Reinventing RETIREMENT

Your Retirement Planning Newsletter

First Quarter 2017

Back to the Future

What will work and life look like 30 years from now?

Thirty years ago, the sci-fi comedy Back to the Future sent its hero, Marty McFly, back in time to 1955 to meet his parents. We won't spoil the plot, but a good part of the movie's adventures involve helping Marty and his eccentric friend Doc find their way back to 1985.

In this issue of *Reinventing Retirement*, we look ahead 30 years to imagine how the future of work and life might differ from the past, and what impact this might have on your finances.

1. You'll likely work later in life, but fewer hours.

One in five of all Americans are working past age 65. That's the most older people with a job since the early 1960s. What's driving this trend? Some do it because they need the money, others because they like to stay active.[1] Sentiment also has been steadily shifting toward a shorter workweek.[2] A growing number of studies show that cutting back would actually improve productivity—and our quality of life.[3]

2. You'll probably enjoy greater work-life balance.

The percentage of women with young children who work is now 71.6%,[4] up from 45% in 1965.[5] With competing demands on time, both women and men are likely to gravitate to companies whose policies enable greater work-life balance. Plus, many of us are caring for aging parents, putting pressure on organizations to reshape their work structures.

3. You'll be able to explore multiple careers and learning opportunities.

With more free time, more of us will have the opportunity to switch careers, or create hybrid jobs based on our interests. You can see this trend reflected in the 33% increase in older students enrolling in distance learning courses between 2012 and 2014.[6] Career mobility and leisure time are also likely to increase as smarter machines continue to replace workers in certain job areas.

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1 Bloomberg.com http://www.bloomberg.com/news/articles/2016-05-13/-i-ll-never-retire-americans-break-record-for-working-past-65

2 Dorothy Sue Cobble, "The Future of Work: Shorter Hours, Higher Pay," Pacific Standard, August 20, 2015. https://psmag.com/the-future-of-work-shorter-hours-higher-pay-62643260b339#.gj10m9eiq

3 Brookings Institution. "Time for a shorter work week?" https://www.brookings.edu/opinions/time-for-a-shorter-work-week/

4 "Women in the labor force: a databook," BLS Reports (U.S. Bureau of Labor Statistics Report 1059: December 2015), p. 20. http://www.bls.gov/opub/reports/womens-databook/archive/women-in-the-labor-force-a-databook-2015.pdf

5 Suzanne Bianchi, Vanessa Wight and Sara Raley, "Maternal Employment and Family Caregiving: Rethinking Time with Children in the ATUS," Paper prepared for the ATUS Early Results Conference, Bethesda, MD, December 9, 2005.

6 Babson Survey Research Group, 2015 Survey of Online Learning. http://onlinelearningconsortium.org/news_item/babson-study-distance-education-enrollment-growth-continues-2/

Putting Mind Over Matter

Do investors rely on emotion when investing? Many behavioral economists and psychologists believe they do.

As much as we recognize the need to save, many small obstacles tend to get in the way. It turns out the decisions we make about financial matters are deeply rooted in emotion. For example, one often cited study shows that investor sentiment is most positive leading up to a peak of exuberance, then moves more negative on the way down before the pattern repeats.[8] Oddly enough, we feel the happiest when we are at the point of highest risk in the market (when markets approach or surpass previous highs) and most anxious when the upside is greatest (at or near market lows).

There's no single rule that neatly connects market volatility and investor behavior. But most psychologists agree that fear is stronger than greed. One theory developed by Daniel Kahneman, a Nobel-winning professor at Princeton University, suggests that our decision-making processes rely on intuition and relative-value judgment.

Professor Kahneman devised a series of experiments that illustrate that investor losses hurt more than gains feel good —the pain of losing $100, for example, was shown to be twice as great as the pleasure of winning the same amount.[9] This may help explain why we have a tendency to sell winning funds too early, and avoid losses altogether—even if it means choosing not to participate in potential gains.

That's why it's critical not only to have an investment plan that matches asset allocation to your objectives, time horizon and risk tolerance, but also to envision ahead of time how you might react to market ups and downs. Managing your emotions, and knowing how to remain flexible and resilient when times get tough, can help you weather inevitable financial storms that arise.

