed in value and the countries of the world began accepting the Dollar as their preferred reserve asset.

With the world's money supply no longer dependent upon finding new gold,, the global money supply exploded up 700% from 1969 to 1989 (it had only risen 55% in the 20 years prior). This vast world expansion of money supply continues today primarily due to the US policy of carrying massive trade deficits.



Too Many Dollars Chasing Too Few Opportunities—The never ending increase in global money supply has created a situation in which there is far too much money chasing not nearly enough global investment opportunities . The natural manifestation of this scenario has been the enormous investment bubbles we have seen repeatedly for the past 20 years .

The Financial Crisis of 2008 gave the world the opportunity to bring the money supply back into check by potentially knocking a large amount of deposits out of circulation. However, by governments stepping in and saving the banks internationally, the system looks fairly similar to the way it looked back in 2007; and more importantly, all that money is still floating around. While we may have staved off a 1930's style depression for the time being, there are certain to be continued unknown and unintended consequences for global markets.

2010 Predictions—While we do not pretend to have a perfect crystal ball, there are a few things we can predict with some certainty. First of all, with the world still flush with cash, it is a given that we will continue to see incredible asset bubbles across the globe. It is our opinion that these increases in asset prices are to be rented and not owned per se. Until the global imbalances of trade are corrected in some way or another, it will be impossible for capital markets to operate in ways that are conducive to traditional buy and hold Stock Market strategies.

Global markets have enjoyed more than a 60% run up in asset prices since March 2009. While we do not currently consider this a bubble, should these type of returns continue for much longer, we will be setting ourselves up for yet another market tumble. For 2010, we expect to see modest investment returns in equity assets across the board (5-10%) with a potential 10-20% pull back at any given time during the year. For this reason, we are recommending being overweight in high-quality fixed income, commodities, and companies that have diversified revenue streams not dependent on US discretionary consumer spending.

Until the next asset bubble occurs, and it will,, we do not foresee another great correction (i.e. 2008) in the markets. So, for the immediate future, continue to ride the wave of appreciation that is occurring in all asset classes, but ride with great caution.

-Ryan Glover, CFP®

2009 Market Wrap

S&P 500	**+24%**
DOW	**+20%**
NASDAQ	**+44%**
MSCI World	**+32%**

Mortgage Rates

15-Year	**4.6%**
30-Year	**5.3%**
5/1 ARM	**4.5%**

Did You Know?

*The first time home buyer tax credit has been extended until April 30, 2010. "Move up" buyers have also been added to the definition of taxpayers that may qualify for up to $6,500 in tax credits. A "move up" buyer is anyone who has used the home being sold or vacated as a principal residence for five consecutive years within the last eight.

*DB(k)s are a new retirement plan ushered in for 2010. They combine a pension and 401(k) into one plan for a small business with 500 employees or fewer.

Should I Convert to a Roth IRA?

Beginning in 2010, the IRS is expanding the eligibility for individuals to convert to a Roth IRA. As of January 1st, the $100,000 income limitation has been removed, Additionally, for 2010 only, you can report the conversion income on your 2011 and 2012 tax returns; thus spreading the tax burden over two years.

So, should I convert my traditional tax-deferred IRA to a Roth IRA? Well maybe; the answer is different for everyone. That being said, there are some important facts you should know to help make this decision.

Let's start with the basics. What exactly are the benefits of a Roth IRA? The biggest benefit of a Roth IRA is that your contributions are considered "post-tax" because you've already paid taxes on the money you invest in your account. Thus, any earnings on those contributions grow tax-free, and when you're ready to withdraw from your account you won't pay taxes again as long as you're at least 59½ years old and have had your account for at least five years.

Another major benefit is that Roth accounts, unlike Traditional 401(k)s and Traditional IRAs, don't require you to take minimum distributions starting at age 70½. You may choose to keep the assets within the Roth IRA indefinitely.

Now that we've established the benefits, let's talk about the criteria for who is a candidate to convert. Generally speaking, if you think you'll be in the same or a higher tax bracket when you retire, it's likely that the taxes you pay on the Roth conversion today would be less than the taxes you'd pay on Traditional IRA or 401(k) withdrawals during retirement. However, this rule of thumb does not take into account the often forgotten benefit of the partial conversion.

A full conversion, which requires you to report the entire conversion amount as income on your taxes, may end up bumping you deep into a higher federal tax bracket. If you get bumped to a slightly higher tax rate, such as from the 25% bracket into the 28% bracket, the conversion benefits might outweigh the difference in taxes. However, if the conversion causes you to move to a substantially higher tax rate, say from the 15% bracket to the 25% bracket, the increase in taxes owed could be substantial. By utilizing the number crunching ability of your accountant, it is often possible to use the partial conversion method to make sure you stay at or below certain income tax bracket thresholds.

Another common question we hear is "Will I need to sell and go to cash to convert to a Roth IRA?" The answer is No. You can convert your eligible retirement assets directly into a Roth IRA without going to cash investments first.

So, with the stock market still well below its previous highs, is this a good time to convert to a Roth? The decision to convert has little to do with the size of your portfolio, so no matter what effect the recent stock market fluctuations had on your portfolio, the market shouldn't dictate your decision. Instead, base your decision to convert on an objective assessment of your current tax and financial situation and your reasonable expectations for your future tax bracket. Remember, converting today means incurring a real and permanent tax liability now in hopes that it will pay off at some distant point in the future. Unfortunately, you won't know for sure if the conversion was the right move until you're ready to withdraw the money in retirement.

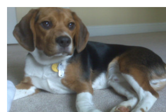
For more information on Roth IRAs and frequently asked questions about conversions, please visit our website at www.TarheelAdvisors.com/rothFAQ.htm. Or, if you would like to find out more about how a Roth IRA conversion might apply to your individual circumstances please feel free to contact us at the numbers listed below.

Walter Hinson, CFP®

Quick Myth: Dogs of the Dow

The "Dogs of the Dow" investment strategy is based on the notion that the stocks with the highest dividend yield will outperform their peers over the course of the year. As the theory goes, an investor should annually select the 10 Dow Jones Industrial Stocks whose dividend reflects the highest portion of their stock price. Why do this? The rationale behind the theory suggests that companies at the bottom of their earnings cycle will generally carry higher yields and should move higher as business conditions improve. So, how did the "Dogs" do in 2009? Last year's "Dogs" retuned on average a gain of 11%. Not too shabby, but when compared with the 20% gain for the full DOW 30, it doesn't appear the investment strategy added any value. Before we take a bite out of this Wall Street Myth based on 2009, it would be wise to note that back-tested data from Investopedia® confirms that from 1957-2003 the "Dogs" outperformed the Dow by 3% on average. With this information in hand, I don't think we can conclude anything other than it is certainly plausible, but not fool-proof. In case you are curious and wondering which company is the biggest "Dog" for 2010 — it's AT&T (T).

Walter Hinson, CFP®



Picture courteousy of Jackson Hinson

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