

Retirement

YOUR RETIREMENT PLANNING NEWSLETTER

Feel The Magic

The magic associated with saving through your 401(k) is no illusion

The wonder of the vanishing tax

One of the most famous tricks performed by your 401(k) is tax savings. Below is a paycheck comparison for someone who makes an annual salary of \$30,000 and contributes 6% each year to their 401(k) account (\$1,800 per year), versus contributing that same amount to a taxable investment (such as a bank savings account). Check out the magic of before-tax saving:

	Before-tax savings account	After-tax savings account
Gross Annual Salary	\$30,000	\$30,000
Less: 401(k) Contribution (before-tax)	(\$1,800)	-0-
Taxable Pay	\$28,200	\$30,000
Less: Estimated Tax Withheld	(\$5,640)	(\$6,160)
Less: Contributions to Other Savings Account (after-tax)	-0-	(\$1,800)
Spendable Pay	\$22,560	\$22,040
Before-Tax Advantage	\$520	None

In this example, by saving before-tax in your 401(k) you would have **\$520 more in take-home pay each year!** That's because saving on a before-tax basis lowers your taxable income, which in turn lowers the amount of tax you pay each year. Another way to look at it is that you save \$1,800, but your net cost is really only \$1,280 (\$1,800 - \$520). Now that's some serious magic!

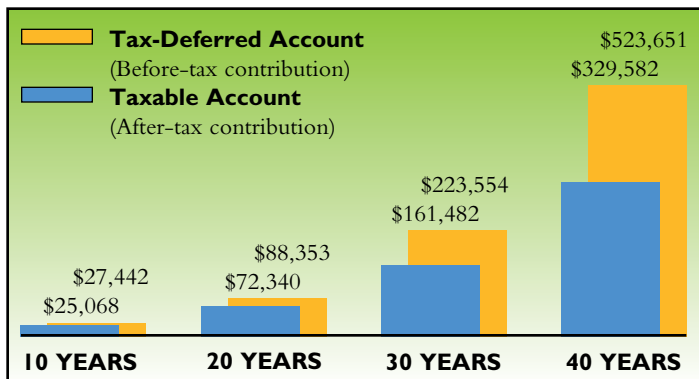
This hypothetical example assumes: 1) 2003 tax withholding rates for a single taxpayer; 2) 15% federal income tax withholding on the first \$28,400 of taxable income and 25% on the amount over \$28,400; 3) 5% state and local tax withholding. It does not account for Social Security/FICA taxes. Unlike bank savings accounts, 401(k) plans are not FDIC-insured and the underlying investments are subject to investment risks, including the possible loss of the principal amount invested.

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The mystery of the multiplying dollar bill

With tax-deferred saving, your contributions can grow without being reduced by current taxes—that means 100% of your money goes to work for you right away! And with the added benefit of compounding, earnings on all contributions are reinvested in your account, where they have the potential to keep growing. That’s no illusion—just another benefit of a well thought out, long-term investment strategy.

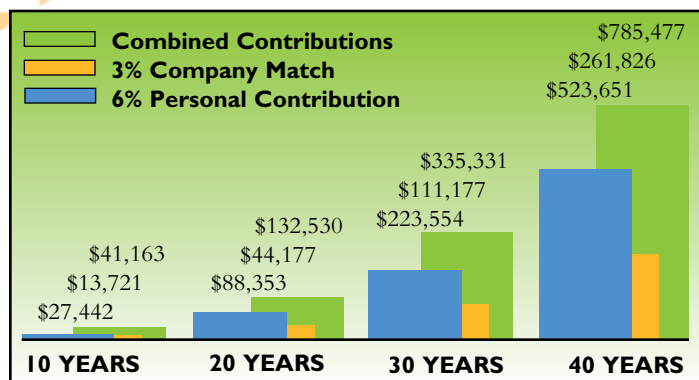
Let’s check out the potential growth for a person making an annual salary of \$30,000 and contributing 6% per year (\$1,800 per year) and compare it with the same contribution to a taxable investment (such as a bank savings account).



This is for illustration purposes only and assumes: 1) a hypothetical 8% annual rate of return (compounded monthly); 2) 2003 tax withholding rates for a single taxpayer; 3) 15% federal income tax withholding on the first \$28,400 of taxable income and 25% on the amount over \$28,400; 4) 5% state and local tax withholding. This hypothetical illustration is not intended to represent the actual performance of any particular security or investment plan, nor does it project or predict future investment results. Withdrawals from 401(k) plans are subject to ordinary taxes, and may be subject to an IRS penalty of 10% if you are under age 59 1/2. Unlike bank savings accounts, 401(k) plans are not FDIC-insured and the underlying investments are subject to investment risks, including the possible loss of the principal amount invested.

