



Research & Guidance for the **INDIVIDUAL INVESTOR**

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High Debt, Low Growth | Breaking News

Excessive borrowing, slowing economic growth, and political divisions are presenting challenges for European leaders.

Source: McGraw-Hill Financial Communications

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Source: McGraw-Hill Financial Communications

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Source: McGraw-Hill Financial Communications

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High Debt, Low Growth

Source: McGraw-Hill Financial Communications

U.S. officials and investors are wondering whether continued economic turmoil in Europe will impact global growth and contribute to further stock declines in the United States.

Summary Points

- Excessive debt is limiting the ability of Greece, Italy, Spain, Portugal, and other countries within the euro zone to stimulate their economies.
- There is concern that crises in Europe could potentially impact the global economy and contribute to a double-dip recession in the United States.
- Investors may want to consider an allocation to blue chip stocks, careful evaluation of U.S. Treasury holdings, the trade-offs associated with excessive cash, and the benefits of tax-advantaged accounts.

Given signs of uncertainty in Europe, predictions about what will happen next are dominating the airwaves and cyberspace. Currently, no one really knows whether a European government will default, whether European officials will agree on a rescue plan, or the outcomes of other concerns that are being debated. But it is important to understand the main factors that are brewing in Europe and to take actions that can help you manage risk.

Growth Versus Debt

The situation in Europe has its roots in excessive government borrowing, slowing economic growth, and a lack of political consensus within the euro zone on a plan to assist financially distressed members. Specifically:

- In 2009, Greek officials announced that the government had spent heavily on public benefits and the country did not have the means to pay its debts. During the past two years, Greece has received a series of bailouts from the International Monetary Fund and the European Union, narrowly avoiding default earlier this year. Greece recently enacted additional austerity measures in advance of an October deadline to obtain \$11 billion in aid to remain afloat financially.¹
- Standard & Poor's lowered its long-term and short-term sovereign credit ratings on Italy from A+ to A, indicating the outlook for the country is negative.² An Italian austerity plan passed over the summer may not achieve the desired savings, according to Standard & Poor's, because Italy has a high tax burden and the country is facing weakening economic growth. The downgrade follows downgrades

to Greece, Ireland, and Portugal earlier this year.

- In April 2011, the International Monetary Fund and the European Union provided a 78-billion euro (\$106 billion) aid package to Portugal.³
- Spanish political leaders are discussing revival of a wealth tax in an attempt to convince potential lenders that the country will control deficits and reform its tax system. Unemployment in Spain was 20.1% in 2010, and Standard & Poor's anticipates economic growth of only 1.0% in 2012.⁴
- The French government recently reduced its forecast for 2011 economic growth from 2.25% to 1.75%. France also is implementing austerity measures in an attempt to retain its AAA credit rating. Moody's downgraded two large French banks, Societe General and Credit Agricole, because of their exposure to Greek debt.⁵
- Recent developments suggest that growth within the euro zone is slowing and, in certain instances, showing signs of contraction. The European Central Bank has lowered its economic forecast for the region, and a preliminary survey of purchasing managers registered the first decline since the euro zone began recovering from recession during the third quarter of 2009.⁶
- The United States and other countries are pressuring the European Central Bank to take quick action to increase the size of a rescue fund to stave off future defaults. Public opposition with Germany and northern euro zone members has raised questions about whether an agreement can be crafted soon enough to avert a Greek default.⁷
- U.S. officials and investors are wondering whether continued economic turmoil in Europe will impact global growth, contribute to further stock market declines, and prompt a dreaded double-dip recession on American shores.

