REINVENTING Retirement
YOUR RETIREMENT PLANNING NEWSLETTER
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# Bubble-Proof
## Your Financial Life

Financial bubbles may be a fact of life. Recent ones include the technology or dot-com bubble of the late 1990s and the U.S. housing bubble of the mid-2000s, which led to the credit crisis of 2007-2009. Why do bubbles happen? And what can you do to protect yourself against them?

Financial bubbles are nothing new. In fact, they've been around for hundreds of years, dating back to speculative trading of Dutch tulip bulbs in 1637. (See Financial Bubbles: History Repeats Itself on page 2.) By definition, bubbles are unsustainable. They eventually pop when greed, speculation, wishful thinking and irrationality are replaced by common sense. Then fear rises as expectations and prices came back down to earth. What soars eventually crashes and investors can get burned.

### Why bubbles happen

Although Dutch tulip bulbs don't seem to have much in common with U.S. technology stocks or residential real estate, two common elements fuel financial bubbles. One is too much liquidity, and an imbalance between supply and demand in financial markets. The other is behavioral finance—a mix of economics and human nature/psychology.

When too much money is available, it tends to chase popular assets, and it can drive their prices well above their fundamental values. Although the Federal Reserve and other countries' central banks have an important role to play in preventing or easing economic recessions by stimulating growth, they face the risk of creating too much liquidity. By lowering interest rates and increasing the supply of money in the economy, the Fed can contribute to a situation where too much demand drives the price of an asset too high.

Human nature can add to the problem. When people see assets—such as stocks and real estate—skyrocket in value, they may morph from investors to speculators. In the heat of the moment, it's easy to get caught up in the excitement about an asset that has doubled in value in just a year, for instance, whether it's stocks, real estate, commodities, fine art or tulip bulbs. When the herd is stampeding, it's hard to just stand and watch it go by, confident in your conviction that this is just a temporary bubble.

### Who's the greater fool?

Bubbles can be explained through the "greater fool theory": When trying to make money by buying and selling securities such as stocks, it doesn't matter whether they are overvalued or not, as long as you can sell them to someone else, a "greater fool" who is willing to pay an even higher price.

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When the bubble eventually bursts, whoever is unlucky enough, or foolish enough, to be holding the assets is the greater fool. When people focus on finding a greater fool instead of analyzing a stock's—or other security's—value, the market could be in a bubble.

### Can we prevent the next bubble?

Probably not. At least that's what former Federal Reserve Chairman Alan Greenspan wrote recently in a 48-page paper, "The Crisis," which looked back at lessons learned from the credit crisis. Greenspan, who famously warned of "irrational exuberance" in December 1996, more than three years before the technology bubble popped, wrote: "Unless there is a societal choice to abandon dynamic markets and leverage for some form of central planning, I fear that preventing bubbles will in the end turn out to be infeasible. Assuaging their aftermath seems the best we can hope for."[1]

We probably can't stop bubbles from occurring entirely. But we can understand them and individuals can try to protect themselves against being hurt by them.

### Ten ways to help protect yourself against bubbles:

1) **Keep your debt levels manageable.**
2) **Lower your monthly financial obligations:** Refinance your mortgage loan to lower your payments. Separate your needs from your wants. Live within your means.
3) **Use payroll deduction or a similar automatic investment or payment plan** to automate certain financial activities, such as retirement plan contributions, college savings, or bill payments.
4) **Diversify your assets broadly**, including your investment style as well as the actual holdings. The lower the correlation of your assets, the greater the chance that some will rise while others decline in value.
5) **Know your risk tolerance and respect it.** (See Tools & Techniques in Retirement in Motion on page 4.) By staying within your risk comfort zone, you can limit the danger of being burned by chasing an asset that is dangerously hot.
6) **Learn to say no.** Let's assume you are still (or once again) able to borrow money too loosely. Just because you are approved or prequalified for a loan, large mortgage or credit card doesn't mean it is wise or prudent to take it. (See Tip #1 above.)
7) **Weigh risk against reward.** Seek to be compensated sufficiently for accepting a higher level of risk. As a stock rises in price, a steadying factor such as its dividend can decrease as a percentage of its value. In that case, investors are being paid less to accept rising risk levels.
8) **Be on the lookout for potential bubbles.** Be skeptical about hot investments and financial trends that seem irrational and highly unusual.
9) **Don't ever accept the infamous words, "It's different this time."** It probably isn't. Instead, remember these words: Once burned, lesson learned.
10) **Work with a financial advisor** to benefit from professional guidance and to try to maintain a steady, disciplined, strategic approach to your personal finances.

