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Market Volatility In Retirement

Retirees usually base spending on an expected “average” return, which rarely occurs in any particular year. Overspending risks are most dangerous when a “bear” market is encountered early in retirement.

Joan entered retirement in January of 2007 with a \$1 million portfolio (hypothetically invested in 60 percent equities, 30 percent bonds and 10 percent cash) and assumed a 6 percent annual rate of return, a 3 percent rate of inflation and a 4 percent withdrawal rate or \$40,000 the first year, increasing 3 percent each year to account for inflation. Such an allocation would seem prudent, based on historic returns.



However, after two years of withdrawals (\$81,200) and market losses through the end of December 2008, the portfolio value would have decreased to \$752,822. Based on her strategy, she would need to withdraw \$42,436 in the third year, more than 5.8 percent of her portfolio value. If she does not change her spending habits, she runs the risk of

Reframing Ideas for 2010: Need or Opportunity

Re-Assess — 2010 is a great time to re-assess the investment strategies and the objectives you have set for yourself. Without a doubt, things have changed in the economy to create the opportunity or necessity for re-assessment. But, while you are at it, have things changed in your own circumstances that might cause a second look at where you are headed, how you are going to get there and, especially, where the roadblocks (and detours to circumvent them) are located? While predicting the future has never been a valid option, creating a future framework is certainly within grasp.

Re-Balance — Based on the analysis in the re-assessment phase, we can then carefully put your portfolio into a configuration geared toward achieving your financial objective. While there are never any guarantees, it may include a rebalance of equity and “guaranteed” investments, it may include a new mix of sector investments or it may include a combination of many different vehicles and strategies — all aimed at getting you closer to your stated objectives.

Re-Build — The final step is to rebuild. And we all have that job ahead of us. While the economy seems to be limping back into positive territory, we need to do at least three very important things to keep our heads high above the mark: **a)** increase our discretionary saving and investing, **b)** take a look at our balance sheet and trim expenses where possible and/or necessary and **c)** maintain our contributions to retirement portfolios.

One other consideration might be working a little longer than you expected before retiring. While it may not be in your future, it’s worth a thought. Let’s talk soon.

continued principal erosion in the event of an extended bear market.

If we review the 2009 portfolio results, Joan would have had \$825,951 to start 2010. If she retains her initial withdrawal schedule (adjusted for 3 percent inflation), her 2010 withdrawal will total \$43,709 or 5.3 percent of assets.

This hypothetical exercise suggests that you consider the cautious approach and schedule retirement withdrawals in the area of 4 percent annually. Despite the severe “bear” market,

Joan still has a reasonable chance of maintaining her lifestyle over the long term. If she withdrew more, the situation might be un-doable.

This scenario is for illustrative purposes only, reflects no particular investment’s performance and is based on the actual S&P 500 Stock Index, intermediate government bonds and 30-day Treasury bills during the period. Your returns will vary; past returns are no indication of future performance.

Source: *The Walsh Group*

19th Annual Retirement Confidence Survey

As Worker Expectations for Comfortable Retirement Plummet, Many Expect to Work Longer Before Leaving Their Jobs

The recession has cast a pall over the retirement expectations of the vast majority of Americans, leaving a record-low 13 percent able to say they are very confident of having enough money to live comfortably in retirement, according to the Employee Benefit Research Institute (EBRI). Among workers, those feeling very confident about retirement has tumbled by one-half in the last two years.

Because of the economic downturn, many workers say they expect to work longer and more workers say they are planning to supplement their income in retirement by working for pay.

Not surprisingly, workers 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, 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.

Overall, the percentage of workers very confident about having enough money for a comfortable retirement continued a two-year decline, falling to 13 percent this year, down from the previous low of 16 percent last year and 27 percent the year before that. This is the lowest since the question was first asked in the survey in 1993 and represents a 50 percent decline in worker confidence. Among current retirees, confidence in having a financially secure retirement also dropped this year to a new low, with only 20 percent say-

ing they are very confident; that's down from 29 percent and 41 percent in the last two surveys.

The **Retirement Confidence Survey** (online at www.ebri.org) is the most comprehensive study of the attitudes and behavior of American workers and retirees toward all aspects of saving, retirement planning, and long-term financial security.

