Your RETIREMENT Matters

Summer 2010

Destination: Retirement

When you plan a vacation, you figure out ahead of time the locations you want to visit, sights you want to see, and things you want to do. Planning your itinerary and activities before you leave home helps make your trip a success.

Planning for your retirement is a lot like planning for a trip. Anticipating your future lifestyle and financial needs before you retire helps ensure your success in reaching your goals.

Book Your Investments

Part of your planning involves selecting investments for your retirement plan account. Which investments should you choose for your retirement plan account? Most plans offer choices in three main categories.

Stocks — Stocks have historically provided the highest potential long-term returns, but they also have the greatest risk of short-term losses. (Past performance does not guarantee future results.)

Bonds — Bonds tend to provide more modest returns than stocks but usually are less risky.

Cash — Investments that can be easily converted to cash, such as money market investments, are the least risky but also offer the lowest potential returns of the three major asset classes.

Historically, the returns of assets in the major categories do not move up and down together. When stocks rise, bonds may decline, and vice versa. You may want to include different types of investments in your retirement portfolio. Diversifying* your portfolio may result in the gains of one investment type cushioning the losses of another type of investment.

Map Out Your Route

How you split up your contributions and existing plan assets among the investment categories will affect the long-term performance of your portfolio. First, consider your goals, risk tolerance, and how far from retirement you are. The longer you have to invest, the more risk you may be able to handle since you'll also have more time to recover from any downturns.

Early in your career, you may be comfortable enough to invest a large share of your retirement money in stocks to increase your potential for long-term growth. As retirement nears, however, you may want to slow down and reduce your exposure to risk. Putting more of your assets in bond and cash investments can help reduce the risk of loss and preserve the value of your portfolio.

* *Diversification does not ensure a profit or protect against loss in a declining market.*

A Wonderful Life

Howard is thoroughly enjoying his retirement years with his wife Helen.* They have their health, family nearby, and good friends. They are also financially comfortable and can afford to travel and pursue their hobbies. One of the reasons Howard and Helen are able to enjoy their retirement years is because they saved throughout their working years.

A Man with a Plan

Howard's first employer offered a retirement savings plan. Even though retirement was a long way off, Howard joined the plan as soon as he was eligible. He knew that compounded savings could add up significantly over time. Howard also invested a significant portion of his account in stock investments. While he was aware that stocks can be volatile, he also understood that stocks have the potential for higher long-term growth than other types of investments.

Multiple Goals

When Howard and Helen married, their goals included buying a house and starting a family. But they also wanted to save for retirement, so Helen started saving in her employer's plan, too. Even when money was tight and their expenses included a mortgage, home repairs, a car payment, and child care costs, Howard and Helen contributed to their retirement accounts. Since their plan contributions were automatically made before they received their paychecks, they weren't tempted to spend that money on other expenses. Since they didn't stop saving, the value of their accounts continued to grow.

Looking Ahead

As retirement drew closer, Howard and

* Howard and Helen are fictional characters used for illustrative purposes only.

Save Through Your Life

Making saving for retirement a priority will help you accumulate more in your account. If you stop saving to take care of other expenses, you'll limit the amount you'll be able to accumulate over the years.

	Lifetime of Saving	Life Gets in the Way
Years	**Monthly Contribution**	**Monthly Contribution**
1 - 10	$200	$200
11 - 20	$200	$0
21 - 40	$400	$400
Account Balance After 40 Years:	**$387,411**	**$303,166**

This is a hypothetical example used for illustrative purposes only. It does not represent the results of an investment in any fund or portfolio. A 5% annual return (compounded monthly) is assumed. Your investment results will be different. Tax-deferred amounts accumulated in the plan are taxable upon withdrawal. *Source: NPI*

Talking Taxes

When you talk about the advantages of your retirement savings plan, you have to talk about taxes. Your plan provides you with pretax savings, tax-deferred compounding, and, potentially, the opportunity to claim the Saver's Credit. (Income limits apply.) The special tax treatment you receive when you participate in your plan truly is something to talk about.

Built-in Benefits

Your retirement savings plan lets you and/or your employer contribute on a pretax basis.* This means the money is deducted from your pay before federal (and, perhaps state and local) income taxes are taken out. You save by paying less in current taxes on your earnings. To increase your tax savings, consider increasing the amount you contribute to your plan.

