



SOCIETY FOR FINANCIAL EDUCATION AND PROFESSIONAL DEVELOPMENT

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financial



U C C E S S

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## Retirement Derailers

In a February 2013 survey of 1,000 employed and retired Americans aged 50–70 with \$100,000 or more in investable assets, 90% of respondents said they had experienced a “retirement derailer” — a specific circumstance that seriously impacted their retirement plans or reduced their retirement savings (Source: Ameriprise Financial, February 2013). Approximately 37% of respondents had experienced five or more such circumstances. The top 10 derailers cited by survey respondents were:

- ✓ Supporting one or more grown children or grandchildren
- ✓ Receiving pension benefits that are lower than expected or not getting an anticipated pension at all

- ✓ Losing some retirement savings because of unsuccessful investments
- ✓ Taking Social Security benefits before reaching full retirement age
- ✓ Experiencing a career or job loss
- ✓ Not getting an anticipated inheritance
- ✓ Having to spend a lot of money on home repairs
- ✓ Taking care of an aging parent or other family member

- ✓ Paying for significant medical bills that aren’t covered by insurance
- ✓ Using retirement savings to pay bills

To make sure your retirement isn’t derailed, consider these tips:

**1. Start saving now.** When asked what they would have done differently, 57% of survey respondents said they wished they would have started saving earlier. Indeed, because of the power of

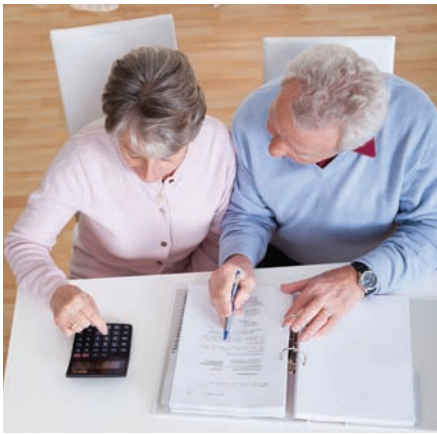
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## Bond Price Fluctuations

There are two primary factors that affect bond prices — interest rate changes and credit rating changes. Interest rate changes typically will cause a bond’s value to fluctuate more than credit rating changes.

As interest rates rise, a bond’s price adjusts down, while the bond’s price will increase when rates decrease. Simply put, bond prices and interest rates move in opposite directions. Also, bonds with longer maturity dates are more vulnerable to interest rate changes, since the difference will impact the bond for a longer time period.

Credit ratings also influence a bond’s price. When a bond is issued, rating agencies assign a rating to give investors an indication of the bond’s investment quality and relative risk of default. Typically, higher-rated bonds pay a lower interest rate than lower-rated bonds. After the bond is issued, the rating agencies continue to monitor it, making changes if warranted. A bond’s price tends to decline when a rating is downgraded and increase when a rating is upgraded. Certain downgrades are more significant, such as a downgrade that moves a bond from an investment-grade to a speculative rating, a downgrade of more than one notch, or a series of downgrades over a short period of time. ○○○



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## Retirement Derailers

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compounding, starting to save for retirement just a few years earlier can make a huge difference in the end.

For example, a 30-year-old puts \$400 per month into a tax-deferred retirement plan (like a 401(k) plan), which generates \$1,015 per month in retirement income for 30 years beginning at age 65. For the 35 years that the individual is saving (from age 30 to 65), she will have contributed \$168,000 to the account. A 45-year-old makes the same amount in total contributions (\$168,000 at a rate of \$700 per month) to the same retirement account. Even though she has contributed the same dollar amount, because her savings compounded for 15 fewer years, she has about 20% less during retirement (Source: Ameriprise Retirement Calculator).

### 2. Save now to spend later.

About 33% of survey respondents said that if they had spent less on discretionary expenses like dining out and vacations during their working years, they would be better prepared for retirement. This is where it's critical to make a budget for current expenditures, a retirement budget, and a plan for how to make retirement work. That plan may involve trimming current expenditures, scaling back retirement expectations, or both.

### 3. Prepare a retirement plan.

Unless you plan to work until the day you die, a retirement plan should be an integral part of your overall investment plan — and no matter what your circumstances,



a very important way to decrease the likelihood that your life plans will be derailed by unexpected circumstances that inevitably arise.

**4. Have a candid conversation with your parents or other family members whom you might be caring for in old age.** Talk about how they'll want to be cared for and the means they have to pay for such care. Urge them to consider long-term-care insurance, which can greatly ease the financial burden of paying for their care in a world in which the average cost for an assisted-living facility is nearly \$42,000 a year and more than \$90,000 a year for a nursing home (Source: *The Wall Street Journal*, October 12, 2012).

