REINVENTING Retirement
YOUR RETIREMENT PLANNING NEWSLETTER

2nd QUARTER 2011

Are You Ready to Join the "American Idle"?

Follow these three simple steps to retirement success

Preparing for retirement is a bit like performing on Fox's hit show, "*American Idol*." Just as "Idols" must have talent and stage presence, pre-retired "Idles" must create a plan, invest and stay on track. Saving for your life of leisure is a big-time responsibility, but you can get there. Have confidence!

Step 1: Start with a plan — *Dream big, but make saving a priority*

Before saving for retirement, commit to spending less than you save, pay off high-interest debt and start an emergency fund. The important thing is to begin planning and saving now, because there's a big cost if you wait even one year. Look how much money a 26-year-old, contributing $100 per month, gives up by waiting:

The Cost of Waiting

Your Starting Age	Your Contributions by Age 65	Your Account Value at Age 65	The Cost of Waiting One Year
25	$48,000	$324,180	
26	$46,800	$299,008	$25,172

This is a hypothetical illustration intended to show how a one-year delay in investing might affect participant account values. It is not intended to depict the performance of any particular security or investment. Assumes monthly contributions of $100, an annual 8% hypothetical rate of return, retirement at age 65, and no withdrawals. Savings totals do not reflect any fees/expenses. The accumulations shown above would be reduced if these fees had been deducted. Source: Kmotion, Inc., 2011.

Step 2: Invest — *The right mix can aid your performance*

Just as a singer's range and audience are important to song selection, you'll want to pick a mix of investments that suits your age, risk tolerance and long-term goals.

" Time…is on my side"

If you're just starting your career, you can make good savings choices right off the bat. But even if you're closer in age to Madonna than Carrie Underwood, it's easy to get started. If you're young, you may be able to put more money in equity (stock) funds because you can ride out the market's ups and downs. As you approach retirement, you'll likely want to shift your mix more to bond funds and cash to help protect your savings. As a rule of thumb, some financial experts suggest that your percentage in stocks be equal to 100 minus your age.

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Are You Ready to Join the "American Idle"? *Continued from page 1*

Bothered by butterflies?

Risk is a fact of performing—and investing. As you create your retirement plan, dial in how much risk you're willing to take.

- A conservative investor is usually not comfortable seeing account values go down, and tends to invest in bonds and cash. Bonds have somewhat less risk, but also generally offer less return. Cash investments are considered very safe, but often produce little return.
- A moderate investor accepts some ups and downs as long as his or her account grows modestly over time. An even balance between bonds and stocks may be appropriate. Stocks historically have produced the highest returns, but also carry the greatest risk.
- If you are comfortable having greater peaks and valleys in your portfolio while pursuing potentially bigger rewards, you are probably a more aggressive investor and may be able to devote more of your plan to stocks.

See the hypothetical increase in value of $1 invested from 1926 to 2010:

	Compound Annual Return	Value in Today's Dollars
Small cap stocks	12.1%	$16,055
Large cap stocks	9.9%	$2,982
Govt bonds	5.5%	$93
T-bills	3.6%	$21
Inflation	3.0%	$12

Past performance is no guarantee of future results. Source: Ibbotson 2010

Judging performance

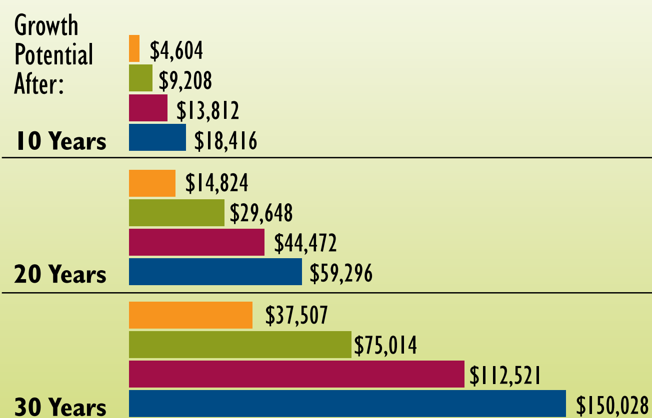
Knowing what type of investor you are can help you decide how to divide your money among stocks, bonds and cash. This is called asset allocation, and it helps determine your account's performance over time.[1] It also can help ensure that you are *well diversified*. Diversification[2] is like putting your retirement eggs in many baskets. When you diversify across domestic stocks, international stocks, bonds, and cash, you may reduce the negative impact from a drop in one investment category.

Step 3: Stay on track — *Rebalance, save on schedule and keep things simple*

Rebalancing keeps your plan from getting too "pitchy." Once a year, make sure your account is not out of whack by having too much in bonds or stocks (see our Q&A on page 4 for helpful rebalancing tips). Invest an affordable amount regularly—every paycheck. Keep your retirement portfolio simple. Only invest in funds that you understand. Always consider increasing contributions to your account: just look at how increases add up!

