Investor Insights & Outlook

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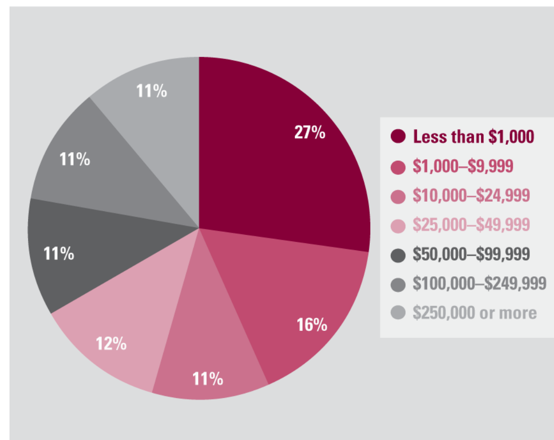
Total Savings and Investments Reported by Workers



Source: EBRI 2010 Retirement Confidence Survey, No. 340, March 2010. Savings reported not including value of primary residence or defined-benefit plans. Percentages may not add up to 100% because of rounding.

Bleak Picture

The Employee Benefit Research Institute (EBRI) is an organization founded in 1978 with the mission of encouraging and contributing to the development of sound employee-benefit programs and public policy through objective research and education. Every year, the EBRI publishes a retirement confidence survey. The 2010 survey interviewed 902 workers and 251 retirees in order to find out their views and attitudes about investing for retirement and their confidence in being able to meet retirement financial goals.

Unfortunately, the survey results look pretty bleak this year. For example, as the image illustrates, 27% of workers report having saved less than $1,000, and 16% report retirement savings in the $1,000–$9,999 range. Overall, more than half of workers have less than $25,000 saved, at a time when people start questioning if $1 million will be sufficient for a safe retirement. Take a minute and see if you recognize yourself in this picture.

Advisor Corner

Hallett Advisors
Plan Well • Live Well

James D. Hallett, MSFP CFP AIFA
jim@hallettadvisors.us
360-457-6000

Retirement Planning in Your 20's and 30's

Is it too early to start planning for retirement in your 20s? The answer is no. As life expectancy continues to increase, planning early can ensure a comfortable retirement. While planning for retirement at this age may be the last thing on your mind, the earlier you start the better chance you have of achieving your retirement goal. An early start also allows more time for your investment to grow through compound interest. In addition to starting early, here are some steps you should consider when planning for retirement in your 20s and early 30s.

Maximize your employer match: Young investors should consider maximizing their employer 401(k) match, since failure to utilize this benefit means missing out on free money. According to a recent study by Hewitt Associates, younger participants are more likely to stop contributing or lower their contribution rates compared with older participants. This study suggests that more than 17% of participants age 20-39 decreased their contribution rates in 2008. Typically employers match 50 cents per dollar invested by an employee, up to a predetermined maximum contribution percentage. If your employer provides this, make sure to put enough money in your 401(k) plan to maximize your employer match.

Consider a Roth investment: Much like a company-sponsored retirement plan, traditional IRAs are a common investment vehicle for investors. Traditional IRA contributions are not taxed, but withdrawals are taxed. A Roth IRA or Roth 401(k) gives you the option of taxing your contribution up-front at the time of investment while the account grows in value tax-free thereafter. This means that withdrawals during retirement are not subject to income tax, provided you are at least 59 1/2 and the account is held for five years or more. This is a great way for younger investors to take advantage of lower tax rates, especially if they expect to be in a higher tax bracket closer to retirement.

Manage your risk: One mistake young investors make is selecting a less than optimal stock/bond allocation based on their age. Typically, investors in the 20s or 30s are best advised to select a stock-heavy portfolio with a minimal allocation to bonds. For investors who feel less comfortable with selecting their own investments, target-date funds can serve as a convenient alternative. Target-date funds start out with heavier allocations to stocks and become more income-oriented depending on the participant's age. If you are in your 20s or 30s, it might make sense to choose an aggressive portfolio allocation and limit your investment in bonds.

Avoid market timing: A look back in time suggests that some of the biggest gains in the stock market have followed periods of poor market returns. Investors can make the mistake of timing the market by pulling out of their investments during market losses and buying back when the market has rebounded. Investors who attempt to time the market run the risk of missing periods of exceptional returns. With time on your side, it is best to adopt a long-term approach to investing.

Keep in mind that you should first determine how much money you may need in retirement as well as determine your annual expenses such as living, health-care, and miscellaneous spending before considering the options outlined above. It is always a good practice to track your spending in addition to identifying your savings and investments.

Source: "How Well are Employees Saving and Investing in 401(k) Plans," 2009 Hewitt Universe Benchmarks.

