

Financial Market Newsletter 4th Quarter 2009

“We pay attention to the Market so you don’t have to”

Playing it Safe can actually hurt your returns

Investors are reacting to down days in the stock market by plowing money into conservative investments, such as stable-value funds, recent data show.

But a new study suggests that for those nearing retirement, there's a big price to be paid for abandoning a diversified portfolio of stocks and bonds.

In 2008, as stocks lost nearly 40% of their value, participants in tax-deferred 401(k) retirement savings plans that are administered by Hewitt Associates sold \$6.3 billion in equity investments, according to the Lincolnshire, Ill.-based human-resources firm.

These investors put the vast majority of the proceeds -- some 85% -- into conservative investments, "mainly stable value funds," which are designed to preserve capital and generate smooth, positive returns, says Pamela Hess, Hewitt's director of retirement research.

The transfers, which have continued this year at a lower level, have helped reduce the average equity exposure to about 53% in June, down from 67% at the end of 2007, according to Hewitt.

But those "who impulsively transfer assets to more conservative funds during market slumps may hurt their ability to save enough for retirement," Ms. Hess says. Hewitt has found that most investors who flee equities "are unlikely to reallocate their investments [to stocks] when the market rebounds," she adds.

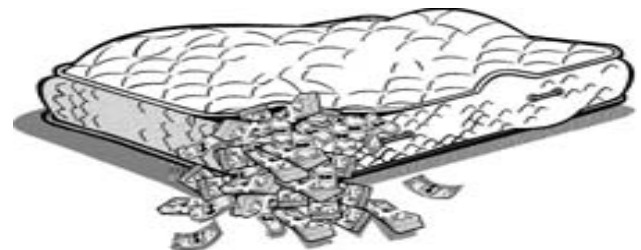
Hard to Catch Up

A study by Financial Engines, a Palo Alto, Calif., investment advisory firm, looks at how self-defeating such a strategy is likely to be. The study examined the effect of the 2008 stock-market selloff on investors age 50 and older who consistently save about 9% of their salaries annually.

It found that those who remain in suitably diversified portfolios can, under most scenarios, expect to retire with 70% of their current income by taking some relatively simple steps -- such as postponing retirement by up to 2½ years, or less if they're willing to ramp up savings.

But those who fled to cash-like investments will generally need to take more drastic steps, such as postponing retirement by an additional year or more, depending on factors such as age and income, Financial Engines calculates.

Consider a 60-year-old who has an annual salary of \$75,000. By remaining in a diversified portfolio, with about 50% in stocks, he or she can expect to get back in shape financially by putting retirement on hold for almost two years -- from age 65 to nearly age 67, according to Financial Engines. After a move to cash, though, he or she would have to stay on the job a year longer. Financial Engines simulated thousands of different potential market returns and calculated the median outcome.



More to Lose

As a rule of thumb, the cost of fleeing to cash rises with an investor's income. Because those with more wealth depend more on savings than on Social Security benefits to maintain their living standards in retirement, they have more to lose by loading up on low-return investments, says Wei-Yin Hu, director of investment analysis and research at Financial Engines.

Likewise, younger investors who abandon stocks are likely to pay a higher price than their older counterparts. Why? They are giving up more in the way of potential future appreciation, Mr. Hu says.

IRS Issues Guidance on 2009 Required Minimum Distribution Waiver

The Internal Revenue Service recently provided guidance for retirement plan administrators, plan participants and retirees regarding recent legislation affecting required minimum distributions. The Worker, Retiree, and Employer Recovery Act of 2008 waives required minimum distributions for 2009 from certain retirement plans.