Back to the Future

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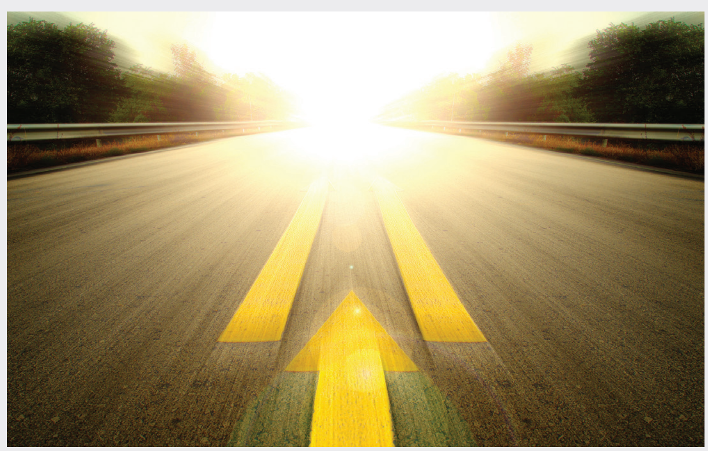
4. You'll have opportunities for gap years and sabbaticals between jobs.

According to Monster.com, 20% of employers now encourage their employees to take advantage of unpaid gap years and sabbaticals.[7] Progressive companies know that encouraging you to travel and explore the world can spark renewed creativity and energy.

As the workplace becomes more fluid, financial planning takes on new importance. No matter how the future looks, your savings likely will need to support changing workstyles, education expenses and gap-year experiences. When going back to the future, the key is not to limit your thinking for what's possible!



7 Source: Monster.com. https://www.monster.com/career-advice/article/take-a-sabbatical-without-derailing

8 "Cycle of Investor Emotions," Behavioural Finance, Barclays, 2006. https://wealth.barclays.com/en_gb/home/research/research-centre/white-papers/Behavioural-Finance/Cycle-of-investor-emotions.html

9 Kahneman, Daniel, and Amos Tversky. "Prospect Theory: An Analysis of Decision under Risk," Econometrica, XLVII (1979), 263-291.

Taking a Second Look at Actively Managed Funds

There may be a role in your portfolio for managers who use research, analysis and experience in making investment decisions.

For many investors, the debate between actively managed mutual funds and passive, or index funds appears to be settled: index investing has largely won, thanks to their lower fees that allow indexers to beat their managed fund counterparts most of the time.

Over a 10-year investment horizon, the majority of large-cap, mid-cap and small-cap fund managers failed to outperform their index benchmarks on a relative basis.[10]

Percentage of fund managers who fail to outperform their benchmarks

Large-Cap Managers	Mid-Cap Managers	Small-Cap Managers
82.1%	87.6%	88.4%

Source: S&P Dow Jones, SPIVA® U.S. Scorecard, Year-End 2015

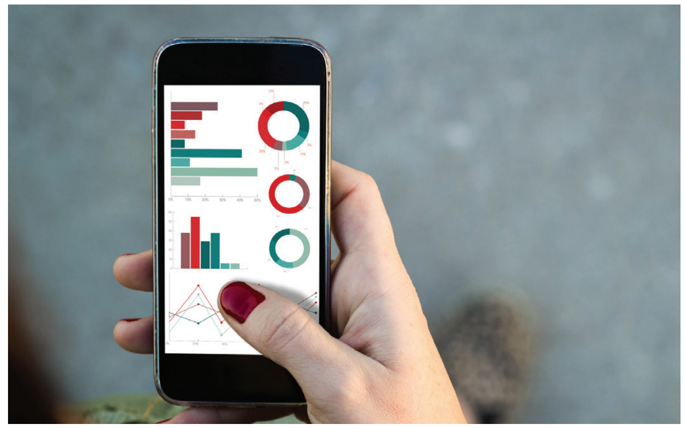
One reason for this performance gap is cost. Owning an index fund is generally much cheaper than an actively managed fund, and in order to compete, an active manager must overcome the drag of higher fees by handily beating the index. The SPIVA Scorecard above illustrates that few managers can do this year after year.

Is there a role for active managers in your portfolio?

Despite the cost advantage of indexed investments, some active funds have an edge in certain sectors.[11] While indexing generally works better for large-company stocks traded in highly efficient markets, a number of skilled active managers may be more effective in less well-covered pockets of the markets, such as small-cap companies, emerging markets and real estate investment trusts (REITs). Of course, all mutual funds, whether they are indexed or actively managed, are subject to market risk, including the possible loss of the money you invest.

