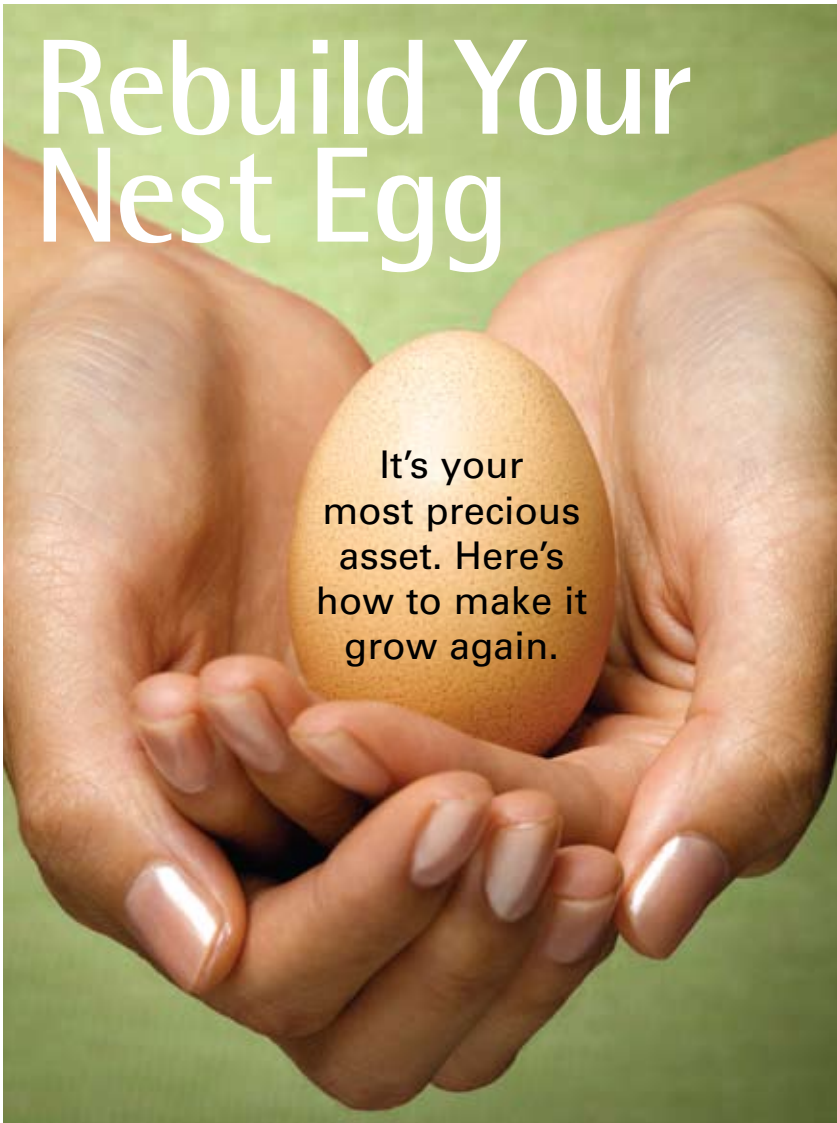


# invest

■ IT'S YOUR FUTURE ■



## Should You Wait to Retire?

ARP reported in January that 57% of Americans over age 45 whose retirement investments declined in 2008 expect to delay retirement and work longer.<sup>1</sup> Postponing retirement can be difficult. But you'll have more money to live on during retirement. Remember: Your Social Security benefit increases by 8% for each year you delay retirement between ages 65 and 70. And your nest egg will have more time to grow. Consider the example of a worker with \$250,000 saved in her workplace plan. Below, you can see the potential impact on her savings if she delays retirement for one, two, or three years, and contributes 10% of her salary to her plan each year she continues working.<sup>2</sup>

### The Power of Patience

|               |           |
|---------------|-----------|
| Waits 1 year  | \$270,375 |
| Waits 2 years | \$292,005 |
| Waits 3 years | \$314,960 |

<sup>1</sup>"A Year-End Look at the Economic Slowdown's Impact on Middle-Aged and Older Americans," January 2009.

<sup>2</sup>Assumes the investor earns \$75,000 the first year, receives a 3% annual raise, and earns a 5% annual return on investments.