Amp Up Your Savings

Amount of Monthly Increase: $25 $50 $75 $100



"What-if" scenario assumes an annual return of 8 percent (compounded monthly) in a tax-deferred account and is intended to illustrate the effect of increasing monthly contributions. It is neither based on any specific investment or savings strategy, nor predictive of returns, which are not guaranteed. Most investments move up and down with the market over time, producing better or worse actual returns. Savings totals do not reflect any fees/expenses. Accumulations shown would be reduced if these fees had been deducted.

Congratulations! You're on your way to becoming an American Idle!

1 A key 1991 study showed that 90% of the variation in your investment return will come from asset allocation, rather than the performance of individual securities. Brinson, et al., "Determinants of Portfolio Performance," Financial Analysts Journal, May-June 1991.

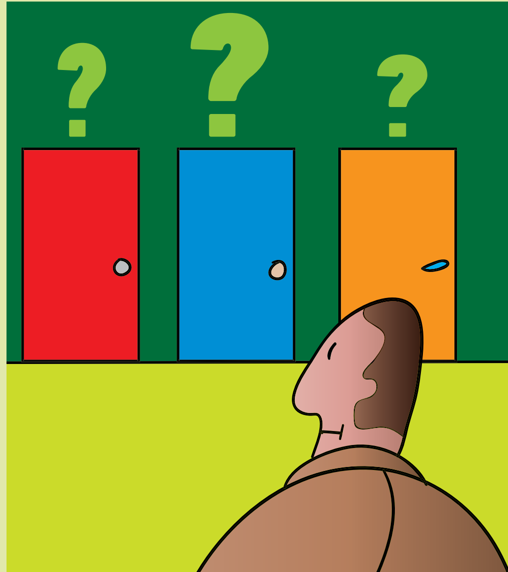
2 Although a diversified portfolio may carry less risk and smooth your returns over time, it cannot protect against market losses.

Let's Make a Winning Deal

Why investing with tax advantages is far better than saving without tax breaks.

In the CBS show *"Let's Make a Deal!"* hosted by Wayne Brady, wildly dressed contestants weigh the potential of buying, selling or trading an offer of a less desirable item, such as a box of cereal, for a more valuable prize, such as a new car or trip. Items for trade are often hidden behind three numbered doors—1, 2 or 3.

Let's pretend Marie is our next contestant on our own show, "*Let's Make a Deal!*" After Marie's screams die down, she gets to pick one of three prizes:



- **Behind Door Number 1 is a brand-new, six-person hot-tub worth $9,000**
- **Behind Door Number 2 is a first-class trip to Hawaii worth $9,000**
- **Behind Door Number 3, Marie is allowed to contribute $6,000 to her 401(k) plan, and her employer makes a $3,000 matching contribution**

Which door should she choose? Before we can answer that question, we need to know that Marie makes $40,000 a year, is in the 28% and 6% federal and state income tax brackets, respectively, and has never participated in any 401(k) plan. Also know that, according to the IRS, for any amounts over $600, winners of game show cash and prizes must pay taxes on the cash they receive. Winners also pay taxes on the fair market value of non-cash prizes they receive (state income taxes also may apply).

"Let's Make a Deal!" Tax Savings Worksheet

	HOT TUB	HAWAII	NEW 401(k) PLAN
Marie's Pre-Tax Income	$40,000	$40,000	$40,000
Marie's 401(k) Contribution	N/A	N/A	$6,000
Employer Matching Contribution	N/A	N/A	$3,000
W-2 Income	$40,000	$40,000	$34,000
Value of Prize	$9,000	$9,000	$3,000
Taxable Income	$49,000	$49,000	$34,000
Federal Income Tax Owed (@ 28%)	$13,720	$13,720	$9,520
State Income Tax Owed (@ 6%)	$2,940	$2,940	$2,040
Total Taxes Owed	$16,660	$16,660	$11,560
Tax Savings from Funding 401(k)	**$0**	**$0**	**$5,100**

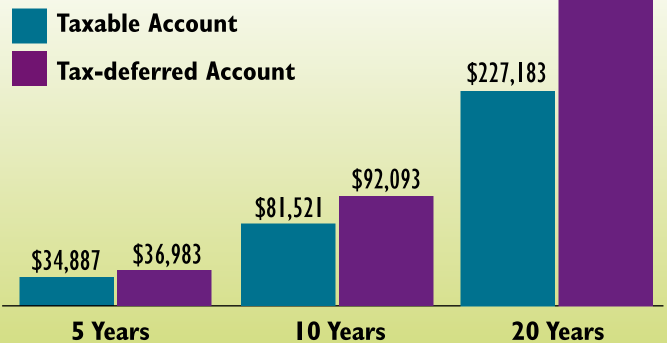
This example is not intended to be tax advice.

