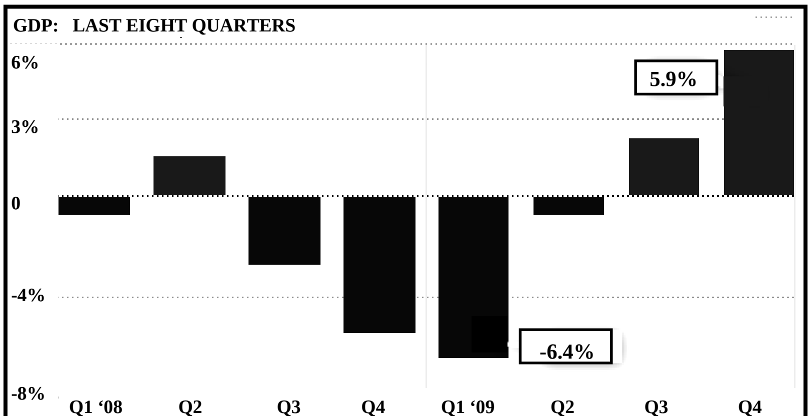
QCI ASSET MANAGEMENT, INC.

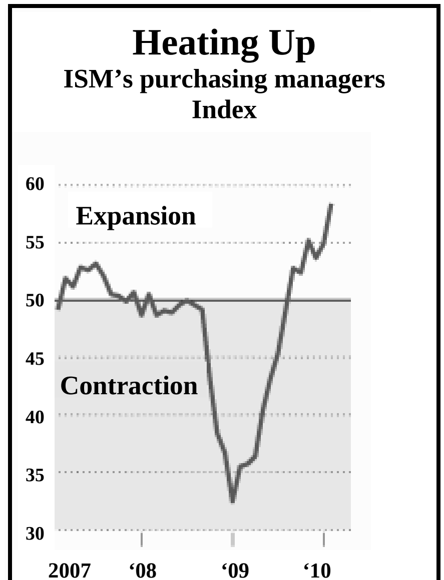
INVESTMENT UPDATE

Spring 2010

Economic Outlook



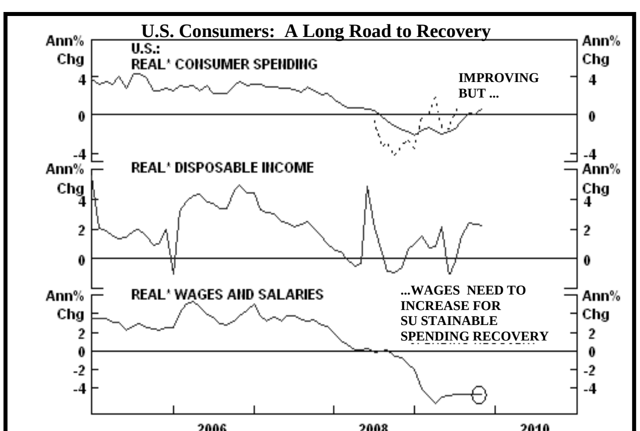
Seasonally Adjusted Annual Growth Rate
Source: Commerce Department, CNN.com



Source: Institute for Supply Management; wsj.com

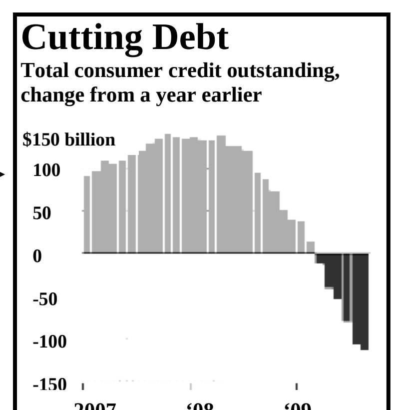
The global recession ended during the second half of 2009, and evidence of ongoing worldwide economic recovery continues to build in 2010. The economy has weathered the severe financial crisis of a year ago, and is slowly recovering, due in large part to the unprecedented monetary and fiscal stimulus that has been put in place. While economic conditions are improved from where they were in early 2009, long term problems - excessive debt/ongoing deleveraging, tight credit conditions, persisting high unemployment - remain. The cyclical recovery from the recent recession should, therefore, be subdued and drawn out versus prior recoveries, with downside risks to even subpar growth still present.

Economic recovery has arrived, but will remain subdued relative to past recoveries …..



*Deflated by Core PCE
Note: Dashed Line in Top Panel is 3-Month Rate of Change
Source: BCA Research 2009

Consumers are shrinking their debt loads … but still have a long way to go ...



Note: Seasonally adjusted
Source: Federal Reserve; wsj.com

2010 Conversion: Traditional IRA to Roth IRA—Yes or No?

Beginning in 2010, income limitations for Roth IRA conversions are eliminated, now providing many investors the opportunity to convert their traditional IRAs to Roth IRAs for the first time. Widespread press coverage, and extensive marketing/education campaigns from the financial services industry, have accompanied this major change in Roth IRA eligibility. Many investors with traditional IRAs are now asking themselves and their financial advisors: "Should I convert to a Roth IRA?"

BACKGROUND

- All traditional IRA owners may convert part or all of their IRA to a Roth IRA starting in 2010, with no income or marital status limitations.
  *Income-based limitations for contributions to Roth IRA's remain in effect in 2010.
- Converted IRA balances are subject to ordinary income tax liability upon conversion, at the taxpayer's prevailing/marginal tax rate.
- If conversion occurs in 2010:
  *Income taxes due on the conversion may be paid in 2010, or:
  * The IRA owner may split the income and tax liability generated by the conversion evenly between 2011 and 2012, at the taxpayer's option.
- Distributions from a Traditional IRA are generally taxed as ordinary income. "Qualified distributions" from a Roth IRA are tax-free, if the Roth IRA account existed for at least five years at distribution.
- Mandatory minimum required distribution from Traditional IRAs begins at age $70^{1/2}$. Roth IRAs have no minimum required distributions.