Is the recession forcing you to tighten your budget? Has the bear market reduced the value of your retirement accounts? Today's challenges call for smarter saving and investing as you work toward rebuilding your nest egg, starting with these goals:

### Build an emergency fund

Financial advisors typically recommend holding three to six months' worth of expenses in an easily accessible account, such as a money market fund. This can help you ride out difficult times without tapping your savings or taking on debt.

### Get rid of credit card debt—for good

The sooner you eliminate credit card balances and other high-cost debts, the less interest you'll have to pay your lenders over time and the sooner you can add to your retirement savings. Say you carry a \$5,000 balance on a card charging 18% interest. If you make only the minimum payment each month, it will take close to 33 years to eliminate your debt—and you'll pay almost \$12,000 in interest.<sup>1</sup> Pay \$250 every month, and you'll get rid of the debt in two years for a cost of less than \$900 in interest.

continued on p. 2

## Rebuild Your Nest Egg (cont.)

### Use a flexible spending account (FSA)

If your employer offers it, an FSA can lower your taxes, leaving you more money to save for retirement. Contributions to the account are deducted from your paycheck before taxes, and you can withdraw money tax-free to pay for certain out-of-pocket costs, including medical and dependent care.<sup>2</sup>

### Save tax refunds and other windfalls

You could, for example, deposit a \$1,200 refund or bonus in a savings account, withdraw \$100 each month for a year to help pay your bills, and then increase your retirement contribution by \$100. Over 30 years, that extra \$100 a month could boost your retirement savings by more than \$122,000, assuming 7% annual returns.

### We want to hear from you!

We hope you're enjoying the newsletter's new look and welcome your feedback and questions. Please send all queries to [investinyourfuture@hearst.com](mailto:investinyourfuture@hearst.com). If we print your query, your name will be withheld.

### Invest for the long term

In general, the longer you have until you need your savings, the more sense it makes to invest more in stocks. For some investors, that may be hard to fathom, considering 2008's declines. But while stocks may experience severe short-term losses from time to time, they offer the strongest

long-term growth potential of the three asset classes (stocks, bonds, and cash). As measured by the S&P 500 Index, stocks have not posted a decline for any 20-year period since 1926.<sup>3</sup>

It will take time and effort to work toward these goals. So get started now—you'll be glad you did. ■

<sup>1</sup> Assumes minimum monthly payment of 2% of outstanding balance, with a minimum payment of \$20.

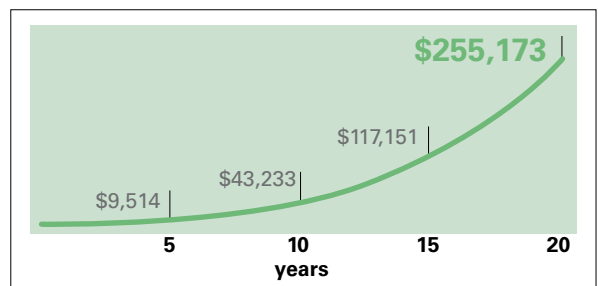
<sup>2</sup> Do not withhold more than you'll need: FSAs for medical and dependent care require you to spend the funds by year-end or you forfeit any money still in the account.

<sup>3</sup> Ibbotson Associates, a subsidiary of Morningstar, Inc.



## Boost Your Contributions

The following chart shows how diligence pays off when saving for retirement. It illustrates savings growth over 20 years for an investor who starts with a salary of \$50,000. She receives annual raises of 3%, initially contributes 1% of her salary to her retirement plan, and each year thereafter increases her salary deferral to her retirement plan by 1%.<sup>1</sup>



<sup>1</sup> Assumes 7% annual investment return.

## Going to Extremes



It can be tempting to put all your money into cash when stocks fall or shift all your savings into stocks after the market rises. The trouble is, jumping in and out of the stock market, known as "market timing," is usually counterproductive.

By shifting your savings to cash after the market falls, you lock in your losses. What's more, you could miss out when stocks rebound. The market historically has produced some of its strongest returns soon after big declines—so missing the start of a recovery could hurt your long-term returns.

By contrast, if you're a long-term investor—particularly in a workplace savings plan—you reap the benefits of dollar cost averaging (DCA). Through DCA feature, your plan automatically invests a certain amount of your contributions at regular intervals, which can help lower the average price

you pay for shares of securities. DCA also helps you avoid the temptation to time the market. You just continue investing, regardless of what the market is doing.