Magician’s assistant

Every good magician can use the help of an assistant. Taking full advantage of your company match (if offered) can help you really conjure up some long-term 401(k) savings growth. Not all plans are able to offer a match (especially during the tough economic times of the last few years, when many companies were forced to decrease or eliminate their match). If your company does offer a match, you should consider yourself very lucky to receive such a valuable benefit! Let’s take a look at the difference a typical company match can mean to a person making an annual salary of \$30,000. Assume the company match is 50% up to 6% of salary (the most common company match according to the Profit Sharing Council of America).



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Levitate your savings rate

Increasing your 401(k) contribution can make a big difference in your long-term savings plan! The chart below shows how just a small increase in your contribution level could mean thousands of dollars over time. All contribution amounts are based on a \$30,000 annual salary, and assume an 8% annual rate of return compounded monthly.

Contribution Increase	Savings After 10 Years	Savings After 20 Years	Savings After 30 Years	Savings After 40 Years
1% (\$25 monthly)	\$4,574	\$14,726	\$37,259	\$87,275
2% (\$50 monthly)	\$9,147	\$29,451	\$74,518	\$174,550
3% (\$75 monthly)	\$13,721	\$44,177	\$111,777	\$261,826
4% (\$100 monthly)	\$18,295	\$58,902	\$149,036	\$349,101
5% (\$125 monthly)	\$22,868	\$73,628	\$186,295	\$436,376
6% (\$150 monthly)	\$27,442	\$88,353	\$223,554	\$523,651

Magician’s Handbook

The Summary Plan Description contains the key information about your 401(k) plan

The truth is, the magic of saving through your 401(k) plan is really no secret. In fact, there’s a document that tells you how to perform all the “tricks.” It’s called a Summary Plan Description, or SPD for short. It’s a very informative piece of information that every 401(k) plan participant should review.

A brief overview

A Summary Plan Description is a summary of the key features of your 401(k) plan. The plan’s full rules are laid out in a longer report called the plan document, but that’s usually too unwieldy to distribute to employees. In short, all SPDs lay out plan rules such as:

- When you are eligible to participate
- The vesting schedule for employer-matching contributions (if applicable)
- The size and timing of the employer-matching contributions (if applicable)
- How to qualify for a loan and apply for and receive hardship withdrawals (if applicable)
- How to apply for a loan and interest rate calculations for loans (if applicable)
- Withdrawal procedures (at retirement and for rollovers)
- Employee contribution rates
- Your rights under the Employee Retirement Income Security Act (known as ERISA)
- Contact information of the plan sponsor and trustee and the plan identification number

The SPD can help you determine such things as what documentation you need to take out a loan or hardship withdrawal (if allowed), and how long it may take to receive your check. It is also a good reference tool for when you are about to retire or leave your job. It spells out the rules for getting your money.

Federal law requires employers to give you a copy of the SPD when you enroll in the plan. Your employer is also required to hand out new copies after five years if there are changes to the plan or after 10 years if there is no change. Many employers hand out updated copies more often than every five years, however, due to the many frequent changes to federal laws over the past few years.

Your employer is happy to let you see the SPD any time you ask. It’s always a good idea to review your plan’s features and benefits—after all, there’s real magic in there!

Paving the Way to a **BIGGER** 401(k)

The key to successful retirement planning is managing your debt wisely

When it comes to debt, what kind of shape are you in? Is your debt situation holding you back from increasing your 401(k) contribution? If so, you would be wise to get a handle on it. Until you do that, you're probably short-changing your retirement dreams in a big way.

One common measure for evaluating your debt situation is known as a debt-to-income ratio. Banks use this ratio to decide whether or not to lend money or extend credit. The ratio is fairly easy to determine and it can be calculated on a monthly or annual basis.

Here's how it works: Take your monthly debt payments (payments made to credit cards, car loans, etc.) and divide by your monthly income (before taxes). The resulting number, expressed as a percentage, is your monthly debt-to-income ratio.

What you need: checkbook register, copies of monthly bills and most recent pay stub.

Debt-to-income ratio example

<i>You pay out ...</i>	
Debt	Monthly Payment
Mortgage	\$750
Car loan	\$300
Visa	\$150
Department Store	\$75
Total Debt:	\$1,275

And you take in ...

Annual Gross Salary	\$35,000
Spouse's Salary	\$25,000
Alimony	0
Interest or Dividends	0
Other	0
Total	\$60,000
Divided by 12	÷ 12
Total Monthly Income	\$5,000

Your monthly debt-to-income ratio is: $\$1,275 \div \$5,000 = .255$ or **25.5%**.