What Investors Can Do

Creating a financial plan to deal with the situation in Europe is challenging because new developments surface every day. But that said, there are steps that may help you manage your financial risk:

- **Focus on blue chips.** During challenging economic times, large organizations frequently are better equipped than small companies to ride out an economic trough. Although there are no guarantees, large-cap companies also are more likely to pay dividends, which provide a return even when stock prices are in a slump. Look for companies with a history of ongoing or increasing dividends.
- **Re-evaluate your bond allocation.** Concerns about volatility have prompted many investors to flee the stock market in favor of U.S. Treasury securities. This money flow has bid up prices and driven yields below 2%. Given these low yields, it is difficult to earn a rate of return that exceeds inflation. Consider balancing your allocation to U.S. Treasury securities with other types of bonds with the goal of balancing risk and return.
- **Review real estate investment trusts (REITs).** Although the real estate market is in a slump in many geographic areas, REITs pay dividends, which are another source of potential return.
- **Capitalize on tax-advantaged accounts.** Individual retirement accounts and 529 college savings plans present tax benefits. You may want to maximize your use of these accounts when pursuing your long-term financial goals.
- **Understand the trade-offs of an excessive allocation to cash.** During difficult economic times, many investors believe cash is king. A short-term allocation to cash may be appropriate when searching for investment ideas, but a longer-term allocation may put you at risk of returns that are below the rate of inflation.
- **Manage your personal debt carefully.** The U.S. real estate crisis and developments regarding sovereign debt in Europe have pointed out the perils of owing more than you can pay. If you have a mortgage and you are able to refinance, consider whether doing so could limit your debt payments. A large mortgage, outsized college loans, excessive use of margin, credit cards, and other forms of debt could work against you if your circumstances change suddenly.

The world economy is navigating a period of uncertainty, and future investment trends may not become apparent for some time. In the meantime, finding appropriate strategies for balancing risk and return may help you stick with a plan when short-term events are challenging.

Investments in REITs are subject to the risks related to direct investment in real estate, such as real estate risk, regulatory risks, concentration risk, and diversification risk. ■

¹Source: *The New York Times*, "New Round of Measures for Austerity in Greece," September 21, 2011.

²Source: Standard & Poor's *MarketScope Advisor*, "The Test for Italy Is Yet to Come," September 20, 2011.

³Source: www.businessweek.com, "Portugal's BPI Says It Doesn't Plan to Tap EU-IMF Rescue Fund," September 23, 2011.

⁴Sources: *Financial Times*, "Spain Revives Wealth Tax Plan Amid Crisis," September 13, 2011; Standard & Poor's *CreditWeek*, "Slowing Growth in Europe Increases the Risk of a Double Dip," September 21, 2011.

⁵Source: www.reuters.com, "Analysis: Bank Woes Could Stymie France's Recovery," September 18, 2011.

⁶Source: *The Wall Street Journal*, "Euro-Zone Economy in Retreat," September 22, 2011.

⁷Source: *The Wall Street Journal*, "Europe Split on Rescue Plan," September 26, 2011.



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Market Recap for September 2011

Source: McGraw-Hill Financial Communications

A summary of market performance for September 2011

Volatility was September's defining theme, as each major U.S. equity index lost value despite a string of six consecutive winning days for the Dow Jones Industrial Average and S&P 500 in the middle of the month. Stock prices initially fell in anticipation of -- and reaction to -- the August U.S. Nonfarm Payrolls report, which was released September 2 and showed no new job growth during the month. The downward trend continued after Labor Day, with prices falling in three of four sessions during the holiday-shortened week. Key concerns included Europe's ongoing debt crisis, the potential for another U.S. recession, and policy comments by President Obama and Federal Reserve Chairman Bernanke that failed to inspire widespread optimism. Momentum then shifted, and stocks surged for a week as investors gained confidence that Greece and Italy were getting a better handle on their debt problems. However, Federal Reserve policymakers subsequently voiced concerns about the domestic economy and announced new steps to stimulate it, sending markets lower again. The sell-off was also fueled by a looming U.S. congressional stalemate over government funding and disappointing manufacturing reports coming out of China and Europe. Stocks were mixed in the final days of the month, and were ultimately unable to overcome earlier losses.