Adhering to a sound long-term investment strategy can help you reach your goals, no matter what the markets do in the short term.

# Proactive on Debt

The current recession has provided many lessons for Americans—chief among them a reminder of the dangers of falling deeply into debt. Use the chart below to analyze your current debt situation.

| Ask Yourself  | Your Status | Our Recommendation   |
|---|-------------|--|
| How many credit cards do I own?   |             | The more cards you hold, the harder it is to keep track of balances and credit lines. Never hold more cards than you can manage.   |
| What is the highest interest rate on my cards?  |             | The average credit card charged 13.54% interest in 2008 (with the highest averaging 22.75%), according to a survey by Consumer Action. Strive to avoid interest altogether by paying your card off each month. |
| How much do I pay on each card every month?   |             | If it's more than you can afford, you need to take action now to reduce your debt.   |
| What are my total debt payments? (Include any mortgage, credit cards, and other debts.) |             | Your total debt payments, including your mortgage, should represent no more than 36% of your pre-tax income. <sup>1</sup>  |

<sup>1</sup>LendingTree.com



## Next Steps

To pay down credit card debt as quickly as possible:

**1 Analyze your spending to find areas where you can free up cash.** For example, you might dine out less frequently or carpool to work rather than driving alone. You may need to make bigger sacrifices as well, like postponing luxury purchases for a year.

**2 Each month, make the minimum payment on all your credit card accounts** to avoid late fees. Then make as large an additional payment as you can on the card with the highest interest rate.

**When your credit card debt is paid off, take a moment to celebrate—then use money you were sending to your card companies to pay yourself by saving more for retirement.**

## Don't Fall for It!

You've seen the offers: "15% off your entire purchase if you apply for a store credit card!" Or "No payments and no interest for a year when you buy a flat-screen TV!" While such offers may be tempting, they can damage an important component of your credit score: your credit utilization rate.

Your credit score essentially measures your ability to pay back debt. Your credit utilization rate measures your debt



as a percentage of your total available credit. Lenders look for credit utilization of 30% or less.<sup>1</sup>

### Use less credit

Many store cards carry low credit limits. As a result, a few purchases might max out the cards, pushing up your credit utilization rate. Likewise, appliance, electronics, and furniture retailers frequently offer no-payment, no-interest deals. These offers have two problems. First, if you don't pay off the balance within the allotted

time you'll owe back interest on the entire purchase price. Second, the deals usually provide credit equal to your purchase amount, and as you pay it off, the credit limit declines. Consequently, you always use 100% of the credit line—increasing your overall credit utilization rate.

**A better bet: Plan ahead and set cash aside to pay for these purchases—and enjoy living with less debt.**

<sup>1</sup>smartmoney.com



## The Fed, Interest Rates, and Stocks

In the past, the Federal Reserve's rate cuts have helped battered stock markets recover. Will history repeat itself?

Since early 2008, the financial pages have been full of news about the Federal Reserve Board's attempts to fix the financial system and stimulate economic growth. In particular, the Fed—through its policy-making arm, the Federal Open Market Committee—has dramatically lowered its target short-term interest rate, known as the federal funds rate. It is the rate banks charge each other for loans.

### A potential market boost

Reducing the federal funds rate effectively injects more cash into the economy, helping to promote stronger economic growth. In the past, lower rates have tended to help the stock market, although the effect has been far from immediate.

For example, during the recession of 2001, the Fed lowered the federal funds rate dramatically. Stocks struggled until October 2002, but then staged a powerful five-year rally—fueled in part by low interest rates.<sup>1</sup>

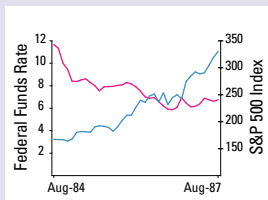
After those five years, signs of a credit crisis emerged, so the Fed began cutting the federal funds rate again in September 2007. The Fed reduced the rate consistently through 2008, and since last December has held it steady at a range between 0% and 0.25%. Will these interest-rate cuts help the stock market break out of its current slump? Only time will tell; but history suggests that they might.

<sup>1</sup>Standard & Poor's.

