

reinventing retirement

Your Retirement Planning Newsletter

Third Quarter 2013

Lift Off for Retirement

Decades ago, workers could count on a company pension, Social Security and Medicare to carry them through retirement. Today's retirees may need to rely more on personal savings.

There's something powerful and serene about seeing hot air balloons rising in the morning stillness, their burners propelling colorful shapes into the atmosphere. Retirement is a lot like untethered flight—life's possibilities are limited only by your imagination and where the wind takes you. At one time you could count on lifts from a pension, Social Security and Medicare benefits, but you will likely need to rely more on your personal savings to fund your dreams once you retire.

Personal savings

57% of Americans report having less than \$25,000 in household savings and investments (excluding homes and defined benefit pensions, which mostly apply to public employees such as teachers and public safety workers).¹ This puts the odds of attaining retirement security at serious risk for most Americans.

The majority of workers can no longer rely on guaranteed lifetime retirement income from a private pension plan. Such plans cover fewer people each year. In 2012, only 18% of eligible private-sector workers could count on a pension, down from 35% in the early 1990s.²

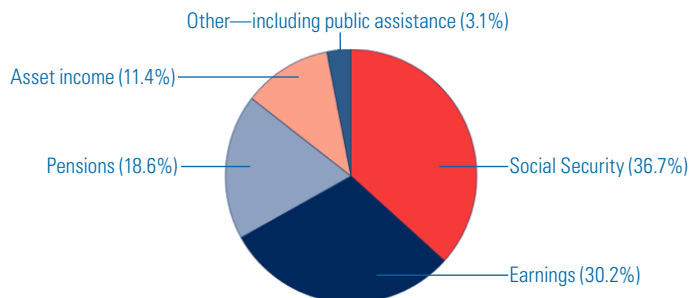
According to the Social Security Administration, most American retirees now fund more than 60% of their own retirement income.



Living within your means and saving more money, ideally in a tax-advantaged way, are tactics that will help your retirement lift off. That means reducing spending, increasing income or both. For most people, reducing spending is probably the most practical approach. Before cutting expenses, you should have some idea of where your money is going. Look through your bank statements and credit card bills. Note where the big spending items are concentrated: dining out, shopping, vacations and everything else. After you've gathered this information, you may be able to cut down on nonessentials—and start adding to your retirement plan.

Social Security

Originally envisioned as an economic safety net, Social Security was never meant to be a primary source of retirement income. Today, Social Security provides a diminishing source of income for the average American retiree, from a high of 42% of total retirement income in 1994 to 37% of total retirement income in 2010.



Source: Social Security Administration, *Income of the Aged Chartbook*, 2010. Released March 2012.

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Although no one knows how Social Security will evolve, it's likely that you'll draw less from it to fund your retirement. The rest will have to come from investment income, earnings and personal savings in your retirement plan.

Medicare

Healthcare expenses are increasing for one simple reason: America's population is aging, and older people tend to have more medical needs. Medicare today is generally regarded as solvent, but due to vast increases in numbers of retirees likely to enter the system over the next 10 to 20 years, it will likely need to be reformed. And, contrary to what some believe, Medicare is not free, and does not cover all healthcare costs. You may want to explore alternatives, such as contributing more to your retirement plan, or opening a Roth IRA or Health Savings Account, to help pay for increased healthcare costs.

It's possible that changes to government programs could lead to a reduction in future benefits. One of your best defenses against this may be to boost your savings contributions—and help your retirement take flight. ■

¹ Employee Benefit Research Institute and Mathew Greenwald & Associates, Inc., 2013 Retirement Confidence Survey, March 2013

² U.S. Bureau of Labor Statistics data, cited in "Private-sector coverage fell by half over two decades," Economic Policy Institute, online posting, January 11, 2013. <http://www.epi.org/blog/private-sector-pension-coverage-decline/>

The Not-So-Hidden Cost of Inflation

When Gladys retired from the phone company in 1997 at age 60, she was happy with her \$800-per-month pension and the \$1,200 per month she was earning from certificates of deposit. Her monthly expenses were about \$1,500, which left enough for an occasional trip.