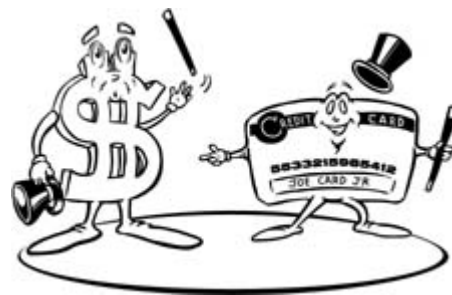
Generally, a required minimum distribution is the smallest annual amount that must be withdrawn from an IRA or an employer's plan beginning with the year the account owner reaches age 70½. The 2008 law waives required minimum distributions for 2009 for IRAs and defined contribution plans (such as 401(k)s) and allows certain amounts distributed as 2009 required minimum distributions to be rolled over into an IRA or another retirement plan.

Notice 2009-82 provides relief for people who have already received a 2009 required minimum distribution this year. Individuals generally have until the later of Nov. 30, 2009, or 60 days after the date the distribution was received, to roll over the distribution.

The notice also provides guidance for retirement plan sponsors. It contains two sample plan amendments that plan sponsors may adopt or use to amend their plans to either stop or continue 2009 required minimum distributions.

Both sample amendments provide that participants and beneficiaries can choose to receive or not to receive 2009 required minimum distributions. Also, both sample amendments allow the employer to offer direct rollover options of certain 2009 required minimum distributions.

Plan sponsors may need to tailor the sample amendment to their plan's particular terms and administration procedures and must adopt the amendment no later than the last day of the first plan year beginning on or after Jan. 1, 2011 (Jan. 1, 2012 for governmental plans).



Credit Card rules that can bite into your budget.

Universal Default is a provision that is generally buried in the fine print of your credit card agreement. Basically, it says that if you are more than 30 days late on any payment to anyone, the interest rate on your credit card could shoot up and your credit score may be damaged. It doesn't necessarily take being late on big-ticket items, such as a car or a mortgage payment to trigger the default clause, Scott Bilker, financial guru and author of "Talk Your Way Out Of Credit Card Debt," explains. "It could be for something as innocuous as an overlooked \$30 phone bill or a forgotten \$20 book club subscription."

What you should do

Contact each company you have a credit card with and ask them if your account has a Universal Default provision. If your account does include this provision you may have a few options:

1. Make sure you meet your monthly obligations not just on time, but at least a week or more ahead of the payment due date.

2. Consider paying bills when they arrive instead of when they are due.
3. Contact the credit card company and ask to have your due date changed so that it falls at a convenient time of the month for you.
4. Consider paying your bills automatically and electronically each month, either by computer or through a banking arrangement.

You should shop for your credit the way you shop for any major purchase: research your options, weigh the costs and benefits, and read all of the fine print. Don't forget that, when you sign up for a credit card, you are entering a legally binding agreement.

Unused vacation? It may pay

Taking vacation pays dividends -- especially if your company allows you to put unused vacation or sick-leave days into your 401(k) or profit-sharing plan.

To encourage savings, the Obama administration recently blessed such transfers. While companies may have to amend their benefit plans to allow it, the administration hopes firms will do so. "We tried to build in as much flexibility as possible to make it attractive," says Mark Iwry, a senior Treasury official.

The techniques are available for use with all qualified plans, which include 401(k), Keogh and profit-sharing plans but not individual retirement accounts or SEP-IRAs. While the rules don't currently extend to the 403(b) plans used by nonprofit organizations, the Treasury is willing to consider expanding them to include such plans, Mr. Iwry says.

The rules apply to "cash-outs" of unused vacation, sick leave or personal days that occur either annually or when an employee leaves a job. If an employer pays for such leave either in whole or in part, the worker could contribute

the entire payment to the company's plan, unless he or she has already maxed out the annual contribution limit. This year the limit for most workers is \$16,500, or \$22,000 for those over 50.

Employers that don't currently pay workers for unused leave may want to reconsider their policies. The transfers compensate workers and encourage savings but don't increase base pay.

