

# Financial Insights®

A Creative Personal Finance Report



(626) 919-3456  
(800) 365-7749  
FAX (626) 919-6127

**JOSEPH N. RUBINSTEIN, MBA**

Personal Financial Consultant  
General Securities Principal

**DIVERSIFIED SECURITIES INC.**

COMPLETE INVESTMENT AND ADVISORY SERVICES  
1000 LAKES DRIVE, SUITE #420, WEST COVINA, CA 91790  
E-Mail: joerubins@yahoo.com CAL. INS. LIC. #0A68771

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June 2009

## On the Roth 401(k) and Roth 403(b)

Most traditional retirement plans have increased limits in 2009. But the best news is that the Roth 401(k) and the Roth 403(b) are still available (until sunset in 2011 unless Congress renews the legislation). They allow employees (and business owners) to contribute more money to retirement plans, thereby increasing the chances that



their retirements will be well-funded.

These are “hybrid” plans that maintain some of the characteristics of the Roth IRA and some of the 401(k) and/or 403(b). The vehicles allow employees to treat part or all of their own contribution amounts — the part that is deducted from their paychecks — as a “Roth-like contribution.”

Of course, it also means that the amount does not result in a federal tax deduction, but the growth, if any, of the employer contribution (and its subsequent withdrawal) will not be subject to income tax the way traditional plans may be. Age requirements (reaching

## Rational Market, Irrational Investors

History is full of instances in which investors have appeared to take leave of their senses . . . from the overvalued **Nifty 50** stocks of the early 1970s, to the 1987 stock market crash, to the **Tech Bubble** of the late 1990s to the recession of 2007-2009. Here are some key behavioral traits that are common among inexperienced investors:

**Euphoria** - Sometimes the past success of a stock colors our view of its future prospects. While it's tempting to continue to ride a winning stock, many investors don't know when to get off the carousel.

**Panic** - Investors commonly unload their investments at precisely the wrong time . . . after they have suffered serious declines and before they have had a chance to rebound.

**Excessive Pessimism** - Skepticism is a valuable trait, but not if it leads you to avoid the calculated risk-taking that's necessary to generate returns.

**Searching for Long Shots** - Lottery tickets are appealing because of the possibility of a huge windfall. But the payoff, by definition, comes to only a few. Buying lottery tickets is not an investment plan. The joy of thinking about hitting a lottery is two-fold: imagining what good you will do and making a list of who won't get a penny!

**Reacting, Not Acting** - Markets always change. Strong companies may fade and miscreants may mend their ways. A good investor (or investment manager) is proactive, seeking out opportunities ahead of the pack and reviewing holdings as they stray from what made them attractive in the first place.

age 59½) apply in order to enjoy tax-deferred withdrawals without penalty.

Bottom line: if you have a Roth 401(k) and a traditional 401(k) with the same amount invested, all other things being equal, the Roth 401(k) **may** be of greater ultimate value since the income taxes imposed on the traditional 401(k) will reduce its future withdrawal value.

Making this choice is similar to the decision that you may have already made regarding contributions to a Roth

IRA or a traditional IRA.

Roth IRA income limitations for 2009 (couples with adjusted gross incomes of less than \$176,000 and singles with AGI of less than \$120,000) do not apply to the Roth 401(k) or the Roth 403(b) plans, allowing higher income taxpayers to participate in the Roth environment.

These Roths do not allow for tax-free first time home purchase withdrawals and must exist for at least five years to allow tax-free withdrawal.

## Questions & Answers

**Q. Financial stress is a well-documented and well-researched phenomenon. What should I do?**

**A.** According to Lucy J. Pearson, former Extension Family Relations/Human Development Specialist and Nancy M. Porter, Extension Family Resource Management Specialist at Clemson University, there are four basic steps.

**First, do not panic.** You can still control your financial situation if you plan carefully.

**Second, communicate.** Analyze your financial priorities and talk with your family about what you can do. Have regular communication with your financial advisors as well.

**Third, do not default on payments.** Explain any situation to creditors and work out adjustments.

**Finally, be prepared to change your way of living,** at least temporarily, so that you do not end up sacrificing essentials.

As a side note, there is no need to watch the indices on an every-day basis. Headlines are lagging, not leading indicators.

**Q. May I invest in a limited partnership in my Individual Retirement Account?**

**A.** Yes, but, sometimes, publicly traded or master limited partnerships generate unrelated business taxable income (UBTI), which is taxable whether it is held in an Individual Retirement Account or not, if the net UBTI income from limited partnership investments exceeds \$1,000.

Consult a qualified tax advisor.

Remember also that limited partnerships involve risks of limited liquidity and potential loss of value as well as ordinary investment risk.