If Marie chooses to fund her 401(k) instead of taking the tub or trip, she would have $5,100 more to spend, after tax.

Tax Benefits of Retirement Plans

Some savings plans offer tax advantages, and some don't. It usually makes sense to use tax-favored plans before turning to those that offer no tax benefits. Your retirement plan offers the following tax advantages:

- Salary deferral contributions are made with pre-tax dollars, which lowers your taxable income
- You pay no current taxes on your employer's matching contribution (if applicable). This is "free money"
- No income tax is paid on any potential growth while your money remains inside the account
- Since taxes do not eat away at your earnings each year, your account has the potential to grow faster than comparable taxable investments, as the following chart shows:



This example assumes contributions of $500 per month, a hypothetical 8% nominal rate of return compounded monthly, and a 28% tax bracket for the taxable account. It does not reflect the effect of taxes on withdrawals on either the taxable or tax-deferred account. This illustration is not intended to predict the return of any investment. Past performance does not guarantee or indicate future results.

Keep in mind that most retirement plan withdrawals are not tax-free. The amounts you withdraw from your plan are generally considered income and will be taxed in the year received, and any withdrawals made prior to age 59½ are also subject to a 10% IRS early withdrawal penalty.

Retirement in Motion

TIPS AND RESOURCES THAT EVERYONE CAN USE

Boomers on the Brink

Counting on an inheritance?
Two-thirds of boomers expect to receive an inheritance over their lifetimes. But don't buy that RV just yet—the median boomer inheritance will be just $64,000, and the majority of heirs will get smaller amounts.[3] Bottom line: don't assume an inheritance eliminates your need to increase savings!

Tools & Techniques

Move the retirement clock forward
If you are a young worker, you can save more now to retire earlier. Let's assume you are 30, currently make $30,000, contribute $125 per month into your 401(k) plan, and want to stop working at age 70. In this case, you will have $388,585 to spend in your retirement. On the other hand, if you increase your savings now to $250 per month, you may be able to retire at 67 with $609,211. This amount may be enough for you to live past age 87 with no changes to your lifestyle.

This is a hypothetical illustration based on a female having no other retirement savings; earning 8% annual return prior to retirement and 6% annual return after retirement, with no employer match. No assumptions for inflation or salary increases were included, nor adjustments for fees or taxes due on withdrawals.

To see how saving more adds up, check out the retirement calculators at www.aarp.org: http://tinyurl.com/AARPNestEggCalculator

Q & A

What is rebalancing? How do I do it?

Rebalancing is resetting your proportion of stocks and bonds back to their original desired percentage.[4] Let's say Amanda has $50,000 to invest and sets a portfolio asset allocation of 60% stocks and 40% bonds. To create her portfolio, she buys $30,000 (60% of $50k) of a stock fund and $20,000 (40% of $50k) of a bond fund. At the end of the year the stock fund has risen 8% and the bond fund has gone down 5%. Her portfolio is now worth $51,400.

Amanda notices that stocks now make up 63% of her portfolio instead of the original 60% she wanted. The bonds are now 37% of her portfolio instead of the original 40%. She decides she wants to rebalance her portfolio so the asset allocation is reset to the same it was when she started.

To do this, Amanda must sell some of the stock fund and use the money to buy more of the bond fund. She takes the new portfolio value ($51,400) multiplied by the stock allocation (60%) = $30,840, which is how much she should have in stocks. Since she now has $32,400 in stocks, she has to sell a little ($32,400 – $30,840 = $1,560) of the stock fund and buy $1,560 of the bond fund. Then her portfolio will be back to 60% stocks and 40% bonds.

Quarterly Reminder

Give yourself a "retirement raise"
The portion of Social Security taxes you pay in 2011 will be 4.2%, reduced from 6.2% in previous years.[5] Why not put this 2% "raise" toward your retirement? For example, Jimmy is single, 32 years old, makes $30,000 and wants to retire at age 67. A 2% tax saving is equal to $600 per year. By choosing to invest this money in his retirement account[6], he'll have $114,694 more to spend in retirement. And, since the money is automatically deducted from his paycheck, he'll never miss it!

Corner on the Market

Basic financial terms to know

Dividends
When you buy stocks, you hope that they increase in value; that is, that their prices appreciate. Dividends are another part of a stock's return, and are comparable to the interest on a bank account. Also called a stock's current yield, a dividend is a company's way of sharing some of its profits with shareholders.

3 Alicia H. Munnell, Anthony Webb, Zehnya Karamcheva, and Andrew Eschtruth, "How Important are Inheritances for Baby Boomers?" Center for Retirement Research at Boston College, January 2011, Number 11-1, p. 4.
4 Rebalancing does not guarantee a profit or protect against losses in a declining market.
5 This is a temporary reduction included in the Tax Relief Act of 2011.
6 This illustration assumes an 8% nominal return, compounded monthly, over 35 years. Returns cannot be guaranteed and may fluctuate.

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