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Retiring in a Weak Economy

It's one of the worst things that can happen to a retiree. Just as you are about to retire or right after you retire, the market substantially declines, drastically lowering your portfolio's value. How damaging can this be to your retirement?

One study looked at the probability of a retirement portfolio lasting 30 years, based on the portfolio's performance during the first five years of retirement. The study assumed that 4% of the portfolio balance was withdrawn in the first year, with withdrawals increasing annually by 3% for inflation. The portfolio was comprised of 55% stocks and 45% bonds. If the portfolio earned between 4% and 5% annually in the first five years of retirement, there was a 74% probability that the portfolio would last for 30 years. With a return of 0% to 1% during the first five years, the probability was reduced to 50% (Source: *The Wall Street Journal*, June 14, 2008).

The market declines of the past couple of years, combined with decreasing housing values, have substantially reduced retirement portfolios. If you are still working, you can work longer to help overcome these lower balances. But if you are already retired or about to retire, the choices aren't as easy. Faced with that situation, consider the following tips:

✔ **Withdraw as little as possible from your investments.** If your investments have declined substantially, reevaluate your withdrawals. Withdrawing the same amount from a substantially smaller portfolio means you'll deplete the balance much sooner. At a minimum, consider freezing your withdrawal amounts and not increasing them for inflation.

✔ **Go back to work on at least a part-time basis.** By going back to work, you'll be able to reduce your withdrawals from your retirement portfolio. Even modest earnings can help.

✔ **Set aside a cash reserve.** This reserve should contain assets not tied to the stock market, totaling two to four years of retirement expenses. With the reserve in place, you'll have money for day-to-day expenses and won't be forced to sell stock investments during market declines. How can you implement this strategy when your portfolio

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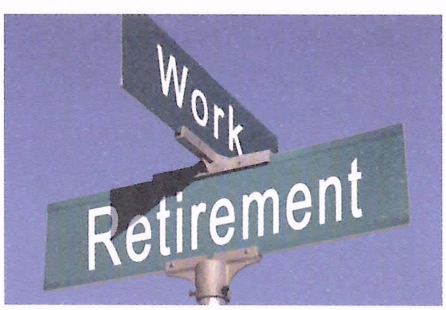

From Our Office to You

We hope the new year has started out on a good note for you. We are continuing to send out paperwork for the transition to LPL Financial. Thank you again for your cooperation with this process.

As you prepare to have your 2009 income taxes prepared, please make sure you review your beneficiaries on all your retirement accounts. Due to the transition, some of you will get multiple 1099s. Please call us with any questions about your year-end tax reporting statements. Our office is always available to you for planning advice, especially on funding your retirement accounts.

Please never hesitate to call to set up an appointment to review your accounts, or with any questions, and continue to refer anyone you think would benefit from our services. Thank you again.

Eileen & Steve Feiertag

Retiring

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values are already lower? Check if you have some stocks that have weathered the declines better than others, or maybe you can sell some bonds to get the reserve started.

✔ **Withdraw funds in a tax-efficient manner.** In general, you should consider withdrawing taxable investments first, so your tax-deferred investments can continue growing. This may also help with income tax expenses. You already paid taxes on your taxable investments, while any withdrawals from tax-deferred investments will likely be fully taxable as ordinary income.

✔ **Annuitize part of your investment portfolio.** Since an annuity is paid for the rest of your life, it protects you from outliving your savings and from the risk of lower-than-expected investment returns reducing your portfolio. Typically, the benefits will stop once you (and your spouse if you elect joint benefits) die, although some annuities will pay benefits to beneficiaries. Thus, it is important to understand that if you die at a relatively young age, your benefits may not equal the purchase price of the annuity. While you probably do not want to use all of your retirement assets to purchase an annuity, you may want to use enough to purchase an annuity that covers your regular monthly expenses. If your main concern is running out of money late in life, you can purchase a longevity annuity that starts making payments once you reach age 85 or so. This type of annuity will be much less expensive than one that starts benefits immediately. All guarantees are subject to the claims-paying ability of the annuity issuer. Annuities are subject to risks and charges, as well as limitations and restrictions, which will vary by insurance company.

Please call if you'd like to discuss how to handle declines in your retirement portfolio. OOO

Is Your 401(k) Plan Enough?