Fifteen years later, Gladys is still collecting \$800 per month from her pension, but only \$900 a month in interest from her CDs. Her monthly living expenses now are \$2,400, and she has been dipping into her principal to cover the difference.

With 100% of her money invested without protection for the rising cost of living or decreasing interest rates, Gladys has reason to worry. Although she felt comfortable at the time she retired, she doesn't at age 75. And since she's in great health, she could live another 15 years.

Over longer time periods, the erosion in the buying power of your investment dollars can be as bad or worse than the effects of periodic market downturns. The risk to keeping all of your money in bonds or CDs is that it may not grow enough to meet inflation. Younger investors should pay close attention to the risk of generating low returns, but so should younger seniors, who may not be using a significant portion of their assets for a decade or more. You may wish to talk to a financial advisor to discover strategies that allow your savings returns to keep pace with or stay ahead of inflation. ■

The Big Three: Stocks, Bonds and Cash

Understanding the most basic tools of investing will help you gain more confidence in what you own in your retirement account

For those who are new to saving and investing, the investment world can be a minefield of jargon and confusion. Most retirement plans offer a dozen or more investment options, each sometimes invested in multiple securities. That said, even novices should take time to learn the basic building blocks of their portfolio: stocks, bonds and cash. Following is a quick introduction.

Stocks as ownership investments

If you want your money to grow and are comfortable with a bit of an up-and-down ride in the value of your investments, stocks may be right for you. Simply put, stocks represent shares of ownership in a company. If you're interested in sharing in the growth and profits of a particular company, you can purchase individual shares, either through a brokerage firm or directly from the company in some cases. As a shareholder, your investment value will fluctuate based on the current and future earnings of each company.

Of course, the companies you own can make lots of money or be unprofitable, and this may affect the value of your shares. (Sometimes even the stock prices of profitable companies can go down, for a host of reasons.) If you'd like to leave the stock picking to professionals, it may make sense

to buy a diversified basket of stocks in a stock mutual fund, rather than going through all the time and trouble of trying to pick individual stocks on your own.

Bonds as lending investments

Another major type of investment are those in which you lend your money. If you are like most people and keep some money in a bank—most likely in a checking account, but also in a savings account or in certificates of deposit (CDs)—you are lending your money to the bank, which in turn uses to make loans to homebuyers or businesses.

Bonds, also known as fixed income investments, are another type of a lending investment. When you buy a bond that has been issued by a government or by a company, you agree to lend your money for a set period of time and receive a specified rate of interest.³ A corporate bond can pay you 3% per year in interest over the next five years, for example. One of the risks to holding a bond is that the issuer may fail to pay you back the principal and interest due to you, which is called a “default.”

Instead of directly sharing in the ownership of a company, as with a stock, with bonds you are lending your money to an organization that will use it to meet business expenses, invest in new business opportunities (in the case of private corporations) or provide certain essential services (such as building highways or meeting the current obligations of the Federal Government). Typically, with bonds you do not share in profits generated by the money you lend to a company; you will simply be paid back your invested principal and any interest promised.

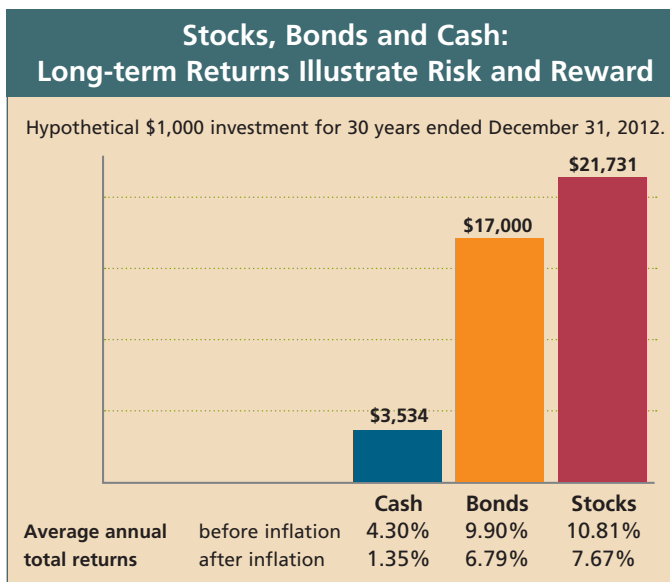
Cash equivalents

Cash equivalents are any investments that can be easily converted into cash without great cost. The loose change on your dresser or the money you extract from an ATM are examples of cash equivalents.

