

---

# J.L. BAINBRIDGE

---

## & COMPANY, INC.

◆PROFESSIONAL MONEY MANAGEMENT◆

---

### 2010 MID-YEAR REPORT


#### INVESTMENT RESULTS

For the first half of 2010, J. L. Bainbridge & Company, Inc. experienced a -2.4% rate of return on all monies managed in its equity investment program. In conjunction with returns in its equity program for 1994, 1995, 1996, 1997, 1998, 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008 and 2009 returns of 10.2%, 38.4%, 20.3%, 23.2%, 29.9%, 5.6%, 16.9%, -3.2%, -8.5%, 13.8%, 14.6%, 5.1%, 13.3%, 3.8%, -36.7% and 34.9 respectively, a January 1, 1994 investment of \$250,000 has grown to a June 30, 2010 value of \$1,077,755. This equates to an increase of 331% over the past sixteen and one half years or 9.3% compounded annually. These results assume reinvestment of dividends and are after transaction costs and our management fee.

#### INVESTMENT REVIEW

The first half of 2010 ended in the same fashion as last year in that both years were at a high point in late April which was followed by a bout of selling in May and June. Specifically in 2010 our results in late April were +8.2% while the selling in May and June brought our return to -2.4% which is 4% better than the S&P 500. This selling in our view was an over-reaction to the financial crisis in Greece and concern that world economic growth is slowing. When considering Greece's economy is less than two percent of the Euro Zone's economy, their problems hardly portend the demise of Europe. As to the world economy, growth is slowing but overall the economic recovery is proceeding at a moderate pace. Although no one can predict the short-term market direction, our expectation is our program will end 2010 with a double digit return.

---



## INVESTMENT STRATEGY

As indicated above we do expect the world economy to continue to recover with the developing area of the globe growing at a fast pace. Relative to the mature economies of Europe and the United States, growth will be more sluggish with subdued consumer spending and a weak real-estate market. In this environment, our strategy is to avoid retail firms and companies with a significant portion of their business dependent on strong consumer demand. For example, we sold Target almost three years ago and recently sold Proctor & Gamble. On the other hand for years our strategy has been to focus on companies with strong positions in fast growing areas of the world. 3M Company is a good example. In 2009, 63% of revenue was generated from international markets. More importantly 29% was from emerging markets up from 17% only three years ago. In the first quarter of 2010 sales from these markets increased a remarkable 47%. 3M is also a leader in developing innovative new products that fuel growth in mature economies. For example 3M has been in the abrasives business for over one hundred years and some would conclude this is a mundane no growth business. However last year they introduced new abrasive products with a surface of tiny pyramids that last twice as long and smooth and shape metal twice as fast as previous products. Consequently, they have taken market share from competitors, and 3M is working hard to satisfy demand. Last week 3M projected second quarter revenue would increase 16% to 18% well above analyst's expectations of 9%, and their stock rose in a declining stock market.

## CONCLUSION

As indicated earlier, no one can forecast the stock market, and therefore attempting to time the market is not a successful investment program. What is an effective investment approach is to own companies that grow earnings and dividends at a double digit rate and are exceptionally strong financially. This has been our program since our firm was founded. However while this has been rewarding over time, we understand the negative market environment over the past ten years has been very difficult for clients as well as for us. However, over this period we achieved a total return of 39%, and our clients have been protected from the overall market decline in which many investors lost a major portion of their retirement savings. Be assured we will not deviate from our proven investment strategy and are confident much higher returns lie ahead. Regarding the past ten years, we are very appreciative of your patience and endurance.

## SPECIAL REPORT: ROTH CONVERSION

---

Beginning in 2010 the income limits to qualify for a conversion have been eliminated, and therefore many clients now have the opportunity to convert all or a portion of their regular IRA assets to a ROTH IRA. In addition, a conversion this year is more advantageous than will be the case in subsequent years because:

- The taxes that will be incurred can be paid over two years.
- Federal income tax rates will be higher beginning in 2011.

But considering the tax liability of converting is substantial, the advantages of a Roth over a regular IRA must be evaluated carefully. These advantages are:

- Both dividend and interest income and capital gains accrue tax free.
- There are no required minimum distributions after age 70½.
- All ROTH IRA distributions are tax free.
- ROTH IRAs inherited by a child or grandchild can be distributed tax free based on their life expectancy.

