new Wealth advisors

December 2009

Separately Managed Accounts: Tailored to Suit You

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About New Wealth Advisors.

New Wealth Advisors is an independent, fee-only, SEC-registered investment advisor, operating as a multi-family investment office. We work with newly wealthy individuals and families to protect, grow and manage assets.

Mutual funds have been, and continue to be, a good solution for many investors seeking professional money management. But when you buy shares of a mutual fund, your assets are pooled with those of other fund shareholders. You gain professional money management, but the fund's manager certainly can't tailor its portfolio to meet your individual requirements.

For investors who want or need a more customized approach – for example, in order to better manage their tax liability or control individual stock holdings – separately managed accounts (SMAs) have become popular. Historically used by institutional investors and high-net-worth individuals, SMAs are now available to a wider group of investors as an alternative to mutual funds, though SMAs typically still require a higher minimum investment than a mutual fund might.

What is an SMA?

An SMA is a personal investment account that is customized and managed for you by one or more professional money managers. In an SMA, your assets are not comingled with those of other investors. With a mutual fund, you buy and sell shares of the fund. Even though each fund share represents a proportionate ownership of individual securities within the fund, your share of each of those securities is tiny. By contrast, you are the sole owner of each security within your separately managed account. You also can place securities you already own in an SMA; with mutual funds, you can't. As a result, you and your financial professional have more control over management of specific investments in an SMA.

Why is that control important? It increases your ability to coordinate the sale of specific securities with the rest of your overall financial plan.

It was once common for SMA programs to require a minimum of $1 million in investable assets, but today you can find separately managed accounts with minimums as low as $50,000. SMAs' lower minimums, along with a growing appreciation of their unique features, have led to their increasing popularity.

Is an SMA the same thing as a wrap account?

Both wrap accounts and SMAs charge fees based on the size of assets in the account, and the terms often are used interchangeably. However, with a wrap account, your financial professional may serve as the account's money manager, selecting individual securities or mutual funds for your portfolio. With an SMA, your financial professional may rely on a separate money manager (or multiple managers) to handle the day-to-day management of the portfolio or specific components of it. For example, with an SMA, you may be able to have a money manager who specializes in bonds manage that portion of the portfolio, while another manager who specializes in stock handles the equity portion. This approach is commonly used at New Wealth Advisors assuring that each component of your plan is managed by experts in each asset class.

How SMAs trump mutual funds on taxes

Mutual funds have an inherent lack of tax efficiency. When you buy shares of a mutual fund, you automatically get a share of its embedded tax liabilities. By law, mutual funds are required to pay out realized capital gains to all fund holders, regardless of how long you have held its shares.

For example, if you buy shares in a mutual fund right before a distribution date, you may receive a distribution and have to pay capital gains taxes even though you may have held the fund for only a short amount of time. The lack of tax efficiency can be a

greater problem for actively managed mutual funds that buy and sell securities frequently than it is for indexed mutual funds.

Also, some fund investors can find themselves owing income tax on their fund investment, even though the fund may have declined in value during the year. If a fund manager sells some of a fund's holdings at a profit but other holdings drop in value, the fund can have a capital gains distribution even though its overall net asset value is lower.

By contrast, each security held in an SMA has an individual cost basis. That allows you to make specific tax-motivated moves. For example, you can request that your manager sell a position with an unrealized loss in order to offset capital gains, thus reducing your income tax liability.

How SMAs compare with mutual funds on trading costs, fees, and performance

Unlike traditional brokerage accounts, which are commission based, SMA fee structures are asset-based. They typically cover the investment management fee, trading costs, custody, reporting, and financial planning services.

One thing to consider when comparing mutual fund expenses against SMA fees is the "invisible" trading costs incurred by mutual funds. Mutual fund expense ratios cover fund management fees, administrative costs, and other operating expenses. However, they don't cover trading costs, which include brokerage commissions whenever the fund buys or sells securities. Although these trading costs can vary significantly by mutual fund estimates of these costs range anywhere from .5% to 1%.

Separately managed accounts held roughly $605 billion in assets under management in the fall of 2008.