## Rate Cuts and Rallies

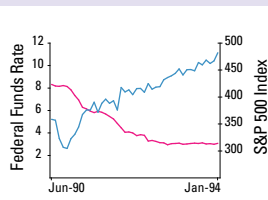
The following graphs show the relationship between the federal funds rate and stocks, as measured by the S&P 500 Index, during three key periods.

— Federal Funds Rate (%) — S&P 500 Index



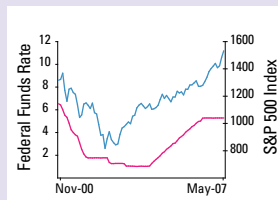
### August 1984 to August 1987

The Fed slashed rates from historically high levels as inflation slowed, helping stocks to nearly double in value.



### June 1990 to January 1994

Rates were lowered to fight recession. Stocks improved modestly at first, then rallied strongly after deeper rate cuts from 1991-1992.



### November 2000 to May 2007

The Fed responded swiftly to recession and the September 11 terrorist attacks with deep rate cuts. By late 2002, stocks entered a five-year rally.

## Pop Quiz on Risk

When most investors think of risk, they think of big declines in the stock market. But that's not the only risk you face when you invest. Take the following quiz to test your understanding of the different types of risk.

**1** The risk that rising prices will decrease the future purchasing power of your savings is called:

- a) Credit risk
- b) Market risk
- c) Inflation risk

**2** Since 1926, the largest calendar-year loss for the S&P 500 Index was:

- a) -15.5%
- b) -43.3%
- c) -66.7%

**3** True or False: Bonds historically have offered the greatest protection against inflation risk.

**4** True or False: Young investors generally should limit their exposure to market declines by holding only a small percentage of their savings in stocks.

**Answers:** 1. C: In 20 years, you'll need approximately \$1.81 to buy what \$1.00 can buy today, assuming inflation increases at its historical average rate of 3%. 2. B: The S&P lost 43.3% in 1931, according to Ibbotson Associates. The S&P's -37.0% return in 2008 was its second-worst calendar year since 1926. 3. False: Stocks historically have offered stronger long-term growth potential than bonds. 4. False: Young investors won't need their retirement savings for decades, so they generally are better off protecting against inflation risk by investing in stocks than guarding against short-term market declines.

# Forging a New Path

A single parent transforms hardship into opportunity.



Tracey Bolton looks forward to a new career and greater financial security.

“I recommend putting that money in a safe, liquid account,” says Brown. “That way she can use it to cover any income shortfall before she finds a job.”

## Invest for growth

Tracey’s 401(k) account lost \$8,000, or about 20% of its value, in 2008. Her asset allocation (the way her investments are divided between stocks and bonds) is 70% bonds and 30% stocks. “In my opinion, that’s too conservative for someone Tracey’s age,” says Brown. “Since Tracey has 20 or more years until retirement, she needs more exposure to

stocks’ potential long-term growth.” Brown recommends that Tracey gradually increase her stock holdings to at least 65%.

Brown says Tracey should also consider rolling her 401(k) savings into an IRA, which may offer lower costs and more investment options than her old employer’s plan.<sup>1</sup> “When she starts a new job at a hospital or other health care facility, she’ll probably be eligible to participate in a 403(b) plan, the nonprofit version of a 401(k) plan,” says Brown. “At that point, Tracey should contribute as much as she can to her new workplace plan.” This will allow Tracey to invest pre-tax dollars, and her employer may match a portion of her contribution.

## Keep saving

Tracey chose to pursue nursing because the work interests her and could offer stable employment. After graduation, she expects to earn roughly 50% more than she did as a loan officer—

meaning she’ll be able to devote more to her retirement savings.

“My kids were my priority when I was younger, not my education or retirement savings,” Tracey says. “Now it’s my turn to finish school and put myself in a better place to help them—and myself—later on.” ■

Last summer, Tracey Bolton was laid off from her job as a loan officer. While it was scary for a single mom with three children during the worst financial crisis since the 1930s, Tracey decided a career switch was in order and went back to school to study nursing. She saw a chance to make a better life for herself and her family.

That’s easier said than done for someone who has multiple financial priorities. This year’s tax refund—approximately \$5,000—could help make a difference. “I want to figure out how to make the most of that tax refund and get on track for retirement,” she says. The following is advice from Dawn Brown, a certified financial planner at L.J. Altfest & Company in New York City.

