

Your Retirement (Quarterly) January - 2010 - A Guide To Your Retirement Planning – VolumeVII, Number 1

Welcome to our web-newsletter with information that can help you with your retirement planning efforts. We provide straight-forward, easy to understand, unbiased and candid information. Feel free to use this information and to also pass it along to your friends and associates. You will find previous issues of our newsletter on our website. If you are interested in additional information that can help you, be sure to check out our web site; retirementplanningconsultants.com or contact Robert R. Julian, at rrj1@cornell.edu

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Investing Success: Start With A Plan

A brand new year can be a great time to begin or refine your retirement investment plan and the first step should be to settle on a written investment plan (your roadmap) called an Investment Policy Statement (IPS).

In The Bogleheads' Guide to Retirement Planning, authors David Grabiner and Alex Frakt state that "if you start with a good plan, you will find it easier to continue to make good investment decisions. Most investors do this backward by starting with investment selection, usually choosing from lists of top performing mutual funds. The portfolio gets pieced together with the flavor of the month."

Your IPS should look into your future and lay out your financial goals and objectives including things like a new car, a home purchase in a few years, education expenses for children, and retirement income requirements. Your IPS should also describe the strategies you will use to meet these objectives and discuss the level of risk you are willing to accept through the selection of investments.

Your IPS is a personal document that can range from simple to very complex. It may include sections on current financial holdings, investment philosophy, investment objectives and timeframes, asset classes to be used and those to be avoided, asset allocation targets and rebalancing ranges, and monitoring and control procedures.

Sample IPS	
Investment Philosophy:	"Buy-and-hold, long-term, all-market-index strategies, implemented at rock-bottom cost, are the surest of all routes to the

	accumulation of wealth" - John C. Bogle
Asset Allocation:	Maintain overall 60% stock + 40% fixed-income allocation until home purchase to accommodate both short-term and long-term requirements. Assets should be diversified across major asset classes including domestic equity, international equity (20-25% of equities), conventional bonds of short to intermediate term, and TIPS (50% of fixed).
Funds & Accounts:	Use low cost mutual funds - index funds preferably - which do not overlap and provide maximum diversification across asset classes. Try to assume only market risk as far as possible. Try to shelter tax-inefficient funds in tax-advantaged accounts to reduce tax drag.
Target Allocation:	--VTSMX - Total Stock Market Fund 45% - Taxable account --VGTSX - Total Int'l Market Fund 15% - Roth IRA --VIPSX - TIPS Fund 20% - Traditional IRA --IIBAX - Intermediate Bond Fund 20% - 401k --VMMXX - Money Market fund (6 months' expenses) - Taxable account
Other considerations:	Automate future contributions wherever possible. Rebalance yearly. No market timing. Exact sub-allocations are not as important as maintaining the overall 60/40 stock/fixed allocation - no need to make things complex in order to meet sub-allocation targets.

If you are married or have a partner, make sure you work together to define your financial goals. This ensures that one of you is not planning on extensive world travel upon retirement while the other plans to retreat into the mountains for contemplation.

An IPS should be reviewed every few years or as your situation changes. Many unexpected life events can happen along the way to retirement like unemployment, divorce, a major illness;--- be prepared to adapt your plan as circumstances change.

Quotable Quote: "Putting your money under the mattress is no long-term strategy. If inflation runs 3% annually, in just 14 years you'll need \$1.50 to buy what costs \$1 today. The long-term performance of stocks -- an annualized return of 9.7% since 1926 -- is a powerful argument for keeping most of your retirement assets invested in them. Yes, they are volatile. But in all but the most extreme circumstances (like those we saw in 2008), holding bonds and other assets can minimize the damage."
Kiplinger's Personal Finance, 11/2009

Fees Gobbling Up Too Much Of Your 401(k)?

The mutual fund industry had a good year in 2008 but you probably didn't. Morningstar, a mutual fund investment research firm, gives an insight into how profitable mutual funds are. Even though it was a tough year for us investors, the managers of the funds enjoyed large paydays because they typically make money based on total assets rather than performance.