If you work at a company that offers a 401(k) plan, especially if the plan offers matching contributions, that 401(k) plan may be the most important part of your retirement investment plan. But should it be the only part? Here are five questions to help you decide:

✔ **What kind of lifestyle do you want to fund in retirement?** You'll find general rules of thumb indicating you need anywhere from 70% to over 100% of your preretirement income during retirement (Source: *Money*, January 2009). How much you'll need depends on your individual circumstances. If, for example, your mortgage will be paid off and you plan to stay home and watch your grandchildren during retirement, 70% of your preretirement income may be sufficient. If, on the other hand, you plan to travel extensively, 100% may be a better number.

✔ **How much can you count on from Social Security?** Social Security benefits were never designed as the sole source of retirement income, but they still are a valuable source of income. Those with lower incomes will find that Social Security replaces a higher percentage of their preretirement income than those with higher incomes. For 2009, the maximum Social Security retirement benefit for a worker retiring at full retirement age is $2,323 per month, with the average benefit totaling $1,153 (Source: Social Security Administration, 2009).

✔ **How much does your employer contribute to your 401(k) plan?** The $16,500 maximum contribution to your 401(k) plan does not include employer contributions. Employer matching contributions vary by plan, but a typical match is 50 cents for every dollar contributed, up to a maximum of 6% of your pay (Source: Center for Retirement Research, March 2009). However, due to these tough economic times, many employers are reducing or eliminating matching contributions. If your employer offers a match, make sure you take full advantage of it. A generous matching contribution can contribute substantially toward your retirement.

✔ **What are your average returns on your 401(k) investments?** You can only invest in investments offered by your 401(k) plan. But within those parameters, select investments that match the long-term nature of your investments and that will help grow your retirement funds over time. This is especially important now that stock market declines have substantially reduced most 401(k) balances.

✔ **What other sources of income can you count on in retirement?** If you already have other retirement assets, you might not need to count as heavily on your 401(k) plan. Other potential sources of retirement income might include a defined-benefit pension plan, individual retirement accounts (IRAs), an inheritance, or other investments.

If you contribute the maximum possible to your 401(k) plan and still aren't sure you'll have enough for retirement, please call for a review. There are a variety of other options you can use for saving for retirement. OOO

How Is the Fed Dealing with the Recession?

As detailed in the 1978 amendment to the Federal Reserve Act, the Fed's goals when setting monetary policy are "to promote maximum sustainable output and employment and to promote stable prices." Monetary policy has historically been implemented through three main methods:

✔ **Raising or lowering the fed funds rate** — This is the Fed's preferred method. The fed funds rate is the interest rate charged to banks for overnight borrowing from banks with excess reserves. Lowering this rate makes it less expensive for banks to borrow money and loan it out, while raising the rate has the opposite effect. Typically made at Federal Open Market Committee (FOMC) meetings, changes in the fed funds rate are widely reported and are viewed as a public signal of the Federal Reserve's monetary policy. While the fed funds rate applies to a relatively small volume of borrowed reserves, it has broader implications. Other interest rates typically change in response to changes in the fed funds rate.

✔ **Purchasing or selling U.S. Treasury securities in the open market** — If the Fed wants to increase reserves at member banks so more funds are available to lend to customers, it purchases government securities in the open market, paying for the securities with a Federal Reserve check. Since this check is not issued by a commercial bank, the entire banking system has more funds available when the check is deposited in a commercial bank. To reduce the supply of funds, the Federal Reserve sells securities.

✔ **Changing reserve requirements** — Each bank is required to keep a certain percentage of deposits on hand that cannot be loaned out. Changing the requirements allows the Fed to change the amount of money available on a large scale.

During the current recession, the Fed has responded to the large increases in the unemployment rate by aggressively cutting the fed funds rate, lowering it from 5.25% to essentially zero. Over the past two decades, the Fed has set the fed funds rate by lowering it 1.3% when core inflation decreases by 1% and lowering it by close to 2% when the unemployment rate increases by 1% (Source: *FRBSF Economic Letter*, May 22, 2009). During 2007 and 2008, the Fed's reduction of the fed funds rate by 5.25% was in line with this formula. However, the situation has worsened in 2009, meaning the Fed would need to reduce the fed funds rate to negative 5% by the end of 2009 to follow this formula. Obviously, they can't reduce the rate below 0%, so they have had to resort to other methods to stimulate the economy.

