

Quarterly Insight

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Investment and Retirement Plan Services

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Now's A Time To Recall Financial Planning Basics

Just a few years ago, almost everyone knew at least one person who had made a fortune in the stock market. Today, many of us have lost a fortune. For those who are wondering what went wrong, here's a refresher course in financial planning basics.

Diversification.

In the late 1990's, many investors thought diversification meant buying three computer stocks and two Internet stocks. Others assumed they were being prudent



because they owned a dozen mutual funds. But true diversification means buying a range of investments in markets that do not move in lockstep with each other. Through most of the 1990s, growth stocks were the spectacular performers; in recent years value stocks have been successful. A balanced portfolio will have both. It will also include bonds. But just starting out with the right mix isn't enough; you also need to rebalance your portfolio regularly, trimming positions that have done well and adding to others that may be poised to rebound.

Planning. Establishing clear life goals and a long-term strategy is the essence of sound financial planning. A solid plan lays out the amount you must save annually, assuming an expected average rate of return, to reach your financial targets. It prepares you for future expenses, such as a child's college education, and unexpected

setbacks, such as premature death or disability.

Saving. Money doesn't grow on trees, but it does grow provided you invest it. The more you put aside and the longer you allow it to compound, the better off you'll be. The rule of 72 is the easiest way to see how this works*. Simply divide 72 by your rate of return to get the number of years it will take for your money to double. For example, with an 8% return, your investment will

double in nine years and quadruple in 18. A steady, automatic withdrawal from your paycheck is probably the most effective way to save. That way, you don't miss the money, because you never see it, and you're able to load up on assets when they're doing poorly and reap the benefits when they go up.

Retirement contributions. The government rewards savers by offering tax benefits to retirement accounts such as 401(k)s, 403(b)s, and IRAs. In most cases, you contribute pre-tax dollars and the money grows tax-deferred, meaning you don't owe taxes on gains until you withdraw the money. With Roth IRAs, you contribute money that has already been taxed but your withdrawals are tax-free. Either way, the boost from Uncle Sam is so generous that it's worth stuffing as much as possible into retirement accounts before allocating to regular savings and taxable accounts.

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Don't Make The Economy's Crisis Your Crisis

As the economic crisis widens, more people are taking early withdrawals from retirement plans. While that may solve immediate problems, draining money from retirement accounts only guarantees you'll feel the effects of these hard times long after they've passed.

According to an AARP survey, 13% of Americans age 45 and older took cash out from 401(k)s or other retirement plans between September 2007 and September 2008 to pay everyday expenses. That's regrettable, for several reasons. It depletes an account that's meant to support you after you stop working, and spending the money now means missing years of potential investment gains. In addition, if haven't passed age 59½, you'll not only be taxed on the withdrawal but also owe a 10% penalty (unless you meet a few special circumstances). Take, say, a \$10,000 distribution, and if you're in the 28% tax bracket, you'll pay \$2,800 in federal income tax plus a \$1,000 early withdrawal penalty. That leaves you just \$6,200—before you pay state taxes.

A better option, if you must tap requirement accounts at all, is to borrow from your 401(k) or make a temporary withdrawal from an IRA that you pay back within 60 days. But touching this money should be only a very last resort. Instead, evaluate your spending habits and give up any non necessities. The economy and the markets will inevitably recover, and so will your retirement plan—but only if you haven't raided it in the meantime.

Lessons From The Wall Street Giants' Fall

The March 2008 downfall of Bear Stearns Cos. was only the first of several failures of erstwhile Wall Street titans. Less than six months after the investment bank had to sell itself to JPMorgan Chase & Co. for next to nothing, Merrill Lynch & Co. was acquired by Bank of America Corp., and Lehman Brothers Holdings Inc. declared bankruptcy. What brought down these and other high-profile institutions was excessive risk and a lack of diversification—the same fatal flaws that doomed the retirement portfolios of employees at Bear Stearns and many other companies. For the Wall Street banks, the problem was massive bets on mortgage-backed securities. For the workers, it was holding too much stock in their own companies.

We've been down this road before. The 2001 collapse of Enron Corp. decimated its employees' retirement portfolios, and that outcome has repeated itself at many a corporate victim of irrational exuberance. Enron's fall cost 5,600 people their jobs, and many had most or all of their retirement money riding on Enron stock, which became worthless

when the energy company declared bankruptcy in December 2001.



(In a settlement reached in September 2008, five banks that worked with Enron agreed to pay a record \$7.2 billion to some investors, who will get an average of \$6.79 per share of common stock. At Enron's peak, shares had sold for more than \$90.)

When Bear Stearns was sold, the investment bank's 14,000 employees owned one third of the firm's stock, which had plummeted by 80% in preceding months. And more than 24,000 Lehman

executives and workers may have lost most of their savings when their employer went bankrupt.

That's the double whammy—losing a job and your savings—that can hit people who devote too much of their portfolios to shares in their own companies. What can make matters even worse is a tendency to invest additional assets in the same industry. Imagine the Bear Stearns employee who had supplemented a retirement plan loaded with Bear stock with holdings in Lehman Bros. and Merrill Lynch.