Expected Retirement and Working in Retirement

The survey made two significant findings concerning workers' expected retirement date and work in retirement:

- Workers apparently expect to work longer because of the economic downturn: 28 percent of workers in the current survey 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 almost half of retirees (47 percent) say they retired sooner than planned.

- More workers are also planning to supplement their income in retirement by working for pay: The proportion of workers planning to work after they retire has increased to 72 percent (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.

Meeting Expenses in Retirement

The survey includes other findings about attitudes toward retirement. For example, workers who say they are very confident in having enough money to take care of basic expenses in retirement dropped to 25 percent (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.

Other key RCS findings:

- 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*.

- 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.

- A large majority of workers participating in a work-place retirement savings plan (72 percent) state that they have not changed the percentage of their salary contributed to the plan in the past year.

Source: Employee Benefit Research Institute



Fixed-Income: Allocation and Diversification

As time horizons for retirement get closer and closer — unless you have come up with a valid alternative, like immortality — allocations of fixed-income or short-term investments often increase, even if only slightly, as a percentage of total assets.

Your portfolio allocated toward a retirement that is but five or ten years into the future should hold a somewhat greater fixed-income allocation that it might have held 20 or 30 years ago.

After establishing an appropriate fixed-income percentage (usually different for unique investors based on factors such as health, risk aversion, how close you are to your goal, how many years you'll expect to be in retirement and, of course, as mentioned above, time horizon), it is time to consider diversification within the asset class.

Diversification and Risk Management

Diversification works the same way for fixed-income investments as it does for equities. And while **diversity will not assure a profit nor protect against loss**, by acquiring a variety of investments, you decrease the risk that a single investment with lackluster performance will significantly reduce the value of the entire asset class since it is only a relatively small percentage.

Let's review, for example, what happened with Treasury bonds and high-yield bonds in 2008 and 2009. In 2008, Treasuries were on the top of the pile and "high yield bonds" didn't live up to their name. In 2009, the reverse was true with the high-yield assets outperforming all the other fixed-income investments. In fact, for the first nine months of 2009, Treasuries were at the bottom of the class. In that scenario, had all of your investments been in either of those fixed income assets, your

portfolio would have performed worse than the average of the two combined.

A diversified portfolio, on the other hand, would have balanced higher returns with lower returns for smoother overall performance. Of course, as mentioned earlier, diversification cannot assure a profit or protect against loss, particularly in a declining market.

Sub-Asset Classes

Bonds vary based on the creditworthiness of their issuers, as well as on whether they are issued within or outside the United States. Although not an exhaustive list, there are several fixed income subcategories, including:

High yield bonds — usually issued by firms that have a greater risk of default. To neutralize the additional risk, these bonds often provide higher income and return potential.

Investment-grade bonds — this group includes Treasuries and high-quality corporate bonds. The bonds in this sub-asset class are generally issued by well-established companies in good financial condition and generally offer relatively stable returns and price variation.

International bonds — securities issued by both governments and corporations outside the United States. These bonds are much like domestic fixed-income securities although they can be subject to greater vagaries such as political instability and other non-domestic problems. Often, international bonds react differently from domestic bonds even when confronted with the same market conditions. Depending on the weakness of domestic bonds, holding international bonds could affect the performance of the total portfolio.

If you are interested in pursuing this

investment idea, I am available for consultation regarding allocations between high-yield bonds, investment grade bonds and international bonds. As mentioned above, maintaining a reasonable mix reduces the possibility that any one sub-asset class will have a disproportio-



tionate effect on your returns.

Managing Your Portfolio

Understanding the qualities and benefits of various types of bonds will help you diversify your fixed income investments and could help balance their risk / return potential.

The decision can often be made simpler by considering fixed-income mutual funds, which may contain different bond types and grades, offering built-in diversification.

Investing in fixed-income securities involves certain risks such as market risk if sold prior to maturity and credit risk especially if investing in high yield bonds, which have lower ratings and are subject to greater volatility. All fixed income investments may be worth less than original cost upon redemption or maturity. Yields and market value will fluctuate so that your investment, if sold prior to maturity, may be worth more or less than its original cost. All bonds are subject to interest rate risk.

Source: R & R Associates, Inc.

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