Compounding Conversation

Whether your contributions come from you or your employer, the pretax contributions and any earnings on your plan investments aren't taxed until you receive distributions from your plan.* Over time, tax-deferred compounding can help your account balance grow. When you are saving over a long period, for example 20 or 30 years, the power of compounding interest has the potential to provide dramatic results.

Tax Credit Topic

If you qualify, you may be able to claim a credit on your federal income-tax return for contributions to your retirement plan. The Saver's Credit is 10%, 20%, or 50% of a maximum of $2,000 in qualified retirement savings contributions for the year. Eligibility and the applicable credit rate depend on your income and filing status.

** Some retirement plans also offer a Roth contribution option. Unlike pretax contributions, Roth contributions do not offer immediate tax savings. However, qualified Roth distributions are not subject to federal income taxes when all requirements are met.*

The Power of Tax-deferred Compounding

Consider the advantages of saving for retirement in a tax-deferred plan.

	Tax-deferred Plan	Taxable Account
Contribution	$2,500	$1,875 ($2,500 minus 25% income tax)
Average annual total return	6%	4.5% (6% minus 25% income tax)
Account value in 30 years	$209,274	$118,654
Federal taxes payable upon distribution (25%)	$52,319	0
Total accumulated for retirement	$156,955	$118,654

Advantage for tax-deferred plan participant: Balance is 32% higher.

Example assumes monthly contributions and compounding. This is a hypothetical example used for illustrative purposes only. It is not representative of any particular investment vehicle. Your savings amount, investment results, time frame, and tax rate may be different. *Source: NPI*

Helen continued saving. In fact, since their children were grown and their mortgage was paid in full, they increased the amount of their contributions. However, they did shift some of their money out of stocks and into less risky bond and cash equivalent investments since they knew they had less time to recover from any short-term stock losses. They held onto some stock investments to help the return on their savings keep pace with inflation during retirement.

The Next Chapter

Now that they're retired, Howard and Helen keep a close eye on their savings. They make sure they don't withdraw more than they need because they don't want to risk outliving their assets. But because they started saving young and continued saving throughout their careers, Howard and Helen are enjoying a comfortable retirement.

Saving continuously for retirement during your working years despite other expenses will help you achieve your retirement goals.

Keep on Building

When the stock market is volatile, you may be tempted to take a break from stock investments for a while. Shifting into less risky investments may seem to make sense at the time. But getting out of stocks could mean missing out on potential gains. When building your retirement account is a long-term goal, consider continuing to contribute to stock funds or portfolios during periods of poor market performance.

Expect Ups and Downs

When you invest in stocks, you have to expect market downturns. Over time, however, long-term gains may more than make up for short-term losses. Although nothing is guaranteed, in the past, the stock market has recovered from every downturn.

Trouble with Timing

Buying low and selling high is an extremely difficult strategy — most experts cannot do it consistently. You may find that, in your effort to time the market, you are actually selling low and buying high. If you decide to move your money out of stocks because they haven't performed well recently, you actually may be locking in those losses because you're selling "low." Then, by the time you realize that stocks are recovering and move your money back into the market, you may miss out on significant gains because you're buying "high."

Build It Back Up

A better plan may be to continue investing in stocks during down periods. Low prices may be a buying opportunity that could pay off if stocks rebound. Maintaining your long-term investment strategy no matter what the market is doing could help you build up your retirement savings over time.

Don't Miss Out

Moving your money out of stocks due to poor performance in the short term may mean missing out on future gains. Below, you can see the impact of missing the month with the highest return each year.

Initial Investment: $10,000

	2005-2009	2000-2009	1995-2009	1990-2009
Stayed in Stock Market	$10,211	$9,090	$31,912	$48,397
Missed Month with Best Return Each Year	$7,949	$4,881	$12,293	$13,564

This is a hypothetical investment that performed similarly to the S&P 500 Index, an index of 500 large-cap stocks. Past performance does not guarantee future results. You cannot invest directly in an index. Your investment results will be different.
Sources: Mellon Analytical Solutions, LLC and NPI