Through 9/30/11*	September	YTD	1-Year	3-Year	5-Year	Closing Value
S&P 500	-7.2%	-10.0%	-0.9%	-1.0%	-3.3%	1,131.42
Dow Jones Industrials	-6.0%	-5.7%	1.2%	0.2%	-1.3%	10,913.38
Nasdaq	-6.4%	-9.0%	2.0%	4.9%	1.4%	2,415.40

Composite						
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Source: Standard & Poor's. The S&P 500, Dow Jones Industrials, and Nasdaq Composite are unmanaged indices. It is not possible to invest directly in an index. Past performance is no guarantee of future results.

*Price only. Does not include dividends.

Fixed-income focus Treasuries continued to rally, with yields on 10-year government debt dropping from 2.19% at the end of August to 1.92% late in the day on September 30. Turbulence in the U.S. stock market and worries about the international economy helped boost demand for the safe-haven securities.

Mixed news on housing U.S. existing home sales jumped 7.7% to a 5.03 million-unit rate in August and a five-month high, the National Association of Realtors reported on September 21. Prices, however, dropped. The median existing home price fell to \$168,300 in August, from \$174,000 in July. On an annual basis, prices declined 5.1%. New home sales dropped for the fourth month in a row in August. Sales were down 2.3% from July's level, to a seasonally adjusted annual rate of 295,000 homes, according to a September 26 U.S. Census Bureau report. The median price of new houses sold was \$209,100, compared with \$222,000 in July. On an annual basis, prices were up 6.1%.

Uncertain outlook The Federal Open Market Committee's bleak announcement on September 21 wasn't a surprise to many market watchers. It essentially confirmed what investors already suspected: The outlook for the U.S. recovery has deteriorated. The immediate market sell-off that ensued pointed to a deeper fear that further Fed actions will not work. ■



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ETFs Turn Exotic

Source: McGraw-Hill Financial Communications

Investments that do not move in tandem with U.S. stocks present opportunities for diversification and potential performance enhancement.

Summary Points

- Exchange-traded funds (ETFs) are a convenient vehicle for accessing a variety of investments other than stocks.
- Alternative investments include hedge funds, commodities, derivatives, and real estate.
- In addition, there are alternative investment strategies that encompass short selling, arbitrage, leverage, and futures.

Of the top-selling ETF strategies to emerge on the scene in 2011, many present investors with choices other than U.S. equities. For instance, an ETF investing in Asian debt topped the list of launches with \$470.98 million in net flows as of June 30, while a managed futures strategy fund came in second with \$192.72 million in net assets.¹ Other funds making the top ten include an ETF investing in senior loans and a fund investing in real estate investment trusts (REITs).¹

What's behind investors' attraction to these more sophisticated, and in some cases more risky, investment choices? People are looking for something besides a plain vanilla fund, something that puts them outside the universe of U.S. Treasuries and domestic equities. They are looking to diversify their portfolios globally as well as thematically via commodities, emerging market debt, and hedging strategies such as managed futures. Managed futures funds invest in listed futures and options to benefit from expected trends in commodity prices, interest rates, or currency exchange markets.

What's driving investors' attraction to the exotic is a desire for investments that historically have not moved in tandem with U.S. stocks. This tendency to move (or not move) in tandem with another investment is measured by a statistic known as correlation. Although there are no guarantees, assets that historically have not moved in tandem with U.S. stocks could help to limit losses when U.S. stocks are in a slump.

Observed one industry analyst: "The alternatives theme is really resonating with people right now, and managed futures was one of the few hedge fund strategies that not only held up but also performed well during the global financial crisis."¹

Given the realities of today's financial markets, it is notable that investors are moving a bit out of their comfort zones in search of performance. That fact undoubtedly warms the hearts of ETF innovators who are busy targeting corners of the market that have thus far been

underrepresented.

What Makes an Investment "Alternative"?

Once exclusively the province of hedge funds and other institutional investors, alternative investments increasingly are becoming available to individuals. What alternative investments bring to the table is the opportunity for investors to gain exposure to an added layer of portfolio diversification and potential performance enhancement. The diversification and potential performance benefit stem both from the type of investment and from the strategy that an investment manager follows.