Companies, of course, tend to encourage employees to invest where they work, often matching 401(k) contributions and paying bonuses in company shares. They may also restrict workers from diversifying out of concentrated positions. Yet, as these unfortunate examples prove once again, finding a way to create a broadly diversified retirement portfolio needs to be every investor's top priority. There are many ways to mitigate an over-reliance on stock in your company, and we can work with you to make sure you won't suffer the same fate as your firm if it's pulled down during these difficult times. ●

Creating A Comfortable Financial Independence Plan

Everyone needs a financial blueprint for life after work. Operating without one is a little like closing your eyes as you barrel down the freeway. It's essential to know where you're going and how you expect to get there. But a financial independence plan will help you achieve your goals only if you incorporate it into your financial life, and that won't happen unless the plan feels comfortable. And that comes from understanding its component parts and how they're connected. Consider these elements:

Cash flow analysis. Your plan

needs to project where your money will come from and where it will go during the rest of your life (and your spouse's life, too, if you're married). What will come in during retirement, from Social Security, a company pension, annuities, and from drawing down your savings? And how will that match the needs of the lifestyle you want? Several unpredictable variables complicate these calculations. Inflation affects how far your money goes, and investment returns, based in turn on economic and market cycles and your choices, determine how much you have to spend. Taxes will also

play a role.

Investment choices. Three factors affect what should be in your investment portfolio. Your goals: What kind of return do you need, both while you're working and during retirement, to support your lifestyle? Your risk tolerance: How much volatility in portfolio returns are you willing to accept to meet your goals? Taking greater risks may provide higher potential long-term returns, but not if you panic and sell when the market takes a turn for the worse. And your time horizon: How long do you have to save for retirement,

Annuities Provide Stability, But You Pay A Price

Many retirees, worried that they'll outlive their savings, are turning to fixed and variable immediate annuities, which can guarantee a lifetime of income. But beware of their fees and inflation susceptibility.

With a fixed annuity, you trade a lump sum of cash to an insurance company. In return, the insurer promises you regular income payments for a defined period or for life. Your income payments are mostly determined by your life expectancy and how much the insurance company believes it can earn on your money. Because the insurer fixes payments based on the longevity of its entire pool of annuity customers, some of whom will die early, your monthly payments tend to be larger than you could earn on your own from similar interest-bearing vehicles.

An immediate annuity's fixed income stream means no more worries about securities markets or interest rates—seemingly just what the doctor ordered to get you sleeping at night. But in today's interest rate environment, the fixed nature of payments is also a potential drawback to an immediate fixed annuity. You're locking in a relatively low interest rate for years to come, and a future brush with inflation could put you right back pacing the floor. This is what happened to retirees who retired on fixed-income pension plans in the early 1970s. Inflation of the

what is your tax bracket, and how many years do you need your savings to last?

Contingency plans. Job losses, expensive illnesses, or the unexpected death of you or your spouse could put your plan off track. There could also be unforeseen expenses involving your children or parents, and the need for nursing home care during retirement could quickly drain your savings. Having a cash cushion along with life, disability, and long-term care insurance can prepare you to handle potential setbacks. Not planning for lifestyle changes is a major mistake and will put your financial future in jeopardy.

late-1970s and early 1980s dramatically eroded the value of their income.

A variable immediate annuity is an alternative. The insurer invests part of your money in an equity-based portfolio and fixed-income securities that promise to pay a fixed amount. Your income payment can go up or down based on the portfolio's performance. One catch: early payments from a variable annuity are generally lower than those of a fixed annuity, and fees are higher. Typical total costs may range from 1.5% to 2% annually, with some variable annuities charging as much as 2.5% annually.

Choosing between fixed and variable? "I'd give strong consideration to the variable," says David M. Cordell, professor of finance at The American College in Bryn Mawr, Pennsylvania. "Even if the stock market performs only moderately well, variable immediates will outperform fixed immediates by a large measure over the long haul."

But you must be aware of the stock market risk of a variable annuity and weigh the possible returns and risk against the fixed annuity's ironclad guarantee and lower costs. The fixed annuity helped new retirees avoid the bear market losses that fractured so many nest eggs, throwing many recent retirees into a fiscal crisis.

Estate planning. This is crucial even if estate taxes aren't likely to be an issue. You need a will, periodically updated, and a letter of instruction that tells heirs where to find information about financial accounts, life insurance, safe deposit boxes, and the like. It's also important to designate beneficiaries for 401(k)s, IRAs, and other financial accounts that reflect your wishes and take into account potential tax liability.

It can be complicated to weave together all of these elements. But we have the tools, expertise, and experience to help you create a financial plan that feels comfortable. ●



Beyond their ability to soothe retirees' fears, annuities can also serve as a way to build a personal pension plan, suggests Geoffrey Bobroff of Bobroff Consulting, a fund industry advisory firm in East Greenwich, Rhode Island. "Most baby boomers, unlike their parents, don't have a defined-benefit plan to fall back on," Bobroff says. "If I think I need \$1,000 a month to cover

essentials, I could buy an annuity to produce that income. If I have a \$500,000 portfolio, ideally I would invest part of it in guaranteed products like annuities and part in vehicles carrying more risk to generate growth."