Based on our analysis, a conversion only makes sense for a client if their income tax rate is low or for a client that meets the following criteria:

- Clients with more money in regular IRAs than they will ever need.
- Clients that either are very near or past the age of 70 ½ where required minimum distributions begin.
- Clients must have the wherewithal to pay the tax liability with funds outside IRAs because using IRA money to pay taxes depletes the remaining IRA balance. This will never be overcome by the tax advantage of no required distributions from a ROTH IRA.

In essence the decision boils down to an estate planning issue in that the total value of the ROTH passes to the heirs tax free. Furthermore if more than ten years go by after the conversion before the death of both the owner and his or her spouse, the total value of the estate will be greater. And in addition, the value of the tax free ROTH would be at least double the regular IRA dependent upon the age of the IRA's owner at the time of the conversion. Assuming a \$500,000 conversion, a return of 8%, an after tax return of 5% and a tax rate of 41%, the following tables illustrate the worth of converting from an estate planning point of view:

*A person converting at age 70 would have an estate as shown below:*

| YEARS          | 10               | 15               | 20               |
|----------------|------------------|------------------|------------------|
| ROTH VALUE     | \$1,079,000      | \$1,586,000      | \$2,331,000      |
| REG. IRA VALUE | \$702,000        | \$765,000        | \$761,000        |
| RMD VALUE      | <u>\$230,000</u> | <u>\$452,000</u> | <u>\$790,000</u> |
| TOTAL          | \$932,000        | \$1,217,000      | \$1,551,000      |

*A person converting at age 80 would have an estate as show below:*

| YEARS          | 10               | 15               | 20               |
|----------------|------------------|------------------|------------------|
| ROTH VALUE     | \$1,079,000      | \$1,586,000      | \$2,331,000      |
| REG. IRA VALUE | \$543,000        | \$472,000        | \$336,000        |
| RMD VALUE      | <u>\$323,000</u> | <u>\$599,000</u> | <u>\$963,000</u> |
| TOTAL          | \$866,000        | \$1,071,000      | \$1,299,000      |

In both of the above examples the tax on the conversion is \$175,000. This is offset by the taxes saved on the required minimum distributions on the \$500,000 remaining in a regular IRA if these funds are not converted. In the first example the tax breakeven point is seventeen years and in the second example thirteen years. Considering the likelihood that either the IRA owner or his or her spouse would live this long is high, in most cases the conversion would be tax advantageous. The tax advantage would be greater if income tax rates are above our 41% assumption which is certainly possible considering the Federal deficit.

However the most important benefit is the size and tax free status of the ROTH passing to children and grandchildren. Minimum distributions, which begin the year the ROTH is inherited, are based on their life expectancy. For example, a child age 60, based on IRS tables, has a life expectancy of 24.2 years. Hence the ROTH could have 25 years of tax free distributions and 25 years of tax free accumulations of dividends, interest and capital gains. In this example, the first year's minimum distribution is 4.1%. This is a tremendous gift from Uncle Sam that should be considered carefully. In the event this option does not work for you, it could for your parents or grandparents. Considering the decision to convert is based on each individual's situation, we are readily available to meet and tailor our analysis to meet your estate planning objectives.

# ENHANCING CLIENTS' LIVES

---

At J.L. Bainbridge & Company, Inc. our business is dedicated to “enhancing clients’ lives” by providing long term professional money management service totally focused on helping clients finance their children’s education, build and preserve the resources for an enhanced retirement and achieve a meaningful higher standard of living.

The foundation of J.L. Bainbridge & Company, Inc.’s business philosophy is based on the full understanding that our future and success is completely dependent on client satisfaction and delivering to clients a consistent long term investment service of the highest level of quality, competence and integrity.

Our commitment to “enhancing clients’ lives” is a guiding light that governs our professional daily activities and demands every decision and action be assessed as to exposure to investment risk as well as the long term benefit to clients.

**J.L. BAINBRIDGE**  

---

**& COMPANY, INC.**

Managing more than \$250 million for over 700 clients nationwide.

VISIT OUR WEBSITE: [www.jlbainbridge.com](http://www.jlbainbridge.com)

---

(941) 365-3435 • (800) 899-5171 • 1582 MAIN STREET • SARASOTA, FLORIDA 34236