Source: Money Management Institute (September 2008)

Also, mutual funds often carry a certain amount of cash as a cushion in case they experience a wave of redemptions from investors. That cash can act as a drag on performance. If a fund has to sell securities to meet redemption demands, that also can affect its results. Though an SMA involves its own risks and doesn't automatically guarantee you'll have better returns, you don't have to worry about the impact of other investors' actions, because an SMA has no other investors.

Because of the different ways in which fees for mutual funds and separately managed accounts are calculated, it can be challenging to compare those fees. We can determine this for you, but generally speaking, the larger your account, the more likely you are to benefit from an SMA.

How SMAs can be customized for your specific situation

Another important feature of SMAs is their ability to allow you to exclude certain securities. You also can set sector guidelines to avoid investing in a sector you might disapprove of (for example, tobacco or casino stocks). This flexibility allows you to tailor your asset allocation for your own circumstances and desires – key considerations for many investors with concentrated stock positions.

However, don't expect to micromanage every single trade, as you might with a traditional brokerage account. Within the guidelines you set, the money manager typically will have discretion to implement strategies that he or she feels will provide the best returns for you. After all, if you want to make all the decisions yourself, it probably doesn't make sense to hire a professional money manager. However, you still have a great deal of flexibility to integrate those decisions with the rest of your financial concerns. And you'll always be able to track what has been bought and sold.

The bottom line

For investors who place a priority on control and tax efficiency, and have the necessary capital, an SMA program may make a lot of sense. Your team at New Wealth Advisors can help you determine if an SMA might be right for you.

Retirement Issues to Watch in 2010

Recent years have seen a flurry of legislation impacting retirement plans. Here are some of the more significant changes that take effect in 2010.

Nonspouse rollovers must be permitted

The Pension Protection Act of 2006 allowed, for the first time, nonspouse beneficiaries to make a direct rollover of inherited funds from an employer plan to an IRA. While the provision seemed fairly straightforward at the time, confusion arose as to whether plans were actually required to allow these rollovers. Congress addressed this in the Worker, Retiree, and Employer Recovery Act of 2008 – beginning in 2010, employer plans must let nonspouse beneficiaries make a direct rollover to an IRA if they so choose. The new law also clarified that prior to 2010 employer plans could, but were not required to, allow the rollovers.

IRA conversions for (almost) everyone!

Beginning in 2010, if you own a traditional IRA, you'll be able to convert it to a Roth IRA. The income limits and marital status requirements that previously applied to Roth conversions were repealed by the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA).

In addition, if you convert a traditional IRA to a Roth IRA in 2010, you'll be able to report half the income on your 2011 tax return and half on your 2012 return. Or, if it's to your benefit, you can instead elect to include the entire amount in income on your 2010 return. It's up to you.

If you inherit a traditional IRA from your spouse, and you elect to treat that IRA as your own, you'll also be able to convert the inherited IRA to a Roth IRA in 2010, regardless of your income or marital status.

Nonspouse beneficiaries, however, still can't convert an inherited traditional IRA to a Roth.

Note that the income limits for contributing to a Roth IRA haven't changed for 2010. If your income is high enough, your ability to make regular contributions to a Roth IRA in 2010 may be limited, or even eliminated. The ability to convert a traditional IRA to a Roth

without income limits, however, provides a potential workaround – you can make your annual contribution to a traditional IRA, and then immediately convert that traditional IRA to a Roth. You'll have to aggregate all your traditional IRAs when calculating the tax effect of the conversion, so speak with a financial professional first to make sure this strategy works for you.

Employer plan conversions for everyone!

Beginning in 2008, employees and beneficiaries were permitted for the first time to essentially "convert" employer plan distributions by rolling the funds over to a Roth IRA. This was allowed, however, only if the payee satisfied the income and marital status limits that applied to traditional IRA conversions. The elimination of those restrictions by TIPRA, described above, also applies to distributions from employer plans – so beginning in 2010, anyone who receives an eligible distribution of non-Roth funds from an employer plan can roll those funds over to a Roth IRA, regardless of income or marital status. This applies even to nonspouse beneficiaries – but only if the transfer to the IRA is done in a direct rollover.

While the special 2010 deferral rule described earlier doesn't apply to rollovers from employer plans to Roth IRAs, there's another potential workaround – you can simply roll your employer plan distribution over first to a traditional IRA, and then convert that traditional IRA to a Roth in 2010. (Again, however, you'll need to aggregate all your traditional IRAs to determine the tax consequences of the conversion, so first make sure this strategy works for you.)