One drawback to immediate annuities: their performance depends on how long you live. Beat the actuarial tables and live longer than expected, and you'll make out well. But if you die before your time, the return could be paltry.

While some annuities promise to pay your heirs for unused benefits, your initial monthly payments will be smaller to pay for that promise to be put in a rider.

Finally, while immediate annuities may have a role in some retirement plans, if you have a substantial portfolio you may also want to consider creating your own withdrawal program. It might deliver more flexibility and greater returns than you'd get with an immediate annuity. ●

A variable product is a contract between you and an insurance company. A variable annuity is part insurance policy and part security investment. A variable insurance policy invests cash values in securities accounts held separately from the assets of the insurance company. The value of variable products will vary depending on the value of the underlying securities.

Guaranteed riders on variable products can be complex and will generally increase the annual costs charged.

Variable products are offered by prospectus. Please consider the charges, risks, expenses, and investment objectives carefully. The prospectus contains this and other information about the annuity and should be read carefully before investing.

To Consolidate Your IRAs Or Not To Consolidate

Although this dilemma isn't as life altering as Hamlet's, it could still have a significant impact on your financial affairs. Here are several reasons to consider one path or the other.

When not to consolidate. While it's generally possible to consolidate multiple traditional or Roth IRAs—that is, merging traditional IRAs with other traditional IRAs, or Roths with other Roths—you can't put a traditional IRA with a Roth, and you can't join an IRA with employer retirement plans such as 401(k)s or 403(b)s.

One reason not to consolidate accounts is that it may mean forfeiting favorable tax treatment. For example, you're not permitted to commingle funds when you've rolled over retirement plan assets inherited from a non-spouse—those must remain in a separate inherited IRA. (You can, however, merge an IRA left by your spouse into your own account.) Or you may have assets in a "conduit IRA," a special kind of account that holds money from a previous employer's retirement plan until you can move it to a plan at your new job. To preserve the advantages of a 401(k) or 403(b)—for example, being able to tap

the account at age 55 if you retire early, or getting better tax treatment for company stock—you must avoid mixing a conduit IRA with other accounts.

You may also not want to consolidate if the IRAs have been separated to accomplish specific planning goals involving beneficiary designations or to set up specific streams of income.

When to consolidate. If none of those reasons apply, bringing together two or more accounts may provide several benefits. Almost all of the advantages involve the fact that it's much easier to manage one account than to keep track of several. Consider the following:

- Making changes in your investment strategy—say, moving to a more conservative mix of assets as you approach retirement—is significantly more complex and time-consuming if it involves several accounts.

- If you have many accounts, you may tend to ignore those that are small or

aren't performing well.

- If your IRAs are at several institutions, each one may charge you an annual maintenance fee. You'll also have more paperwork, with multiple monthly statements and end-of-year tax forms.

- When it's time to begin distributions from a traditional IRA—the year after you turn 70½—the amount of the required withdrawal is

based on the total value of all IRAs. Neglect to include one in your calculations and you'll face punishing tax penalties.

- Before consolidating IRAs, consider rolling over your 401(k) plan to an IRA so that you can "stretch" the IRA over a beneficiary's life expectancy. If a 401(k) participant dies before doing this, beneficiaries are generally required to take a full distribution and pay income taxes on it within five years.

We can help you decide if you should consolidate your IRAs and consider how those assets fit into your overall financial plan. ●



Financial Planning Basics

(Continued from page 1)

Tax planning. Hidden within hundreds of pages of tax laws are a broad range of special breaks for taxpayers. Shifting income from one year to another, selling assets that have lost money to balance out gains from top performers, and making contributions to educational savings accounts are just three possibilities. Review your tax situation with a financial professional at the beginning of the year and again in December.

Insurance. Planning for the unexpected is the key when determining insurance needs. You should have enough life insurance to meet heirs' long-term needs. Your health insurance should include coverage of

catastrophic accidents or illnesses. Disability insurance is relatively inexpensive, but could make a big difference if you need it. And you should seriously consider long-term care insurance if you don't think your retirement income will be sufficient to pay for nursing home care.

Estate planning. Having the right estate plan will ensure that your wishes are respected. If you have substantial assets, developing a well-thought-out estate plan can minimize taxes even while you are alive and maximize the amount you are able to leave to loved ones and your favorite charities. Even if you don't have enough in your estate to be liable for federal or state estate taxes, having a valid will can save your heirs a lot of trouble and money.

In the dying days of the 20th

century, there was talk about how the old financial rules no longer applied. "It's different this time," everyone said. But it wasn't all that different, and millions of investors lost ground and time on the road to their financial goals. It's never fun to start over, but it does give you one more chance to do everything right. Taking care of these basics should prepare you well, and we are happy to help. ●

***The Rule of 72 is hypothetical and there can be no assurance that any investment will double within the specified timeframe.**