Portfolio Performance

A portfolio is a group of asset classes, such as stocks or bonds, held by an investor. When it comes to constructing an investment portfolio, risk tolerance, time horizon, and investment objectives need to be carefully considered.

Would you lie awake at night worrying about your portfolio if it was heavily invested in stocks? How long is it before you will need to start withdrawing money from the portfolio? If retirement is still 30 years away, you might be able to invest in riskier asset classes because you have time to ride out potential down periods. Your financial advisor can help you address these potential situations and much more.

The table illustrates how various portfolios performed since 1926. Each portfolio's total return is presented along with its corresponding risk, and a few other statistics are highlighted as well. Notice that as the allocation to stocks increases, the returns increase. However, these higher portfolio returns are associated with much greater risk than in portfolios with a lower allocation to stocks. For instance, out of the five portfolios presented, the 100% stock portfolio provided the highest return but also came with the most risk. When the 100% stock portfolio is compared with the 50% stock and 50% bond portfolio, one will notice that the risk decreases dramatically; however, the return also declines—by 1.7%. Stocks have a higher level of risk than bonds and those who invested in this asset class were rewarded accordingly. One other thing to note is that the 25% stock and 75% bond portfolio came with the least amount of risk (9.0%) and a moderate return of 6.9%. Despite the fact that bonds are considered less risky than stocks by many investors, the portfolio with the least risk did not consist entirely of bonds. The reason for this is that stocks and bonds are not highly correlated; meaning, they tend to move independently of one another. So, if stocks took a hit, bonds might be up and vice versa. These opposite movements may help reduce the overall risk of the portfolio.

An investor with a long time horizon might be able to deal with short-term risk in order to receive the higher return opportunities that more aggressive portfolios may provide. On the other hand, an investor with short-term goals may opt for a more conservative portfolio for more stability and potentially less downside risk.

Constructing an investment portfolio is not an easy task. Moreover, once the allocations have been determined, they tend to shift over time because of the performance of the underlying asset classes. Consequently, the portfolio will need to be rebalanced in order to maintain a target asset mix and a given level of risk. Lastly, as you grow older and your goals and risk tolerance change, your portfolio allocation will need to change as well. Investing is an ongoing process—be sure to consult with your financial advisor throughout this challenging journey.

Summary Statistics of Various Portfolio Allocations 1926–2009

Portfolio	Return	Risk	# Positive periods	# Negative periods	Highest return	Lowest return
100% Stocks	9.8%	20.5%	60	24	54.0%	–43.3%
75% Stocks/ 25% Bonds	9.1%	15.6%	63	21	41.3%	–34.2%
50% Stocks/ 50% Bonds	8.1%	11.4%	65	19	34.7%	–24.7%
25% Stocks/ 75% Bonds	6.9%	9.0%	69	15	35.7%	–15.0%
100% Bonds	5.4%	9.6%	62	22	40.4%	–14.9%

Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than bonds. An investment cannot be made directly in an index. The data assumes reinvestment of income and does not account for taxes or transaction costs. Portfolios are always rebalanced. Past performance is no guarantee of future results.

Source: Stocks in this example are represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general. Bonds are represented by the 20-year U.S. government bond.

Simplifying Your Investment Strategy

Low maintenance, professional management, and one-stop investing are all phrases that describe life-cycle funds. These vehicles are designed for investors seeking an easy, convenient, and balanced investment option. Life-cycle funds can be classified into two distinct types: target date and target risk. There are unique differences between the two.

Target-date lifestyle funds have a designated maturity year, typically aligned with the age you plan to retire. The money manager automatically adjusts the portfolio's asset allocation over time, shifting the balance from more aggressive to more conservative portfolios as you near retirement.

Target-risk lifestyle funds are designed to keep a consistent asset allocation based on specific risk levels. Portfolio allocations typically span from conservative to aggressive risk options. However, unlike the target date funds, it is up to the individual investor to change from one portfolio to the other as their lifestyle, needs, and financial goals shift over time.

While both products provide several benefits (diversification, professional management, and automatic rebalancing), there are also drawbacks. For one, most carry additional fees for the management services provided. In addition, the success of a fund hinges on the quality and selection of the underlying investments. If combining with other holdings, be aware of overlap.

Diversification does not eliminate the risk of experiencing investment losses. Lifestyle funds are subject to market risk, will fluctuate in value, and you can lose money. Past performance is no guarantee of future results.

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James D. Hallett, MSFP CFP AIFA
321 East First Street
P. O. Box 3050
Port Angeles, Washington 98362
jim@hallettadvisors.us
Tel:360-457-6000