## Financial Bubbles:
### *History Repeats Itself*

Some of the more famous—or infamous—historical bubbles include:

- **Holland's Tulip Mania in 1637:** Tulip bulbs traded on Dutch stock exchanges. At the height of the bubble, a rare tulip bulb was valued at several times the average person's annual salary.
- **The U.K.-based South Sea Company bubble in 1720:** The company's shares soared, driven by rumors and speculation, before they plummeted. Thousands of people lost their life savings.
- **In the technology bubble of the late 1990s**, start-up companies that had yet to produce earnings traded at such high prices that their market capitalizations (share price times number of issued shares) dwarfed large, well-known companies.

1 *Greenspan Concedes That the Fed Failed to Gauge the Bubble http://www.nytimes.com/2010/03/19/business/economy/19fed.html*

# Consolidate Your Accounts
## A Simple Solution

Picture yourself on a nice summer day, relaxing by a pool, on a beach or on a golf course. Now, contrast that with sitting in your den or kitchen, going through recent statements from a half dozen or more investment accounts. Time is precious, whether you are retired and want to enjoy your golden years fully or are busy raising a family and trying to complete a long "to-do" list.

Going through financial paperwork probably doesn't rank high on your list of preferred activities, but it is important. However, by having too many accounts, you could be passing up some enjoyable activities with friends and family or simply spinning your wheels. Having fewer investment accounts to keep track of may give you more free time to spend pursuing your favorite interests, particularly in retirement.

### Simpler can be better

In addition to saving time, consolidating your accounts can simplify your finances, cut down on paperwork and eliminate duplication. A common myth is that more investment accounts, or dealing with numerous investment firms, will diversify your investments further. But one focus should be to diversify the contents of the accounts—the actual investments—and not the accounts themselves. A more efficient and logical solution may be to hold a variety of funds within a single investment account at a well-respected financial firm.

To consolidate your accounts and transfer assets between firms, select the one that you would like to continue to deal with, and obtain an account transfer form from that company. You will provide the account number and name of the firm where the assets will come from. The process normally takes a couple of weeks.

What NOT to do: When transferring between tax-deferred retirement accounts, do not have money sent to you as a check. It's simpler and less confusing to have the money transferred directly from one firm to the other. This will avoid the risk of being expected to pay taxes on a check sent to you, which could be mistaken for an account withdrawal.

### Both IRAs for different tax treatment

When consolidating individual retirement accounts (IRAs), it could be beneficial to have at least one traditional IRA and a Roth IRA. Having both types of IRAs diversifies the tax treatment of your account withdrawals in retirement. This could be helpful because of uncertainty about future income tax rates. Roth IRA withdrawals are tax-free if certain requirements are met. In contrast, traditional IRA withdrawals are fully or partially taxable depending on whether the initial investments are tax-deductible. The tax benefit is received when contributing.

### A balanced approach

Another way to make investing simpler is to invest in a balanced fund or a target-date fund.[2] Target-date funds have a mix of stocks, bonds and cash. They automatically rebalance gradually to a less risky mix of assets as a target date approaches. This reflects a decreasing time horizon and presumed lower tolerance for risk.