## Start a rainy-day fund

Tracey hasn’t saved much for retirement, but her finances are fairly solid. She has no debt other than the \$225,000 mortgage on her house, which is worth approximately \$300,000. And her monthly income—from a combination of unemployment benefits and child support payments—exceeds her modest expenses by roughly \$600.

Tracey’s nursing studies qualify her for extended unemployment benefits, which she expects will run out before she graduates in mid-2010. With that in mind, Brown advises Tracey to use her tax refund to open an emergency fund.

## At a Glance

**Tracey Bolton**, age 38, Sewell, N.J

**Family:** Single mother to Becca, 18; Michael, 16; and Luke, 4

**Occupation:** Full-time nursing student

**Income vs. Expenses:** \$4,200 vs. \$3,600 (monthly)

**401(k) Savings:** \$29,000

<sup>1</sup> For information regarding IRAs and Roth IRAs, see the Smart Moves “Strategies for Tough Times” article on page 6.

# SmartMoney

THE WALL STREET JOURNAL MAGAZINE

## Strategies for Tough Times



status. You'll even be able to make contributions to the roll-over IRA, provided you meet certain income requirements.

A final option: Roll your wife's workplace retirement plan assets into a Roth IRA, if she's eligible.<sup>1</sup> You'll have to pay taxes on the entire amount you roll over, but your withdrawals will be tax-free. That will be a big advantage for both your heirs, and yourself (if you expect to be in a higher tax bracket when you're retired).

**Q:** I'm too nervous to ride out the stock market's ups and downs. Where can I put my money that's less risky?

**A:** Before adjusting your portfolio, it's worth considering risk a bit more closely.

In the short term, stocks do have a greater chance of losing value than bonds and cash investments. But stocks have consistently produced gains over longer periods. In fact, the stock market, as measured by the S&P 500 Index, hasn't lost ground during any 20-year period since 1926.<sup>2</sup> Stocks have also produced much stronger returns than bonds or cash: A \$10,000 investment in stocks in 1984 would have grown to more than \$100,000 by the end of 2008—even after last year's historic losses—assuming stocks matched the return of the S&P 500.<sup>3</sup>

Bonds and cash, on the other hand, rarely post big short-term losses. In exchange for that stability, they provide lower rates of return. While you may be willing to accept that tradeoff in the short term, it can cause a significant problem down the road: Your investments may not outpace inflation, so over time your purchasing power will steadily erode.

The best tool for managing risk is a diversified portfolio. Maintaining investments in a variety of stocks, bonds, and cash funds may minimize the impact that market declines and inflation might have on your investments.

» If you have a question about investing or managing your retirement savings plan, email us at [smartmoves@smartmoney.com](mailto:smartmoves@smartmoney.com).

**Q:** My wife recently lost her job. What should we do with her workplace retirement plan assets?

**A:** Above all, avoid tapping your wife's retirement savings. You'll have to pay income tax on any money you take out—and if your wife is under age 59½, she's likely to owe a 10% early-withdrawal penalty. She'll also lose the potential for that money to generate tax-deferred growth.

If the balance in your wife's account is more than \$5,000, you can leave the money there for now. Or you can wait until she finds a new job, then roll over the money into her new employer's retirement plan, if the company allows roll-overs. If your wife's new firm won't allow her to roll over her savings, you might consider rolling the account into an IRA. With a traditional IRA, the rollover will be tax-free, and the new account will preserve the money's tax-deferred

<sup>1</sup> See clarification below for income eligibility.

<sup>2</sup> Ibbotson Associates, a Subsidiary of Morningstar, Inc.

<sup>3</sup> Data provided by Ibbotson Associates and Standard & Poor's.

**CLARIFICATION:** In the Winter 2009 issue, a reader asked if a married couple can invest in IRAs when they both participate in a workplace retirement plan. Our response included a table that showed adjusted gross income (AGI) and eligibility requirements for Roth and traditional IRAs for spouses who file taxes jointly. The table referred to 2008 AGI limits, but the numbers are actually 2009 limits. In 2009 for Roth IRAs, combined AGI must be \$166,000 or less for each spouse to make the full contribution, phasing out at \$176,000. For traditional IRAs, combined AGI must be \$89,000 or less, phasing out at \$109,000.