



## In This Issue

[Top Up vs Bottom Down: A Current Tug of War](#)

[Retirement Plan Tax Benefits](#)

[Mail Bag](#)

### Top Up vs Bottom Down: A Current Tug of War:

On Thursday the 6<sup>th</sup> of May, the markets had a brief but violent down-turn followed by an equally quick rebound in what is being called the “Flash Crash”. If you are like me, you sometimes wonder how stock prices can change so much from day to day, not to mention how much they changed in these few minutes. After all, stock prices are supposed to represent a piece of a real company and all the shares put together should equal the real value of the whole company. The reality is that stock prices routinely change by 1% up or down daily. Businesses simply don’t change that fast. So, what causes such drastic volatility?

One answer might be the current tug-of-war between top down and bottom up approaches to investing. The “top down” school of thought focuses on macroeconomic and geo political issues to try and make determinations on which types of investments will do well in the current environment. In contrast, a “bottom up” approach focuses on a specific investment’s fundamentals and attempts to make an investment decision based on things like cash flow, management, return on equity and intrinsic value.

(Continued on page 2)

### Retirement Plan Tax Benefits:

When I was growing up there were only a few days of the year that really meant something special to me. Among those was my birthday, Christmas, the last day of school and the Super Bowl. Since then I have come to recognize a few other days like my anniversary, my family’s birthdays and, oh yeah, April 15<sup>th</sup>.

This year April 15<sup>th</sup> wasn’t as bad as it has been past years. This year, April 12<sup>th</sup> was bad (I finished my taxes early for once). I felt like the song in the movie Footloose “where have all the deductions (good men) gone?”

(Continued on page 2)

### Mail Bag:

I received the following in an e-mail from a 401(k) participant in March of 2010 (names blanked out) (Continued on page 4)



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## Cont—Top vs Bottom: A Current Tug of War:

Currently, “top down” investment management is concerned with several very negative situations like excessive European debt, the oil disaster in the gulf, high unemployment, a slowing Chinese economy and a number of government interventions such as financial regulation and health reform. Add to that the fear of surprise geopolitical events and you have a group of investors that are very much on the edge. On the flip side, many “bottom up” managers are seeing lots of great opportunities as companies report significant earnings growth, strong balance sheets and a pick-up in orders. These investors sometimes view macroeconomic problems as opportunities to buy high quality investments for good prices.

I don't know that I have ever seen a tug of war between these two schools of thought exceed that which is going on today. You can't watch CNBC for 30 minutes without hearing compelling arguments from both sides. On the one hand the world is coming to an end, inflation will rage out of control and everything but gold is going to pot. On the other hand, xyz coming has a new product that is increasing productivity, serving a growing market and that is selling like hot cakes. In the end, we don't need CNBC to tell us there is a tug of war, just look at the markets. It seems as though we are up or down triple digits nearly every day.

So what does all this mean to you? The answer to that may not be the same for everyone. Some investors can handle the volatility better than others. We say that your portfolio of investments is “SUITABLE” when it fits the objective, which includes your time horizon, risk tolerance level. If you want to discuss your situation review and your suitability point, give me a call.

## Cont—Retirement Plan Tax Benefits:

It seems like there are a lot of deductions that you only get if you do this or if you do that or if you earn that or less than that etc.etc. For example, I thought I was going to qualify for one of the housing tax credits because we bought a house in the summer. OOPS!, my bad, we needed to buy it after November. It's like the spelling rule with i and e. You know, i before e except after c or when sounding like A as in neighbor and weigh and in about a million other cases.

Thankfully, we still have good old qualified retirement plans, like 401(k)s. When you make a traditional contribution to your 401(k) plan it comes right off the top of your income. In fact, it actually reduces box 1 of your W-2. A lower box 1 on your W-2 could affect other tax items such as child tax credits, alternative minimum tax and other items.

When you make traditional (pre-tax) contributions to your 401(k) account, the money is taken out before you pay taxes. That means that if you choose to contribute \$100 traditionally to your 401(k) plan, your take-home check may only go down by \$70 or \$75. (Continued on page 3)

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[Top Up vs Bottom  
Down: A Current  
Tug of War](#)

[Retirement Plan  
Tax Benefits](#)

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## Cont—Retirement Plan Tax Benefits:

Depending on your income, there may even be additional tax advantages to 401(k) contributions. If you fall into the category of low income savers, you may be eligible for a tax credit of up to \$1000. You can go to the following link for details on “low income savers” : <http://www.research401k.com/401k-tax-credit.html> . Remember that a tax credit is much better than a tax deduction. A tax credit reduces your taxes (or increases your return) dollar for dollar while a tax deduction decreases your taxes at your personal marginal tax rate.