Based on economic forecasts of the Fed's FOMC, the fed funds rate should be near zero for several years. Due to the severe depth of the recession, it will take several years of significant growth for the economy to eliminate all slack.

The Federal Reserve has also implemented a number of programs designed to support the liquidity of financial institutions and foster improved conditions in financial markets, which has significantly increased the assets on the Fed's balance sheet. As of May 2009, the Fed's balance sheet has doubled in size to just over $2 trillion, with commitments for further increases by year-end (Source: *FRBSF Economic Letter*, May 2009).

The first set of tools, which are closely tied to the Fed's traditional role as lender of last resort, involves providing short-term liquidity to banks, other depository institutions, and other financial institutions. Because of the global nature of banks, the Fed has also approved bilateral currency swap agreements with 12 foreign central banks to help them provide dollar liquidity to banks in their jurisdictions.

A second set of tools provides liquidity directly to borrowers and investors in key credit markets. The Commercial Paper Funding Facility, the Asset-Backed Commercial Paper Money Market Fund Liquidity Facility, the Money Market Investor Funding Facility, and the Term Asset-Backed Securities Loan Facility fall into this category.

As a third set of instruments, the Fed has expanded its traditional tool of open market operations to support the functioning of the credit markets through the purchase of longer-term securities for the Federal Reserve's portfolio.

When credit markets and the economy begin to recover from the current financial crisis, the Fed will need to wind down some of its various lending programs and eliminate others. The Fed's balance sheet can be reduced relatively quickly, since a substantial portion of the assets are short term in nature and can simply mature. The Federal Reserve also holds significant quantities of longer-term assets, such as agency debt and mortgage-backed securities. Although these longer-term securities could be sold, the Fed will likely not dispose of more than a small portion in the near future. As the size of its balance sheet and the quantity of excess reserves in the banking system decline, the Fed should return to using the fed funds rate as its primary tool to implement monetary policy.

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Unemployment in the Current Recession

With unemployment rates higher than they've been in decades, how quickly will unemployment numbers come down once the recession is over? Researchers focus on two components of the unemployment rate — the inflow rate, or the rate that workers are moving into unemployment, and the outflow rate, or the rate that workers are moving out of unemployment.

During recessions in the 1970s and 1980s, employees were getting fired and were unable to find new jobs because employers were not hiring. This caused large spikes in the overall unemployment rate. However, once the economy turned around, the inflow and outflow rates returned to normal levels, bringing the unemployment rate down.

But during the 1991 and 2001 recessions, unemployment rates spiked up primarily due to lack of hiring, not due to massive layoffs. As the economy started to recover, employers were slow to hire, creating jobless recoveries.

During the current recession, the labor markets are again more typical of recessions in the 1970s and 1980s, with high levels of firing and low levels of hiring.

To try to determine how much hiring employers will do once the economy starts to recover, a couple of other indicators can be reviewed. During recessions, the number of temporary layoffs and the number of involuntary part-time workers typically increases. However, during this recession, there are more permanent, rather than temporary, layoffs, meaning that employers do not intend to rehire these employees in the near future.

The number of employees who are working part-time involuntarily is at a historical high, increasing from 3.0% in December 2007 to 5.8% in April 2009 (Source: *FRBSF Economic Letter*, June 5, 2009). This increase has occurred in a broad range of industries in a wide range of occupations. Many see this as a sign that once the economy recovers, employers will just move employees from part-time to full-time status, without the need to hire more employees. ❍❍❍

Why Isn't Inflation 0%?

One of the main goals of the Federal Reserve is to maintain inflation at a reasonable rate, currently targeted at 1.5% to 2% annually. So, if the Fed is trying to control inflation, shouldn't they shoot for a zero percent inflation rate? The answer is probably no, for a number of reasons:

- Current measures of inflation are believed to overstate inflation, so that low inflation rates may actually be close to zero percent.
- While it is usually difficult for employers to lower wages, they can accomplish the same result by not increasing wages as much as inflation.
- Deflation is considered more costly than a reasonable level of inflation, so low levels of inflation can help ensure against falling prices.
- At low levels of inflation, nominal interest rates are close to zero percent. The preferred strategy used by the Federal Reserve to stimulate the economy is to lower short-term interest rates. Once short-term interest rates are at zero percent, the Fed must resort to other strategies to help stimulate the economy. ❍❍❍

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