Alternative investments include hedge funds, commodities, derivatives, and real estate. In addition, investment managers also use innovative strategies, such as short selling, arbitrage, leverage, and futures, in an attempt to achieve a given objective.

- Short selling occurs when an investor borrows shares to sell, with the goal of buying them back later at a lower price and pocketing the difference. Investors short shares of a security when they believe the price will fall, although there is no guarantee this will happen.
- Arbitrage is an attempt to capitalize on market inefficiencies by simultaneously purchasing and selling an identical or similar investment on different markets or in different forms. Arbitrage is a difficult strategy to execute because market inefficiencies often are eliminated very quickly.
- Leverage involves use of borrowed funds to enhance returns. Examples of leverage include options, futures, and margin accounts.
- Futures contracts represent agreements between two parties to trade a commodity, financial instrument, or currency at a fixed price at some future date. Futures can be used to hedge against the risk of price moves or to profit from price speculation.

Managers using alternative strategies typically seek to generate returns that exceed or that do not move in tandem with a market benchmark.

Alternative investments and alternative investment strategies have gone mainstream. Widely available vehicles such as ETFs are among the most popular ways for investors to add this component to a portfolio.

Before investing in an ETF, be sure to carefully consider the fund's objectives, risks, charges, and expenses. For a prospectus containing this and other important information, please click on the prospectus link. Please read the prospectus carefully before investing. ETFs are baskets of securities that may track a sector-specific, country-specific, or a narrow/broad market index. ETFs trade on an exchange like a stock. ETFs are subject to risks similar to those of their underlying securities, including, but not limited to, market, sector, or industry risks, and those regarding short selling and margin account maintenance. Commission fees typically apply.

Diversification does not assure a profit or protect against loss.

Investments in REITs are subject to the risks related to direct investment in real estate, such as real estate risk, regulatory risks, concentration risk, and diversification risk.

Alternative investments -- These provide investors with exposure to markets and investment strategies that cannot be accessed through traditional fixed-income and equity markets (such as real estate, commodity, or natural resources). Investing in these investments is speculative, not suitable for all clients, and intended for experienced and sophisticated investors who are willing to bear the high economic risks of the investments. ■

¹Source: *Investment News*, "The top-selling ETF strategies? Investors seeking risk for reward," July 17, 2011.

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Long-Term Lens on Volatility

Source: McGraw-Hill Financial Communications

Volatility is likely to continue as the financial system undergoes a series of fundamental changes.

Summary Points

- A variety of issues have contributed to the market volatility of 2011, and investors may need to adopt more than one strategy when coping with it.
- Some observers believe that the financial system is undergoing fundamental changes that will contribute to heightened volatility for some time.
- Focusing on long-term financial goals may help investors avoid being distracted unduly by short-term events.

The list of factors driving the stock market's ups and downs during 2011 seems to grow all the time. Investors have witnessed a natural disaster in Japan, debt crises in the euro zone, persistently high unemployment, and Standard & Poor's downgrade of U.S. Treasury securities from AAA to AA+. Not to mention a housing market that has yet to recover from a multiyear slump.

There's no question that external events are influencing both the U.S. economy and investor perceptions about managing their assets. But when making decisions about your portfolio during 2011 and beyond, you do not necessarily have to be a victim to the news flow. Many market observers believe that the advent of high-speed trading, the growth of exchange-traded funds, and other developments within the financial system are causing changes that may not be understood for many years. In the meantime, high levels of volatility are likely to be the norm.¹ Creating a strategy to cope with it will not guarantee that your portfolio will not be affected, but you may be better prepared to deal with events now and in the future.

What Investors Can Do

When facing an uncertain market environment, consider the following strategies:

- Follow an investment plan based on your risk tolerance and time horizon. Many observers believe that the stock market's long-term direction is more important than day-to-day developments.
- Emphasize sector strategies that can help capitalize on short-term events while you remain invested in stocks. Given the recent volatility in Financials, Standard & Poor's recommends underweighting this sector.² In addition, investors may want to consider

underweighting value stocks in favor of growth stocks because financial stocks typically are in the value category.