Enter your own personal monthly debt-to-income ratio here: _____%

Evaluating Your Debt-to-Income Ratio

15% or less. You are in excellent financial shape if you have a mortgage. You are in fair shape if you don't have a mortgage.

16% to 20%. Some financial advisors consider 20% to be at the top of a healthy range for your debt-to-income ratio (if you have a mortgage). You should try to reduce your non-housing debt to no more than 10% and ultimately to 0%.

21% to 35%. Most Americans are in this range. You may be finding that the majority of your income is going to pay off your debt. At this level, your main goal should be to reduce debt (even before investing any savings you may have).

36% to 50%. This is excessive. You most likely are sacrificing all your short-term and long-term financial goals by carrying this much debt. You need to begin making smarter spending choices and perhaps stop carrying your credit cards with you. You are likely to not be approved for additional loans and may likely have trouble getting a mortgage loan.

51% or more. You need to seek the assistance of a credit counselor immediately.

Resources for help in managing debt

- National Center for Financial Education (www.nfce.org)
- American Savings and Education Council (www.asec.org)
- Debt Counselors of America (www.dca.org)
- Quicken Personal Finance Software (www.quicken.com)





Retirement in Motion

A REGULAR SPOTLIGHT
FOR PARTICIPANTS APPROACHING RETIREMENT

Get REAL

The Price Is Right

The Bureau of Labor Statistics Web site features an Inflation Calculator that can give you a good idea of how inflation will affect your future buying power. Go to <http://data.bls.gov/cgi-bin/cpicalc.pl>

Back in 1970, the price of a candy bar was about 25 cents. In the 1980s, that same candy bar cost around 50 cents. Now, you can't get near a vending machine for much less than a dollar! That's known as the power of inflation, which is the gradual rise in consumer prices over time. Because of inflation, a dollar is worth more today than it will be in the future. Whether you are close to retirement or a long way off, inflation is something you definitely want to understand and manage.

When it comes to investing, inflation is the difference between your actual rate of return and your **real rate of return**. The fact is, most people are probably not earning as much as they think on stock funds and other investments. That's because they forget to factor inflation into the equation. You can determine your real rate of return by subtracting out the inflation rate from the rate of return you're earning. For example, if the actual rate of return on your stock fund is 10%, and the inflation rate is 4%, then your real rate of return is only 6%. Inflation has eaten away 4% of your investment income:

Figuring Your Real Rate of Return

10% Actual Return on Stock Fund
- *4% Assumed Inflation Rate*
= *6% Real Rate of Return*

Everything you wanted to know about inflation—but were afraid to ask!

The federal government has several ways to measure inflation. The most common

is the Consumer Price Index (CPI). The CPI measures the average change over time in the prices paid by urban consumers for what is called a market basket of consumer goods and services. The government announces the CPI every month.

The CPI measures how prices have changed since 1982–84. According to the Bureau of Labor Statistics, the CPI in September 2003 was 185.2, which means that by the end of September 2003, prices had increased by 85.2% over price levels set in the mid-1980s. In addition, the CPI in September 2003 was 2.3% higher than the CPI for September 2002. This represents a period of time when inflation was held relatively low compared to the historical average. Other periods, such as the 1970s, experienced double-digit inflation rates. According to Ibbotson, inflation has averaged 3.1% from December 31, 1925 through December 31, 2002.

Inflation and your retirement income

A good way to measure the impact of

inflation on your future purchasing power is to use the **Rule of 72**. Here's how it works: Divide 72 by the inflation rate and this will tell you how many years it will take for costs to double. For example, if the inflation rate is 4%, an item that costs \$25 today will cost \$50 in **18 years** (72 divided by 4 equals 18). Taking the Rule of 72 one step further, that means that the price of many things will most likely double during your 20+ years in retirement—including everyday "retired life" things such as groceries, cruises, a round of golf and gasoline.

You'll want to keep track of how inflation affects your Social Security and any pension income that you anticipate receiving.

The annual Social Security Cost of Living Adjustment (COLA) will help your benefits keep pace with inflation. But pension benefits are not usually adjusted for inflation.

Since most people can expect to spend 20 years or more in retirement, you should consider an investment strategy that will help you stay ahead of inflation during this life stage. Consider investments such as stocks that have a history of beating inflation over the long term. In addition, inflation-indexed Treasury Securities may be a sensible alternative. Inflation-indexed Series I Savings Bonds from the U.S. Treasury are guaranteed to provide returns over and above the rate of inflation for up to 30 years. Be sure to consult with a financial advisor as you begin to develop a post-retirement investment strategy.