



Stephen Molyneaux

# Swine Influenza And Financial Markets

## An Acute Pandemic Could Pose Challenges To The Global Financial System

The only certainty regarding influenza is its lethal history. Each year, approximately 35,000 Americans die of influenza and its associated disease, pneumonia. The current swine flu (H1N1) is probably a descendant of the infamous Spanish flu of 1918 which killed between 50 and a 100 million people as it spread across the globe. The Spanish flu pandemic of 1918-1919 killed more people in 24 weeks than AIDS has killed in 24 years. (John Barry, *The Great Influenza*)

There has been great speculation about the recent strain of swine flu and how it may impact financial markets. We see three major concerns for investors:

- *The severity of the virus could roil financial markets.*
- *A severe pandemic may have economic ramifications which sparks a major sell-off.*
- *Stock selection and asset allocation could offer portfolio protection.*

Currently, the medical community is closely monitoring the spread of the H1N1 virus worldwide. No one can say with any degree of certainty how lethal a specific pandemic may become. The most recent pandemic in 1968 was nearly indistinguishable from any other typical annual flu outbreak, and ran its course virtually unnoticed.

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Frank Johnson, CFP

# Time To Convert Your IRA To A Roth IRA?

## Roth IRA May Offer Tax Benefit And Hedge Against Future Tax Increases

Now may be the time to consider moving all or a portion of your retirement funds from a traditional IRA to a Roth IRA. Anyone with a modified adjusted gross income of less than \$100,000 a year (individual or joint income) can convert their traditional IRA account to a Roth IRA. Higher-income investors are currently scheduled to receive the same option in 2010 under a provision of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA).

### Converting To A Roth IRA While Market Is Near Bottom May Offer Tremendous Tax Benefits

The big difference between a traditional IRA and a Roth IRA is in how they are taxed. With a traditional IRA, the investor is allowed to save money tax-deferred with deductible contributions until the investor begins to take withdrawals. Once the investor begins to withdraw money, the money is then taxed. Roth IRAs don't allow tax-deductible contributions, but they allow tax-free withdrawals of funds upon retirement. It is really a question of do you want to pay the tax on your retirement as you are funding it, or do you want to pay the tax on it when you are withdrawing the funds.

The reason you may want to consider converting your traditional IRA to a Roth IRA at the current time is

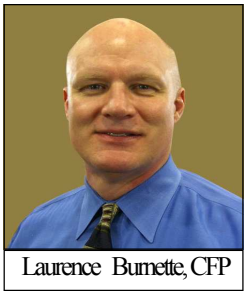
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### HIGHLIGHTS

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529 College Funds ..... Pg.2



Laurence Burnette, CFP

# Rebalancing Your 529 College Savings Plan

## - New Investment Options Offer Investors Wider Range Of Plans - Selecting The Correct Option Can Be Challenging

Hidden in the fine print and legalese at the bottom of every advertisement for 529 college savings plans includes the warning, "Accounts may lose value." Unfortunately, millions and millions of investors have discovered the hard way the warning can become a reality. As the stock market has suffered challenging losses in this brutal recession, families have watched their

stock based 529 college savings plans shrink along with the market. Many of these families may now be considering running for cover. A highly volatile stock market can unduly influence people to invest at extremes. To protect investors in the future from the volatility of the equities market, a growing number of states with 529 college plans intend to offer accounts that are insured by the FDIC. According to *Investment News*, Arizona, Ohio, Montana, Virginia and the latest state, Utah, have adopted FDIC-insured investment options such as savings accounts and certificates of deposit. Could your state's plan be next?

### The Terrible Performance Of Some 529 Plans In 2008 Illustrates The Importance Of Finding The Best 529

Before an investor makes a decision as regards 529 investment options, the investor should seek the advice of a financial adviser or tax expert. An investment professional can evaluate not only your 529 investments but your entire investment and savings situation to make sure you are not only doing the best for your college bound children, but for your retirement – which actually should be your first priority. After one of the worst market downturns since the Great Depression, now is actually a great starting point for this kind of advice.

Here are a few things to consider about more conservative investments in a 529 portfolio:

#### **Is a 1 or 2 percent return good enough for your time horizon?**

Yes, keeping your investment safe is a critical goal during a downturn, but how long do you have until your child needs the money and how close are you to your savings target? Investing for such an expensive goal takes a mixture of risk and caution. A mixture of equities and fixed-income investments are the best structure for these portfolios, but they bear watching in case of a downturn.

#### **CD flexibility is very limited:**

The attraction of investing in CDs is not only safety, but they also offer the ability to "ladder" (buying varying maturities) your investment into a number of CDs. Here is the problem - current rules for 529 savings plans allow investors only one investment change per calendar year. For 2009, the IRS made an exception and allowed two changes. So much for laddering! The strict regulation means you can not roll over funds from a matured CD into a new one more than twice a year. Some of the plans are devising ways to automatically roll over mature CDs into shorter-term investments as the funds meet their target date of use.

#### **Could rolling into more conservative investments now be a mistake?**

Knowing when a market bottoms out would guarantee riches. Investors have to have some exposure in the portfolio to the possibility of growth, even in these tough times. Rolling your investments into conservative waters may actually lock in losses of as much as 40 percent. It makes sense to get professional advice when contemplating such a move.

#### **Let the younger child's 529 pay for the older child's tuition:**

If your oldest child is ready to or has started college and you have more than one child and one 529 plan for each, consider using the cash in the younger child's plan to pay for the older child's tuition. This way the equity investments in the older child's plan have a chance to recoup their losses and pay for the younger child's tuition in future years.