That said, research shows that not all active managers are equal in two key respects. Truly skilled fund managers identify companies that the broader market misses, potentially helping them outperform. Experienced managers may also have another edge: They may be able to help investors manage risk in down markets by moving a part of their portfolios into cash before the market turns, and put those funds back into the market when investment conditions improve.

For those reasons, you may want to consider combining active and passive strategies in your retirement plan. What characteristics should you look for in an actively managed fund? Here are several guidelines to keep in mind:



- **Ignore short-term performance.** As the old saying goes, investing isn't a sprint, it's a marathon. Short-term performance is often driven by reaction to economic or geopolitical events that have little to do with the long-term performance of the companies you own in your account.
- **Make sure expenses are reasonable.** It's true that higher expenses in an underperforming fund can be a significant drag on your savings growth over time. But you shouldn't necessarily ignore a great fund just because it charges more.
- **Pay attention to risk-adjusted returns over the long term.** Standard deviation (which looks at how returns are spread around their average) is generally considered a good way to measure how much an investment moves up or down over time. The higher the standard deviation, the more risky the fund.
- **Seek managers who can clearly articulate a disciplined investment approach.** Don't invest in a fund you don't understand, or in a fund that deviates significantly from its stated strategy.
- **Pay attention to the culture of the management firm.** Lots of staff turnover at an investment firm usually signifies a level of internal discord, which can negatively impact long-term performance. Re-evaluate your fund selections if there's a manager change.

Investment styles fall in and out of favor. Although indexed-based approaches are currently hot and getting lots of media attention, some investors may wish to include some exposure to actively managed funds in certain asset classes — not only for their ability to control the risk of large losses, but also their potential to outpace the market.

10 Source: SPIVA® U.S. Scorecard, S&P Dow Jones Indices, Year-End 2015. Past performance is no guarantee of future results.

11 Jeff Brown, "Do Actively Managed Funds Really Pay Off for Investors?" U.S. News & World Report, April 14, 2016. http://money.usnews.com/investing/articles/2016-04-14/do-actively-managed-funds-really-pay-off-for-investors

Retirement in Motion

Tips and resources that everyone can use

Are Social Security benefits taxable?

According to the Social Security Administration, roughly four in 10 beneficiaries pay taxes on their benefits. If you receive income from other sources, such as wages or a 401(k), you're likely going to pay taxes on your benefits. If you file a joint return, and your combined income is below $32,000 in 2016, none of your benefits are taxable. For combined income totals between $32,000 and $44,000, as much as 50% of your benefits are subject to taxes; if it exceeds $44,000, as much as 85% of your benefits are subject to taxes. (Income thresholds are lower for individual filers.) An accountant or financial advisor may be able to help you devise strategies to lower the total taxes you owe.

Q&A

Can we use a 529 account to pay for graduate school?

Yes, withdrawals from 529 funds can be used to pay for qualified education expenses at grad schools tax-free. The account owner can also change the beneficiary of a 529 plan to any direct relative of the original beneficiary at any time, which preserves the 529 account's tax advantages if you have other family members you want to help send to college—or go back to school yourself!

Quarterly Reminder

Maxed out on your 401(k)? Add to your IRA

If you are contributing the maximum amount allowed in your 401(k), consider an individual retirement account (IRA) or Roth IRA. You can invest up to $5,500 in earned income to either plan for 2017 ($6,500 if you are age 50 or older). That contribution can be made until April 15, 2018, but the sooner the better. Note that there are certain income limits to be eligible to contribute to a Roth IRA, and the deductibility of a Traditional IRA depends on several factors. For details, visit irs.gov.

Tools & Techniques

Thinking of making a career or lifestyle change?

Life Reimagined, a service of AARP, has a number of online tools to help you figure out what you really want from life, in the areas of well-being, work and relationships. You can test drive the service with a 14-day free trial and a free 30-minute coaching session. Sign up at https://lifereimagined.aarp.org/.

Corner on the Market

Basic financial terms to know

Liquid net worth – The part of your net worth that can be easily turned into cash is your liquid net worth. (Net worth is generally all of your assets—what you own outright—less what you owe—on mortgages, credit cards, college debt and car loans.) Liquid net worth typically includes certain investments such as stocks, mutual funds and cash, but does not include assets that are not readily converted into cash, such as real estate or a car.

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