- Consider overweighting the Consumer Staples and Utilities sectors, which outperformed the S&P 500 year-to-date as of September 12, 2011.
- Look for investment themes based on long-term trends. As an example, the aging of the global population will continue for some time. This trend could present opportunities for medical device companies, retailers, marketers of personal care products, insurers, pharmaceutical firms, and other industries that potentially benefit from this situation.³
- Consider an allocation to bonds. Prior to Standard & Poor's downgrade of U.S. Treasury securities in August 2011, many observers predicted that a downgrade would prompt investors to sell U.S. Treasury securities, causing their value to drop. But this scenario did not happen. Instead, stock market volatility induced many investors to seek perceived safety in U.S. Treasury securities, which caused their value to rise.⁴ Although there are no guarantees about what might happen in the future, the Federal Reserve's plan to keep interest rates low for another two years may help to stabilize the fixed-income market.
- Dig for dividends. The S&P 500 Dividend Aristocrats and the Dow Jones Select Dividend IndexSM track companies that have paid dividends or increased dividends over time. Many investors believe that a history of dividend payments is a sign of management's commitment to providing shareholders with a return. Note that dividends are not guaranteed, and companies can reduce or eliminate them to conserve cash.
- Contribute to tax-advantaged accounts such as IRAs. With a traditional IRA, investors at any level of income can make contributions and contributions may be tax deductible if you meet income thresholds established by the Internal Revenue Service (IRS). Required minimum distributions after age 70½ are taxable. With a Roth IRA, you must meet IRS income thresholds in order to contribute. RMDs are not mandated, and qualified distributions are tax-free. Learn more from IRS Publication 590 available at www.irs.gov.

Just as more than one issue is contributing to the volatility of 2011, you may need to rely on more than one strategy for managing volatility over time. Keeping focused on your long-term financial goals may make it easier to avoid short-term issues that could thwart your planning. ■

¹Source: *The New York Times*, "Market Swings Are Becoming New Standard," September 11, 2011.

²Source: Standard & Poor's, U.S. Investment Policy Committee Notes, September 14, 2011.

³Source: Standard & Poor's *MarketScope Advisor*, "Corporates Eye Silver Years Money," September 14, 2011.

⁴Source: McGraw-Hill Financial Communications, *Market Recap for August 2011*, September 1, 2011.



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Trading When Markets Go Haywire

Source: McGraw-Hill Financial Communications

Heightened volatility can magnify the risk associated with certain trading strategies.

Summary Points

- Establishing parameters for trading activity may be beneficial during periods of market volatility.
- Using stop orders may help to avoid outsized losses.
- Resizing your positions, engaging more often with smaller contract size, and adopting options strategies that take advantage of elevated volatilities may be viable approaches.

Periods of heightened market volatility often prompt traders to reassess their risk tolerance and trading strategies. If you have been wondering how to respond to the stock market's recent ups and downs, the following tips may be worth considering:

- **Make a Plan.** Setting parameters for your trading activity could reduce the chances that emotions will take over when the stock market has a bad day. These parameters could include entry points, exit points, the size of your financial commitment to a given security, and your willingness to hold positions overnight.
- **Set Limits on Losses.** Decide ahead of time the maximum that you are willing to lose on a position. If you lose the maximum, close your position and don't look back. You may want to consider stop orders, which permit you to set a floor at a particular price and will activate only if there is a drop below that price. Typical baseline prices for stop orders include purchase price, intraday high or low, or breakout support numbers. Stop orders may be used for almost any security, including equities, bonds, shares in exchange-traded funds, options, and others.
- **Reevaluate Existing Stop Orders.** Thresholds for existing stop orders need to be examined periodically during periods of extreme market volatility. A trigger price that is too close to the current trading range can be activated by daily volatility before market trends assert themselves. This situation can cause unnecessary sales and boost transaction costs significantly.
- **Consider Position Sizing.** Rather than purchasing 900 shares, it may make sense to purchase 300 shares at three different prices, using volatility to get a better price on each purchase and allowing you to assess in each case if that is the position you actually want. This also allows you to engage with the market more often, which will ultimately help give you a better understanding of the products you trade. Think of it like golfing, if you only swing occasionally, it may be rougher than those that swing the club more often.
- **Consider Put Options as a Hedging Strategy.** Purchasing a put option permits a buyer to sell a given number of shares of stock at a contracted exercise (strike) price. If the price of the stock rises, the buyer's loss is limited to the cost of the put option. If the stock