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*This column is provided by Laurence C. Burnette, CFP, and a member of the Financial Planning Association.*



that there may be a great tax benefit. If your traditional IRA has suffered a significant loss in the recent downturn, you could convert part or all of your traditional IRA to a Roth IRA and you would pay tax on the new lower balance, and when the market recovers, as history shows it always does, and you recoup your losses, you would not have to pay any tax on the new higher balance of your Roth IRA.

**Example:** *Let us assume you are in the 25% tax bracket and you have a traditional IRA that had a \$150,000 balance at the beginning of the year that has since fallen to \$100,000. If you decided to do a full conversion to a Roth IRA at the current depressed stock prices you would be liable for \$25,000 to pay the tax bill, but owe no additional taxes when your new Roth IRA balance rebounds. If you keep your traditional IRA as it is and don't do a conversion, when the market rebounds and your IRA balance returns to its original value you will have a tax liability of \$37,500.*

Keep in mind, if you opt to do a conversion, you must pay income tax on the monies you are converting, and you may be pushed into a higher tax bracket. *It is imperative you consult a financial planner or tax advisor to consider the tax options and consequences of making a conversion.* Another reason to consider moving a portion of your retirement funds to a Roth IRA is to offset the possibility of any future tax increases. A Roth IRA may be used as a hedge against any future hikes in the tax code. By paying the tax at the time when you move from a traditional IRA to a Roth IRA, your retirement funds are protected from any future tax increases. Of course, if the lawmakers in Washington decide to lower future tax rates, then the traditional IRA would be a better retirement vehicle. Unfortunately, with the tax code in perpetual motion, it may be prudent for all investors to consider diversifying their retirement planning with additional hedging against the tax tinkering habits of Washington lawmakers.

Depending on the severity of a pandemic, the degree of public panic is difficult to quantify. Media sensationalism may fuel an already nervous citizenry with a constant barrage of impending doom. During an avian influenza scare in Indonesia, there was a national stock market sell-off triggered by a news story detailing the nation's first death due to bird flu. The same news stories precipitated minor sell-offs in other Asian markets as well. Panic is an emotional response, and trying to accurately predict how frightened people will react is not feasible.

If a severe, widespread virus emerges – there may be dire economic consequences. The gravity of any pandemic depends, among other things, on numerous variables: fatality rates, infection rates, length of recovery, geographical impacted areas, etc. While these pandemic variables make strategic planning nearly impossible, there are some assumptions we can make. Common sense dictates that the more severe the pandemic, the more dire the economic consequences, but attempting to offer a detailed portrait of any hypothetical pandemic is purely speculative. If the illness infects large swaths of the population, we would expect to see economic disruptions on the supply side due to high absenteeism.

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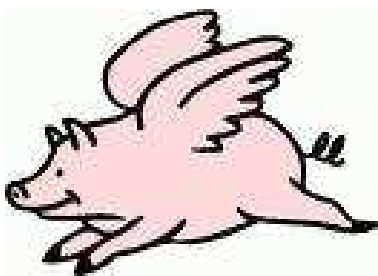


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infected rate of the company's employees.



Employee absenteeism would be multiplied well beyond just the healthy employees would also be absent due to a variety of factors: having to care for other sick family members, school closings, closure of daycare facilities, transportation disruptions, and a general fear of going to work for fear of becoming infected by their co-workers.

Wide-ranging absenteeism in the work place would translate into not only a tremendous drop in productivity, but also a steep decline in consumption as a large portion of the population remained at home in a self-imposed quarantine – consumer spending would plummet during this self-imposed worker's exile.

If the pandemic was severe enough, there is the possibility of official quarantines and social unrest. Public gatherings

**The World Bank Estimates A Level 6 Flu Pandemic Would Result In A 5% Drop In The Global GDP**

were outlawed in certain cities during the 1918 pandemic. The Mexican government outlawed many public venues during the latest swine flu outbreak. How useful any widespread quarantine would be in today's highly mobile, global community is a questionable matter – it is estimated that at any given time of day there are nearly 500,000 airline commuters crisscrossing the globe.

According to a recent report by the International Monetary Fund, an acute pandemic could pose challenges to the

**With 500,000 Commuters In The Air At Any Given Time - Containing A Global Pandemic Seems Unlikely**

global financial system. There would be an increase in risk-aversion and a large surge in demand for liquidity – especially cash and low-risk assets. This “flight to quality” may lead investors to seek the safety of the highest quality bonds, such as U.S. Treasuries. The cost to the overall economy could be staggering. The latest swine flu outbreak in Mexico is estimated to have cost Mexico City alone - \$57 million dollars a day just in lost revenue. The World Bank estimated in 2008 that a level 6 flu pandemic could cost \$3 trillion and result in a nearly 5% drop in world gross domestic product.

Stock selections in preparation for a possible pandemic would dictate the avoidance of most retailers, movie theater chains, airlines, and any other enterprise which would bring patrons in close proximity to others. Amid a severe pandemic, the general population will probably go to great lengths in avoiding any company or service which requires face-to-face interaction. In conclusion, a pandemic is not inevitable, and not all pandemics are highly lethal. Historical records and data are impossible to extrapolate into our sophisticated, contemporary world. The global community of 2009 has very little in common with the world of 1918, and any serious comparison between the Great Influenza of 1918 and a pandemic in 2009 is impossible to make – there are far too many variables. Investors should remain informed and keep abreast of the possible pitfalls an enormous public health calamity could have on their investments.

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