Money market mutual funds offered by your retirement plan are another form of cash equivalents. Money market funds generally invest in ultra-safe instruments such as short-term CDs, U.S. Treasury bills and securities issued by corporations with the best credit ratings.⁴ Although money market mutual funds are considered among the safest options available, they tend to pay very low rates of interest in exchange for that safety and security. ■



Over long time periods, stocks and bonds have produced attractive long-term returns relative to cash. However, when stock prices fall, investing more in bonds and cash may provide a useful cushion. Talk to your financial advisor to see what balance of stocks, bonds and cash might be right for you based upon your risk tolerance.



Source: Ibbotson — cash (U.S. Treasury Bills Index); bonds (Long-Term Corporate Bonds Index); stocks (Large Company Stocks Index). The indexes are unmanaged; you cannot invest directly in an index. Returns do not take into account the effects of taxes; if they had, returns would be lower.

³ Government bonds are not guaranteed. Their price and investment return will fluctuate with market conditions and interest rates. Bonds, when redeemed, may be worth more or less than their original cost.

⁴ Note that an investment in a money market fund is not insured or guaranteed by the FDIC or any other government agency. Although a money market fund seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in a money market fund.

retirement in motion

Tips and Resources that everyone can use

Boomers on the Brink

Issues affecting participants as they approach retirement

Consolidate accounts before you turn 70½

If you own several Traditional IRAs, SEPs or SIMPLE IRAs along with a qualified plan at work, you may want to consider consolidating them into one account before you turn 70½. That's the age when the IRS says you must begin taking required minimum distributions (RMDs). An RMD is the amount that qualified plan participants must begin distributing from their accounts by April 1 following the year they reach age 70½. The amount of the distribution is calculated by dividing the prior year-end fair market value of the account by the applicable distribution period or your life expectancy. Consolidating your accounts may make it easier to calculate your RMD.

Tools & Techniques

Resources to help guide your retirement plan

Charitable deductions

Americans are well known for their generosity, particularly when tragedies—such as Hurricane Sandy or

the Boston Marathon bombing—strike. But if you aren't careful about making sure the charity you are giving to is properly registered as a charitable organization, you could end up losing the tax deduction that the IRS offers for charitable donations. To check on the tax-exempt status of any organization, visit the IRS Exempt Organizations Select Check at www.irs.gov/Charities-&-Non-Profits/Exempt-Organizations-Select-Check.

Q & A

Common questions plan participants ask

Am I over-diversified?

Owning a mutual fund that invests in 200 companies doesn't necessarily mean it's properly diversified. Many mutual funds concentrate in certain sectors, so while owning a utility or real estate fund means you are probably well diversified within that industry, you are not as diversified as you could be by investing across various industries and sectors. Balanced funds may offer better risk protection, since they own 100 or more stocks across the broader market.⁵ Also, you should beware of owning two or more funds that invest in many of the same companies.

⁵ Diversification does not ensure a profit or protect against loss.

Quarterly Reminder

Catch up before year-end

If you will be age 50 or over at the end of 2013, if your plan allows, you are permitted to make catch-up contributions up to \$5,500 to a 401(k), 403(b) or governmental 457(b) plan. Catch-up contributions only kick in after you have exceeded the \$17,500 annual contribution limit in 2013 for these plans, or the plan limit (if any). This means that if your plan permits it, you can sock away a total of \$23,000 this year. Act quickly, though; catch-up contributions must be made by the end of the plan year. Check with your plan administrator for details.

Corner on the Market

Basic financial terms to know

Inflation

Inflation is the rate at which the general level for goods and services is rising and, subsequently, buying power is falling. For example, if the inflation rate is 2%, then a \$1.00 pack of gum will cost \$1.02 in a year.

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