declines, you can put the stock to someone else at the strike price or sell the put and realize the profit. This uses much less money or margin than shorting a stock without the associated risks. Options trading involves risk, and it is important to make sure you have a solid understanding of options before trading these securities regularly.

There may be other approaches unique to your situation, but the suggestions presented here may help you deal with volatility over time. As you implement tactics that you prefer, be sure to do so with your risk tolerance in mind. ■

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Reversing a Roth IRA Conversion

Source: McGraw-Hill Financial Communications

If an investor converts from a traditional IRA to a Roth IRA and subsequently changes his or her mind, a process known as recharacterization reverses the conversion.

Summary Points

- A conversion from a traditional IRA to a Roth IRA can be reversed through a process known as recharacterization.
- Investors may want to consider recharacterizing if a conversion from a traditional IRA to a Roth IRA increases their marginal tax rate.
- Because recharacterization triggers a tax payment, investors considering this strategy may want to consult a tax professional to make sure they understand the tax issues.

As a volatile stock market continues its ups and downs, many investors facing losses are searching for appropriate strategies. Retirement investors may want to examine converting a traditional IRA to a Roth IRA, with the understanding that the conversion can be reversed if needed.

Why Now

Thanks to legislation that took effect in 2010, investors at any level of income can convert a traditional IRA to a Roth IRA. A choppy market can be an excellent time for those considering a conversion to take the plunge.

- A conversion triggers a tax bill on the amount of money that is converted, so a smaller account balance results in a smaller tax bite.
- Many observers believe that federal taxes are likely to increase in the years ahead as the federal government grapples with budget problems. Currently, qualified withdrawals from Roth IRAs after age 59½ are tax-free, which presents an important benefit for retirement investors.

Before deciding whether a conversion makes sense for you, make sure you understand the differences between a traditional IRA and a Roth IRA, which are explained in IRS Publication 590. Also consult an accountant to help you calculate the corresponding tax bill that may result from a Roth IRA conversion. Financial advisors usually recommend that taxes associated with a Roth IRA conversion be paid from assets outside of the Roth IRA account so as not to disrupt retirement savings.

There's a Redo

If you convert from a traditional IRA to a Roth IRA and you subsequently change your mind, you can move the assets back to a traditional IRA through a process known as recharacterization. TD Ameritrade can handle this transaction for you, and you will be required to file an amended tax return. There are several reasons why an investor who converts assets from a traditional IRA to a Roth IRA may want to consider a recharacterization, among them:

- The conversion from a traditional IRA to a Roth IRA may increase an investor's marginal tax rate. (Consulting a tax advisor in advance could help determine whether this situation applies to you.)
- The investor may not have enough cash on hand to pay the taxes.
- The investor may have changed his or her mind.

Note that the IRS does not specify these reasons. According to current tax rules, an investor does not need to present a reason for recharacterizing.

What You Need to Know

Recharacterization needs to be complete by the last date when federal taxes, including extensions, are due. This date is usually in mid-October of the following tax year. (For example, a Roth IRA conversion for the 2011 tax year needs to be recharacterized and an amended tax return filed by mid-October 2012.)

Some investors maintain multiple IRAs and undertake multiple recharacterizations as a tax management strategy. This process is very complex and should be undertaken with guidance from a tax professional. ■

¹Unless certain criteria are met, Roth IRA owners must be 59½ or older and have held the IRA for five years before tax-free withdrawals are permitted.



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Market volatility, volume, and system availability may delay account access and trade executions.

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