Here comes the DB(k) …

Beginning in 2010, "small employers" (those that generally employ at least 2 and no more than 500 employees) can adopt a DB(k) plan – a single plan that incorporates both a 401(k) plan and a defined benefit plan (including a cash balance plan). A single trust is used, but there is separate accounting for the defined benefit and 401(k) portions of the plan.

The plan must meet certain benefit, contribution, vesting, and nondiscrimination requirements. In return, the plan will be exempt from top-heavy rules and certain 401(k) testing. Because the DB(k) plan is one plan instead of two, it is expected that the plan will be simpler to administer and less costly than maintaining two separate plans. This, in turn, may provide an incentive for employers to begin offering defined benefit plans to their employees in addition to 401(k) plans. Whether this proves to be the case, however, remains to be seen.

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ASK THE EXPERTS

What is a residence short sale?

A short sale occurs when a mortgage lender allows a borrower (the short seller) to accept a sale offer that is less than ("short") the balance due on the outstanding loan.

Lenders generally will consider this option only when (a) the market value of the home is less than the mortgage balances due, and (b) the borrower, having fallen behind on mortgage payments, has little hope of bringing the mortgage current even if it were modified. The lender expects the proceeds from the short sale will be greater than what could be expected in a foreclosure.

If the proceeds from the sale don't satisfy the total mortgage and/or lien balances due on the property, one or more deficiencies may occur. Short sellers should always find out (in writing) what will happen to any deficiencies. If a deficiency isn't forgiven, the lender may be able (depending on state law and how the mortgage note or lien is structured) to pursue the borrower for it.

Junior liens (e.g., second mortgages, home equity loans, or other liens) are not dissolved in short sales (as they are in foreclosures). As a result, either the short seller or the first lien holder may have to give some consideration (something as low as pennies on the dollar) to junior lien holders to satisfy their claims. The short seller should again get notification in writing of what will happen to any remaining deficiencies.

Forgiven deficiencies can have tax consequences; the IRS generally considers debt forgiven or cancelled by a lender to be taxable income. However, recent legislation allows (for calendar years 2007 through 2012) up to $2 million of forgiven debt ($1 million if married filing separately) to be excluded if the debt was incurred to purchase or improve a principal residence.

After completing a successful short sale, borrowers may be eligible to apply for a new mortgage on another home after two years; foreclosures require a five-year waiting period.

What is a deed-in-lieu of foreclosure?

In a deed-in-lieu of foreclosure (often referred to as a DIL), a mortgage lender allows a borrower to sign the deed over to the lender in exchange for relief from the obligation to repay the mortgage.

DILs are usually issued only if the value of the property is less than the indebtedness against it and the borrower no longer has the ability to pay the mortgage. Prior to accepting a DIL, a lender usually must be convinced the property cannot be sold (even by short sale) within a reasonable amount of time.

Lenders will generally accept a DIL only if the property has no other liens against it. Department of Housing and Urban Development (HUD) borrowers may receive up to $2,000 in compensation to discharge junior liens. (If none exist, the borrower may use the money for relocation expenses upon vacating the property.) And the Making Home Affordable program directs the U.S. Treasury to provide $1 for

ASK THE EXPERTS (CONTINUED)

every $2 paid by a lender toward the release of junior liens, up to a maximum contribution of $1,000.

HUD will accept DILs only on owner-occupied residences; the borrower must be one month or more delinquent on the mortgage. The DIL must be completed within six months of the date of default on the mortgage, or within 90 days of the failure of a special forbearance agreement or short sale attempt.

In most cases, a DIL agreement forgives a borrower of any obligation to repay a deficiency if all the conditions of the agreement have been met. Forgiven debt may be considered taxable income by the IRS. However, recent legislation allows (for calendar years 2007 through 2012) up to $2 million of forgiven debt ($1 million if married filing separately) to be excluded if the debt was incurred to purchase or improve a principal residence.

Homeowners who successfully complete a DIL are eligible to apply for a new mortgage four years after the execution of the DIL (two years if there are extenuating circumstances) and are required (for up to seven years) to provide a minimum 10% down payment. Foreclosures require a five-year waiting period.

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