If you have already been impacted by one or more of the derailers listed above — or any other circumstance that has impacted your retirement plans, here are five ways you can get back on track:

**1. Take advantage of catch-up provisions.** If you are 50 or older, you can contribute more tax-deferred income to a 401(k) or IRA (these are called catch-up contributions). In 2013, you can contribute \$5,500 more to a 401(k) or 403(b) and \$1,000 more to an IRA.

**2. See where you can trim expenses to save more.** Boosting your savings to get back on track for retirement might be easier than you think: most of us spend more than we realize on discretionary things like meals out, clothing, travel, and other personal expenditures. Take a hard look at your budget and see where you can cut back — even \$100 per month can make a difference in your retirement savings.

**3. Evaluate your investment choices.** Review your current asset allocation. Many individuals close to retirement pulled money out of the stock market during the financial crisis; and if you haven't since reassessed your asset allocation,



you're probably missing out on significant investment opportunities as the equity market rebounds. That said, you want to ensure that your asset allocation is appropriate (not too heavy in equities) given your age and target retirement date.

**4. Reevaluate your retirement lifestyle.** Most financial advisors recommend that you be able to replace at least 70% of your pre-retirement income during retirement. So if you planned to spend 85% of your current income in retirement, you might be able to scale back and still retire comfortably.

**5. Work longer.** When Social Security was created in 1935, the average American 65-year-old man could expect to live to age 78 and the average American woman to 80. Today, the average American 65-year-old man can expect to live to 84 and the average American 65-year-old woman to 86 (Source: Social Security Administration, 2013). In that context, working five more years might not be such a sacrifice — and it can make a big difference in the retirement lifestyle that you can afford. For a 60-year-old who has a retirement account balance of \$250,000 today and contributes \$2,000 a year, pushing retirement back from age 65 to age 70 would yield an additional \$158,410 in total savings (not counting Social Security) — adding \$300 per month to the individual's retirement income.

No matter where you are on the path to retirement or whether you've been derailed or not, please call your financial advisor to discuss this in more detail. ○○○

## Changes in Estate Taxes and Planning

**O**n January 2, 2013, President Obama signed into law the American Taxpayer Relief Act (TRA 2013). In addition to preserving the Bush Administration income tax rates for most people, it also made significant changes to the federal estate and gift tax provisions. Here's a summary:

**Estate tax changes** — Without the new law, federal estate taxes were due to revert to an exemption of \$1 million — down from \$5.12 million in 2012, and the maximum tax rate was set to increase from 35% to 55%. That would have made for a larger number of estates subject to federal taxes. Instead, TRA set the exemption at \$5.25 million (to be increased by inflation in the future), while raising the maximum estate tax rate to 40%.

**Gift tax changes** — TRA 2013 maintains the unity of gift and estate taxes. In other words, the extent to which you make tax-free gifts over your lifetime reduces your estate tax exemption. Otherwise, the new tax law made the same changes in gift taxes as it made in estate taxes. The lifetime limit on tax-free gifts is \$5.25 million per donor (\$10.5 million for married couples) in 2013, indexed to the annual rate of inflation. The gift tax rate was raised from 35% to 40%.

**Portability of the estate tax exemption** — TRA 2013 made permanent the portability of the estate tax exemption, which was scheduled to expire at the end of 2012. Portability refers to the automatic transfer of any unused portion of the deceased spouse's estate tax exemption to the surviving spouse, without the use of a credit-shelter trust (also known as an A/B or bypass trust), subject to the discretion of the executor of the estate.

Despite portability, in some cases a credit shelter trust may still be beneficial. For example, if there is

a long period of time between the death of a husband and that of the surviving spouse, it's possible that the value of the husband's assets could grow to an amount that exceeds the combined exemptions. Creating and funding a credit shelter trust with some or all of the husband's assets would provide greater

assurance that the wife could pass on her entire estate with minimal or no federal estate taxes.

It's a good idea to review your estate plan with your estate attorney for any amendments you might need to make in view of these changes. ○○○

## Does Diversification Still Work?

**O**ver the last 10 years, the stock market has experienced two bear markets, testing anyone's belief in investment principles. But it shouldn't, for the following reasons:

**Diversification reduces risk; it can't eliminate it.** The truth is, all investments are subject to risk. Diversification remains one of the primary ways of managing and reducing investment risk. It does so by spreading your investments not only among different securities, but among different sensitivities to phases of the business cycle and to different cycles altogether. By doing this, you decrease the chances that you'll lose money because any one issuer has gone out of business.