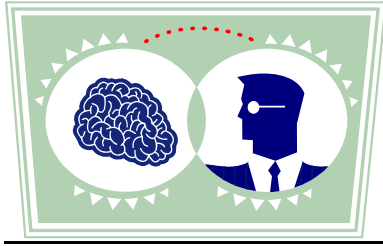
Companies can opt to pay workers for unused leave only if they bank the money in a 401(k) or other qualified plan -- in effect requiring employees to save or else forgo the money. A firm also may let employees decide whether to save or spend.

Things you should have learn from 2008-2009

Know yourself and know your risk tolerance – One of the lessons learned in the past year is that many investors thought they had a higher tolerance for risk than they actually did and panicked when their portfolios started losing money – in many cases, more quickly and dramatically than they had anticipated. Because money is an emotional subject and emotions can often lead us in the wrong direction, there are few things more important than knowing you as an investor. That means examining your attitude toward risk – understanding the potential for seeing your investments lose value and how you might react in various situations.

Develop a plan and stick to it – If you don't already have one, you should develop a strategy for investing. Jumping in and out of the market is not an investment strategy. Ever since the market rebound began to take shape in March, many investors have talked repeatedly about missing a moment in time to get back in the market. We encourage our investing clients against trying to "time" the market and urge them to take a longer-term view and a more holistic approach to investing and saving. Dollar-cost averaging can be a simple way to ease into investing in the stock

market. You will also want to think about how to diversify your portfolios – based on both your particular investment goals and risk tolerance – and should use an appropriate asset allocation among various investment vehicles.



Just the Tax Ma'am:

Special Sales Tax Deduction for Car Purchases Available through End of 2009

With 2010 models arriving in dealer showrooms, the Internal Revenue Service reminds taxpayers that purchasing a new car, light truck, motor home or motorcycle could qualify them for a special deduction for the state and local sales and excise taxes on their 2009 tax returns.

Purchases made before Jan. 1, 2010, will qualify for this deduction under the American Recovery & Reinvestment Act of 2009 (ARRA).

The deduction is limited to the sales and excise taxes and similar fees paid on up to \$49,500 of the purchase price of a new vehicle. The deduction is reduced for joint filers with modified adjusted gross incomes (MAGI) between \$250,000 and \$260,000 and other taxpayers with MAGI between \$125,000 and \$135,000. Taxpayers with higher incomes do not qualify.

The special deduction is available regardless of whether taxpayers itemize deductions on their returns. Taxpayers who do not itemize will add this additional amount to the standard deduction on their 2009 tax return.

Inflation Having Little Effect on Tax Rates

WASHINGTON — Tax rate brackets and various tax benefits will remain unchanged or change only

slightly in 2010 due to inflation, the Internal Revenue Service announced today.

By law, the dollar amounts for a variety of tax provisions must be revised each year to keep pace with inflation. As a result, more than three dozen tax benefits are subject to inflation adjustments each year, but because recent inflation factors have been minimal, many of these benefits will remain unchanged or change only slightly for 2010.

Key provisions affecting 2010 returns, filed by most taxpayers in early 2011, include the following:

- The value of each personal and dependency exemption available to most taxpayers is \$3,650, unchanged from 2009.
- The new standard deduction for heads of household is \$8,400, up from \$8,350 in 2009. For other taxpayers, the standard deduction remains unchanged at \$11,400 for married couples filing a joint return and \$5,700 for singles and married individuals filing separately. Nearly two out of three taxpayers take the standard deduction rather than itemizing deductions, such as mortgage interest, charitable contributions, and state and local taxes.
- Various tax bracket thresholds will see minor adjustments. For example, for a married couple filing a joint return the taxable income threshold separating the 15 percent bracket from the 25 percent bracket is \$68,000, up from \$67,900 in 2009.
- The annual gift tax exclusion remains unchanged at \$13,000.

Thank you for your many kind referrals!

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"It's not how much you make... but rather how much you save that counts in the end."

-Chas P. Smith, CPA/PFS, CPS Investment Advisors