### What can you do to consolidate your finances?

- Do you have more than one 401(k) plan? Why not consolidate all with your current plan? ☐ Yes ☐ No
- Do you use one insurer for your home and car insurance? If so, this should entitle you to a discount on insurance premiums. ☐ Yes ☐ No
- Do you have accounts with more than one bank? Could you combine any? ☐ Yes ☐ No
- If you owe money, could you consolidate your debts? This could help to lower your interest rate. ☐ Yes ☐ No
- Are there other ways you can consolidate your finances?

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*2 Target date funds are based on an estimated retirement age of 65. Should you choose to retire significantly earlier or later, the fund may no longer be an appropriate investment. Investments are not guaranteed at any time, including on or after the target date.*

# Retirement in Motion

TIPS AND RESOURCES THAT EVERYONE CAN USE

## Boomers on the Brink

*Issues facing participants approaching retirement*

**Plan for rising medical costs**
Rising retiree health care costs will become an increasing concern in the next few decades. A report by the Urban Institute, *"Will Health Care Costs Bankrupt Aging Boomers?"* predicts that with health care costs rising faster than average household income, retirement-age Americans will spend 19% of their income on health care in 2040 versus 10% today. Using figures provided by Medicare, the study estimates that median out-of-pocket costs for Americans age 65+ will rise to about $6,200 in 2040 from $2,600 in 2010. But the study projects that household income for this group will only grow to $34,600 from $26,800 over the same period. This underscores the need for baby boomers to plan for future health care spending.

## Q & A

*Common questions asked by retirement plan participants*

***As I near retirement, how much stock should I transfer to bonds and cash?***

You may wish to gradually scale back on riskier investments, such as stocks, because your portfolio will have less time to recover in the event of a general market downturn or poor fund performance. Rather than make a sudden change, make it a steady shift. Plan to keep a sizable amount invested in stocks/stock funds even well into your retirement in order to outpace inflation. One quick way to estimate your allocation to stocks is to subtract your age from 110 or 120, which is a simple range to use depending on your comfort level. This would mean 50%-60% in stocks at age 60, 45-55% at age 65, and 40%-50% at age 70. Of course, individual circumstances vary, so consult your financial advisor to determine what is best for you.

## Quarterly Reminder

**Are you on track for your retirement goals?**
To see if you are on track to reach your savings and investing goals, refer to at a recent statement and use a calculator such as those available at www.dinkytown.net. If you are falling short on your retirement savings, increase your plan contribution level. For example, if you are saving 5% of a $40,000 salary, that is about $77 per biweekly paycheck, or $2,000 a year. To add 1% of your salary would take just $15.38 more every two weeks, or $400 a year. Over time, that difference can add up.

## Tools & Techniques

*Resources and ideas to guide you in your retirement planning efforts*

**Take a risk tolerance quiz**

Do you know how much tolerance you have for risk, or volatility, among your investments? Knowing how you rank in risk tolerance can help guide you to investments that are appropriate for you. How would you feel if an investment lost 20% or more of its value in a brief period? What if it doubled in value? In either case, would you be inclined to sell, buy more or hold on to what you have? Take a risk tolerance quiz to find out. Here are a couple available on the Web:
**http://moneycentral.msn.com/investor/calcs/n_riskq/main.asp**

**http://njaes.rutgers.edu/money/riskquiz/**

## Corner on the Market

*Basic financial terms to know*

**Value & growth investing**
The terms 'growth' and 'value' describe two basic investing styles. Value-style investors look for stocks that are trading at a discount to their intrinsic value. They use measures such as price-to-earnings ratio. They might invest in a stock that is attractively valued but sell the same stock after it rises in price if they believe it is overvalued. Growth-style investors, on the other hand, focus more on companies that appear likely to deliver above-average earnings growth. These two investing styles often take turns outperforming one another. Many investors try to maintain a balance of the two styles for better diversification.

Kmotion, Inc., P.O. Box 1456, Tualatin, OR 97062; www.kmotion.com