**In bad times, a lot of different kinds of investments perform the same way: poorly.** Investment professionals track something called correlation, which, roughly speaking, measures the degree to which different investments, asset classes, and subasset classes produce gains or losses at the same time. In 2008, for example, four stock subasset classes delivered major losses. U.S. large-cap stocks lost 37% of their value, U.S. small-cap stocks lost 34%, the stocks of major developed foreign countries were down 43%, and emerging foreign market stocks lost 53%. Even diversifying by investment style didn't help — large value stocks in the U.S. lost 39%, while large growth stocks lost 35% (Source: Invesco, 2012).

**Diversification is for the long term.** If you need all of your money in the next year, you should put it all in cash, where your chances of a loss are mostly theoretical. But if you're planning for the next 10 to 20 years, you're likely to lose the battle against inflation if you don't keep some money in stocks.

**Diversifying is an alternative to market timing, which very few get right.** How confident are you that you know exactly when to move your money out of stocks at the right time to avoid losses and then move back in when stocks start making money again? Most investors haven't been successful at timing the market that way. The most common mistake is to get out too late and then wait too long to get back in.

**Diversifying may still avoid the deepest possible losses.** 2008 was, we've noted, a very bad year for stocks. But the total U.S. bond market, including Treasuries and corporate, returned 5.24% that same year, and Treasuries increased 12.39% (Source: Invesco, 2012). If you'd had 40% of your money in bonds, that loss would have been trimmed to 20.1% — a reduction of nearly half.

Diversification still buffers your portfolio from the worst possible losses but does not guarantee profit or protect against loss in declining markets. ○○○

## Assess Your 401(k) Plan

**A**t least annually, you should thoroughly review your 401(k) plan. Some items to consider include:

✓ **Have your goals or objectives changed?** Most people use their 401(k) plan to fund retirement, although it can also be used for other things. Take time to reassess your goals and objectives, which can impact how much you contribute and how you invest those contributions.

✓ **Are you contributing as much as you can to the plan?** Look for ways to increase your contribution rate. One strategy is to allocate any salary increases to your 401(k) plan immediately, before you get used to the money and find ways to spend it. At a minimum, make sure you are contributing enough to take full advantage of any matching contributions made by your employer. In 2013, the maximum contribution to a 401(k) plan is \$17,500 plus an additional \$5,500 catch-up contribution for individuals age 50 and older, if permitted by the plan.

✓ **Are the assets in your 401(k) plan properly allocated?** Some of the more common mistakes made when investing 401(k) assets include allocating too much to conservative investments, not diversi-

fying among several investment vehicles, and investing too much in the employer's stock.

✓ **Do your investments need to be rebalanced?** Use this review to ensure your allocation still makes sense. Also review the performance of individual investments, comparing the performance to appropriate benchmarks. You can't just select your investments once and then ignore the plan. Review your allocation annually to make sure it is close to your desired allocation. If not, adjust your holdings to get your allocation back in line. Selling investments within your 401(k) plan does not generate tax liabilities, so you can make these changes without any tax ramifications.

✓ **Are you satisfied with the features of your 401(k) plan?** If there are aspects of your plan you're not happy with, such as too few investment choices or no employer matching, take this opportunity to let your employer know.

Managed properly, your 401(k) plan can play a significant role in helping to fund your retirement. Please call if you'd like help reviewing your 401(k) plan and investments. ○○○



## Keep Track of Your Retirement Plans

**M**ost of us change jobs at least twice before retiring, leaving a trail of retirement nest eggs behind us. Here are a couple of tips to keep track of your retirement plans:

**Organize your records.** As long as you continue to hold your account in a former employer's plan, you should receive statements. Keep them all in a file — or, even better, enter them all in a spreadsheet, tracking the combined balances and the amount in each type of investment.

**Consolidate your accounts.** It's much easier to manage your assets if they're all in one place. Fill out the paperwork necessary for rolling them over into one account. That single consolidation account could be the plan you're currently contributing to, if the plan permits rollover contributions. You can also open a rollover individual retirement account (IRA) and have the funds from your other accounts directly transferred there. Be careful about asking for a check. Withholding taxes may be taken out, and you may have to pay a penalty if you don't deposit the check into a qualified account within 60 days. ○○○

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