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*We will accept questions from readers and reprint selected answers in this column. Send your question(s) to us; we'll answer as many as we can.*

# Financial Notes Worth Noting

## Behavioral Economics

As investors, our goal is to make rational decisions, basing our next steps on solid and accurate estimates and objective data. However, according to a relatively new field called "behavioral economics," when money is part of the equation, we often make decisions with the wrong reasons in mind: emotion sometimes takes over for common sense.

Some of the common mistakes that investors make, according to behavioral economic theories, include:

- **accepting modest gains and selling successful investments prematurely;**
- **increasing risk by holding on to losing investments for too long; or**
- **accepting more risk than is reasonable or realized because decisions are made based on emotion.**

Two psychologists (Daniel Kahneman from Princeton University and Amos Tversky from Stanford University), rather than economists, pioneered the topic of behavioral economics in 1979 with the idea of Prospect Theory, concluding that people tend to settle for the certainty of modest gain and expose themselves to risk of greater loss by waiting for a bad investment to "turn around." In 1998, research by Terance Odean, published in the *Journal of Finance* analyzed 10,000 accounts at a large brokerage house and found that investors are quick to take gains and slow to recognize losses.

We need not succumb to the vagaries of emotional decision-making, however. Objective investing might include:

- **making it automatic, adding to investments on a regular basis rather than when the "time seems to be right;"**
- **based on your time horizon, designing an asset allocation model and keeping to it with a view to long-term financial goals; and**
- **diversifying within each asset class as a further defense against investment decisions that might be based on emotional responses.**

Please remember that neither asset allocation nor diversification can eliminate the risk of fluctuating prices and uncertain returns in a down market.



## Making the Most of Your Time

Denis Waitley, in a book called **The Joy of Working** says: "Time is an equal opportunity employer. Each human being has exactly the same number of hours and minutes every day. Rich people can't buy more hours. Scientists can't invent new minutes. And you can't save time to spend it on another day. Even so, time is amazingly fair and forgiving. No matter how much time you've wasted in the past, you still have an entire tomorrow. Success depends on using it wisely — planning and setting priorities. The fact is that time is worth more than money and by killing time, we are killing chances for success."

## Laws of the Month

**Murphy's Law:** If anything can go wrong, it will.

**O'Toole's Commentary on Murphy's Law:** Murphy was an optimist.

**Green's Law of Debate:** Everything is possible if you don't know what you're talking about.

**Stewart's Law of Retroaction:** It is easier to get forgiveness than permission.

**Barth's Law of Distinction:** There are two types of people: those who divide people into types and those who do not.

**Howe's Law:** Every person has a scheme which will not work.

**Skinner's Constant:** The quantity which must be multiplied by, divided by, added to or subtracted from the answer you get to give the answer you should have got.

## 2009 Retirement Confidence Survey

# Economy Drives Confidence to Record Lows; Many Looking to Work Longer

**T**he recession has cast a pall over the retirement expectations of the vast majority of Americans, leaving a record-low 13 percent this year able to say they are very confident of having enough money to live comfortably in retirement, according to the 19th Annual Retirement Confidence Survey (RCS) conducted by the Employee Benefit Research Institute. Among workers, those feeling very confident about retirement has tumbled by one-half in the last two years.

**RECORD LOW CONFIDENCE LEVELS:** Workers who say they are very confident about having enough money for a comfortable retirement this year hit the lowest level in 2009 (13 percent) since the Retirement Confidence Survey started asking the question in 1993, continuing a two-year decline. Retirees also posted a new low in confidence about having a financially secure retirement, with only 20 percent now saying they are very confident (down from 41 percent in 2007).

**THE ECONOMY, INFLATION, COST OF LIVING ARE THE BIG CONCERNS:** Not surprisingly, workers overall who have lost confidence over the past year about affording a comfortable retirement most often cite the recent economic uncertainty, inflation, and the cost of living as primary factors. In addition, certain negative experiences, such as job loss or a pay cut, loss of retirement savings, or an increase in debt, almost always contribute to loss of confidence among those who experience them.

**RETIREMENT EXPECTATIONS DELAYED:** Workers apparently expect to work longer because of the economic downturn: 28 percent of workers in the 2009 RCS say the age at which they expect to retire has changed in the past

year. Of those, the vast majority (89 percent) say that they have postponed retirement with the intention of increasing their financial security.



Nevertheless, the median (mid-point) worker expects to retire at age 65, with 21 percent planning to push on into their 70s. The median retiree actually retired at age 62, and 47 percent of

retirees say they retired sooner than planned.

**WORKING IN RETIREMENT:** More workers are also planning to supplement their income in retirement by working for pay. The percentage of workers planning to work after they retire has increased to 72 percent in 2009 (up from 66 percent in 2007). This compares with 34 percent of retirees who report they actually worked for pay at some time during their retirement.