CONSIDERATIONS

- **"Pay me now, or pay me later":** prior to converting, taxpayers need to determine if they can pay the resulting income tax. If the tax bill can only be paid out of the converted IRA balance, the intended build-up of future tax-free earnings from converting the Roth IRA is diminished. Postponing the 2010 conversion's taxable event into 2011-2012 makes sense only if tax rates remain the same or are lower after 2010 - there can be no assurance on that - or if it is the only way the ultimate tax liability is affordable to the taxpayer.
- **Future earnings and tax rate assumptions:** owners of traditional IRAs who anticipate being in a higher tax bracket in retirement (due to assumed higher tax rates, or higher taxable income, or both) versus their current bracket may want to consider a Roth IRA conversion now, at the projected lower (2010) bracket. Conversely, those who anticipate their marginal tax bracket to be lower in retirement/withdrawal- due to assumed reduced taxable income during retirement - should probably avoid conversion. **Note**: accurate assumptions of applicable tax rates at various future time frames are needed to arrive at a definitive "yes or no" decision on conversion - this is a difficult assignment.
- **Time to distribution:** generally, the longer the time frame between Roth conversion and planned, tax-free withdrawals from the Roth IRA, the more advantageous the Roth conversion is now - due to the longer time for the account to grow tax-free.
- **Income tax rates and Roth IRA tax rules:** can we reasonably assume that these will not change in the future? If there are changes, will they be to our advantage or detriment, relative to having made a Roth IRA conversion now?
- **Estate planning considerations:** a Roth IRA conversion may make sense for traditional IRA balances that are unlikely to be needed by the original owner, who intends to leave that account to heirs - they will enjoy tax-free lifetime withdrawals upon inheritance. Conversely, a traditional IRA owner, who intends to leave an unneeded IRA account to charity or to younger heirs for their education, may find the existing IRA structure a more tax-efficient solution.

BOTTOM LINE: there is no "one-size-fits-all" answer to the Roth IRA conversion question. A case-by-case analysis with your professional advisors should be completed, prior to deciding on whether to make a partial or total conversion in 2010.

QCI Strategy

The stock market correctly anticipated the improving economy in 2009. After hitting cyclical lows in early 2009, stocks rallied dramatically through the rest of the year. The market-based indicators that we utilize, which were clearly "flashing green" during the depths of the market slide in early 2009, have now turned considerably more mixed/neutral, reflecting the dramatic stock market rally since March. Indicators of market momentum and investor sentiment are now suggesting caution, particularly in the short term. While equity valuations still do not appear stretched relative to the low yields available from cash and the bond market, much of the 2010 expected recovery in corporate profits appears priced into stocks at current levels. We expect stock price appreciation to pause/level out over upcoming months, as prices may be modestly ahead of underlying fundamentals at this point. Ongoing economic recovery and high levels of liquidity do provide a level of support against major downside risk.

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The corporate bond market substantially outperformed U.S. Governments in 2009 - the opposite outcome versus 2008. The historically wide yield spread/advantage to corporate in early 2009 has now narrowed considerably, but remains at an attractive level, given the current cyclical recovery. We are maintaining below-benchmark maturity in our tax-exempt bond portfolios given our concerns of reviving inflation with economic recovery, leading to upward interest rate pressures.

Municipal bond yields have also declined, both in absolute terms and relative to Treasury yields. Even so, they remain above their historic averages versus Treasuries, due in part to the challenges facing municipalities at all levels. In our Autumn 2009 newsletter we outlined the measures QCI has taken to protect muni bond portfolios in this environment. We continue to refine our approach as we move through the challenging period, and a comprehensive review of our current strategy is posted on our website, www.e-qci.com. **(Click on "QCI Media", within "Featured News", for article, "How Safe are Municipal Bonds?")**

CONGRATULATIONS TO TIM CALKINS, who passed Level III of the CFA exam, and has been awarded his Chartered Financial Analyst designation. Tim was recently promoted to Portfolio Manager/Senior Fixed Income Manager at QCI as well.

Tim joined QCI in 2002, after graduating from Canisius College. His primary responsibilities include fixed income research and trading, and portfolio management for taxable and tax-exempt fixed income portfolios.

Tim Calkins

Tim has been awarded his Chartered Financial Analyst designation and promoted to Portfolio Manager/Senior Fixed Income Manager.

Reminder: Maximum Benefit and Contribution Limits for 2010

Federal Estate Tax - Unified Credit

2010: Estate tax "repeal"; step-up in basis is limited to $1.3 million

2011: Estate tax "returns": $1,000,000 exemption; inflation-adjusted in future years

Annual Gift Tax Exclusion

2010: $13,000 per donee, per year

Phase-out MAGI Levels

Roth IRA Eligibility:

Roth IRA Conversions: MAGI limitations eliminated in 2010

IRA Deductibility Limits:

(with company pension)

Up to $66,000 MAGI (single)

Up to $109,000 MAGI (joint)

Social Security/FICA:

Taxable wage base: $106,800

Payroll tax rate: 6.20% (max. $6,622)

Medicare tax rate: 1.45% (with no limits)

401(k)/403(b) Plans

Maximum Deferral: $16,500

Over Age 50 catch up: $5,500

Maximum Annual Contribution: $49,000, or 100% of compensation

IRA limit: $5,000
(Up to 100% of earned income)

IRA catch-up: $1,000

SIMPLE limit: $11,500

SIMPLE catch-up: $2,500

Defined Benefit - Maximum Annual Benefit: $195,000

We're on the web: www.e-qci.com

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