If a married couple earn a combined adjusted gross wage of \$50,000 and contribute \$2,000 to a 401k retirement plan (pre-tax contribution), then their net wage would be  $\$50,000 - \$2,000 = \$48,000$ . Their tax credit would therefore be:  $10\% \times \$2000 = \$200$ . Now let's assume that their employer matched 25 cents on the \$ up to 4% of their pay. That means that by contributing \$2,000 to their 401(k) plan they actually felt their take home pay go down by about \$1,500. However, they also received a \$200 tax credit at the end of the year and \$500 in match. All told, it cost them about \$1,300 to get \$2,500 in their 401(k) account.

You may be wondering how much you are allowed to contribute to a 401(k) plan. For 2010 you can contribute \$16,500. If you are over age 50, you can also make an additional “catch-up” contribution of \$5,500 for a total of \$22,000. Some plans limit your contribution to a certain percentage of your pay. While this is not common any more, you should consult your plan administrator for details.

You may also have heard about Roth contributions. In contrast to Traditional (pre-tax) contributions, Roth contributions are after tax. That means that you feel the full impact of the contribution today. In other words, if you contribute \$100 to your Roth 401(k), your net take home will go down by the full \$100. However, your Roth contributions will grow tax free and qualified withdrawals come out tax free at retirement. Low income savers will get the same tax credits whether they make Roth or Traditional contributions. To view a short instructional video on Roth contributions visit <http://united401k.acrobat.com/roth> .

Remember that this is not meant to be tax advice and that I am not a tax or legal advisor. You should consult your tax or legal advisor to see how contributions to your 401(k) account could affect your personal situation.

In conclusion, while taxes are complicated and deductions seem to have become a thing of the past, 401(k) plans are still available.

(Continued on page 4)

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## Cont—Retirement Plan Tax Benefits:

Traditional (pre-tax) contributions can reduce your taxable income now and offer long term retirement security. For some, choosing Roth contributions may offer a better long term alternative in exchange for a higher cost today. Either way, 401(k) plans offer a great way to save for retirement with a little help from Uncle Sam.

As always, if you have any questions on this topic or other questions o your 401(k) or even general retirement savings questions, please feel free to contact me via e-mail or phone.

## Cont—Mail Bag:

*Jere, I am trying to figure out what is going on in the markets. For now, I have left my new contributions buying growth investments. But, the way I am looking at it, soon taxes are going up, we have looming debt, possible hyperinflation, and world- wide natural and man- made disasters.*

*Response on Wall Street...rally to record highs. (This was before the recent downturn) Go figure? Once you figure this mess out Jere, please let \_\_\_\_\_ and I know.*

I replied with the following,

I too am often amazed at the market action given many of the conditions that exist right now in the US. However, remember that prices go up when demand goes up or supply goes down. In our current market, supply is hindered by people that refuse to part with their investments until they at least get back to even and demand is being supported by the fact that there is essentially no place else to go with bank and bond rates so low, the real estate market so volatile and the commodities markets so high.

In the end, I would lay out the progress of my investment knowledge and corresponding investment performance as the answer to your question.

1. At first, I didn't really understand the markets, the risks or the options available and my investment performance was good. In hindsight, I made decisions based on a few broad ideas that I did understand (like suitability and diversification) and occasionally took chances based somewhat on hunches.
  2. As I began to really understand the equation, I began to think that I knew what would happen. Of course, I made investment decisions based on what I felt I knew would happen. My additional knowledge actually interfered with my investment performance.
- (Continued on page 5)

## In This Issue

[Top Up vs Bottom Down: A Current Tug of War](#)

[Retirement Plan Tax Benefits](#)

[Mail Bag](#)



Cont—Mail Bag:

3. One day during the recovery of this downturn, I realized that “you always never know” what is going to happen. The definition of a market is one that requires an argument on both sides of a trade. The price is the result of the argument. When I look at \_\_\_\_\_’s account, I see investments that were made based on this philosophy. If you always never know, you should invest your 401k according to risk tolerance, time horizon, diversification, dollar cost averaging etc.

To me, that means that even though I think we may be in a market similar to the 70s where we are moving up in the face or tremendous economic headwinds only to potentially work are way all the back just to take another significant dip, the fact is that “we always don’t know”.

On 01/11/1973 the Dow closed at 1051 on 12/9/74 it closed at 579 (OUCH) on 03/24/76 it was back to 1,009 and on 03/01/1978 it closed at 743 (ouch again). What is the lesson to be learned? I don’t know what all the lessons are but one of them is that it closed over 11,000 in 1999. So I love the fact that you have kept new contributions buying stuff that has been down.

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