**GREATER WORRY ABOUT BASIC AND HEALTH EXPENSES:** Workers who say they very confident in having enough money to take care of basic expenses in retirement dropped to 25 percent in 2009 (down from 40 percent in 2007), while only 13 percent feel very confident about having enough to pay for medical expenses (down from 20 percent in 2007). Among retirees, only a quarter (25 percent, down from 41 percent in 2007) feel very confident about covering their health expenses.

*Source for this page:  
Employee Benefit Research Institute*

## HOW WORKERS ARE RESPONDING

Among workers who have lost confidence in their ability to secure a comfortable retirement, most (81 percent) say they have reduced their expenses, while others are changing the way they invest their money (43 percent), working more hours or a second job (38 percent), saving more money (25 percent), and seeking advice from a financial professional (25 percent). Among all workers, 75 percent say they and/or their spouse have saved money for retirement, one of the highest levels ever measured by the RCS.

**IGNORANCE STILL A MAJOR FACTOR:** Many workers still do not have a good idea of how much they need to save for retirement. Only 44 percent of workers report they and/or their spouse have tried to calculate how much money they will need to have saved by the time they retire—and an equal proportion (44 percent) simply guess at how much they will need for a comfortable retirement.

# Luxury or Necessity?

**F**rom the kitchen to the laundry room to the home entertainment center, Americans are paring down the list of familiar household appliances they say they can't live without, according to a new national survey by the Pew Research Center's Social & Demographic Trends project.

No longer do substantial majorities of the public say a microwave oven, a television set or even home air conditioning is a necessity. Instead, nearly half or more now see each of these items as a luxury. Similarly, the proportion that considers a dishwasher or a clothes dryer to be essential has dropped sharply since 2006.

These recession-era reevaluations are all the more striking because the public's luxury-versus-necessity perceptual boundaries had been moving in the other direction for the previous decade. For example, the share of adults who consider a microwave a necessity was just 32% in 1996. By 2006, it had shot up to 68%. Now it has retreated to 47%. Similarly, just 52% of the public in the latest poll say a television set is a necessity — down 12 percentage points from 2006 and the smallest share to call a TV a necessity since this question was first asked more than 35 years ago.

Along with a new creed of thrift, there's another factor — technology adoption — that appears to be shaping public judgments about some of these items. Take cell phones. A relative newcomer in the everyday lives of most Americans, the cell phone is among a handful of newer gadgets that have held their own on the necessity scale from 2006 to 2009. Moreover, it may have contributed to a drop in necessity ratings for the older-era appliance it has partially supplanted. The survey finds that people who consider a cell phone a necessity — some 49% of the public, including a disproportionate share of young adults — are less inclined than

others to feel the same way about a landline phone.

In addition to exploring these shifts in consumer perceptions, the survey asked respondents about a range of belt-tightening strategies and behaviors triggered by the recession, which officially began in December 2007.

It finds that eight-in-ten adults have taken specific steps of one kind or another to economize during these bad times. Almost six-in-ten say they are shopping more in discount stores or are passing up name brands in favor of less expensive varieties. Nearly three-in-ten adults say they've cut back spending on alcohol or cigarettes. About one-in-four say they've reduced spending on their cable or satellite television service or canceled the service altogether. About one-in-five say they've gone with a less expensive cell phone plan, or canceled service. One-in-five say they've started mowing their own lawn or doing home repairs rather than pay others for the service. And about one-in-five adults say they are following the example of first lady Michelle Obama and are making plans to plant a vegetable garden to save money on food.

As expected, the survey also finds that people who have taken the biggest economic hits during this recession are the ones most inclined to have tightened their belts. So, for example, if a respondent or someone in that person's household lost a job in the past year, had trouble paying the mortgage or rent, or lost more than 20% in a retirement account or other

investments, the respondent is more likely than others surveyed to have economized in a variety of ways.

However, this distinction doesn't apply to changing perceptions about what's a luxury and what's a necessity. These shifts have occurred across-the-board, among adults in all income groups and economic circumstances — perhaps suggesting that consumer reaction to the recession is being driven by specific personal economic hardships as well as by a more pervasive new creed of thrift that has taken hold both among those who've been personally affected and those who haven't.

## Luxury or Necessity?



The survey does find that the recession has touched the lives of most Americans in one way or another. About one-in-four respondents say they or a member of their household has lost a job in the past year. Nearly half say they or another household member has lost more than

20% in a retirement account or other investments. About one-in-five say they or another member of their household has had problems making mortgage or rent payments. Taken together, about two-in-three American families have faced at least one of these problems in the past year — with young adults, women and the less affluent more likely than others in the population to have been affected.

The Pew Research Center's Social & Demographic Trends survey on the effects of the recession was conducted by landline and cell phone April 2-8, 2009, among a nationally representative sample of 1,003 adults ages 18 or older.

Source: Pew Research Center

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