According to the Wall Street Journal, "The five big-loser, big-payday funds: American Funds Growth Fund of America, which was down 39.1% in 2008, but gathered management fees of \$351.2 million in the fiscal year ending in August 2009; American Funds Capital World Growth & Income, down 38.4% and collecting \$375 million through November 2008; American Funds EuroPacific Growth, -40.5% and \$381.6 million through March 2009; Fidelity Contrafund, -37.2% and \$348.6 million through December 2008; and Fidelity Diversified International, -45.2% and \$348.1 million through October 2008."

So, let's just ask ourselves this question ----

**Q How much are 401(k) fees removing from your retirement nest egg every year?
A.If you are either unaware of or don't know their amounts, don't worry. Nearly 83% of Americans don't know either (AARP). (see chart below)**

The Securities and Exchange Commission (SEC), Congress and the Department of Labor have been working on legislation and regulation that would early this year require employers to disclose more information about administration and management fees in an understandable way. And an independent website, Brightscope.com, seems to be gaining traction as it aims to provide workers with company 401(k) plan ratings that include fee information.

Securities and Exchange Commission Chairman Mary Schapiro declared that "we must critically rethink how 12b-1 fees are used and whether they continue to be appropriate."

About 70% of funds charge 12b-1 fees, named after the SEC rule that permits them. These charges help defray marketing and distribution costs, which might include commissions to financial advisors, processing and record-keeping in a 401(k) plan, mailing prospectuses.

Typically running \$1.50 to \$3 a year on each \$1,000 you've invested, 12b-1 fees may appear to be small. However, the bigger expense, at perhaps 1% of assets, is the "management fee," which pays the fund's costs of investing. But 12b-1 fees add up-- since 1990, based on data from Lipper Inc. and the Investment Company Institute, investors have paid more than \$140 billion in 12b-1s. That indeed is not "small".

A GAO report states that "A long-term investor in a 401(k) plan that charges 1.5% in annual expenses is likely to end up with a 20% smaller nest egg than someone in a plan that costs 0.5% ."

Steve Kerch, Assistant Managing Editor, Personal Finance, MarketWatch E-Newsletter states that the mutual fund business has sometimes been compared to a casino, skimming investors' nest eggs with high fees. But no casino would survive by offering the payouts actively managed mutual funds offer: Only the top 3% of all such funds manage to beat similar lower-cost index funds. That means mutual fund shareholders lose 97% of the time instead of win.

Kerch adds compares the mutual fund business with the casino slot machine business. He tells us that at “any decent casino, the slot machines will pay out somewhere around 97% of the time: Put in \$100, get back \$97. If you are lucky, you collect your \$97 long before you finish putting in the \$100. He and a number of others tell us that it is the strike-it-rich proposition that keeps casinos in business and keeps players coming back despite the fact that, over time, they'll be at least 3% poorer.

But here's an even bigger shock: A new study shows reveals that it is impossible to tell whether those 3% who do manage to outperform their comparable index fund do so out of skill or because of pure luck. The skilled managers are likely to repeat their success, but the lucky ones ... well, their luck always runs out.

Kerch says that the upshot is simple: Placing your bets with active mutual fund managers is a huge crapshoot where the only sure winner is the house.

FEES AND YOUR 401(K)

401(k) plan participants know little about 401(k) fees:

83% say they do not know how much they pay in fees and expenses.

Among those aware of such fees, 22% estimated that their fees were 2% or more of their account balance, and 33% indicated that they pay no fees.

54% said they do not feel knowledgeable about the impact that fees can have on their total retirement savings.

79% who make decisions about their 401(k) investments said fees are an important consideration.

Source: AARP 401(k) Participants'

Awareness and Understanding of Fees, conducted online June 8-24, 2007; 1,584 respondents. Margin of error is +/-2.5 percentage points.

Our Planning – Saving – Investing For Retirement Workshops: What Do You Really Need To Know?

As we move into 2010, a good number of us continue to worry about a number of problems. We are seeing and in some cases, experiencing job losses every day. We are still in a recession. A growing number of retirees returned to or are trying to get back in the workforce. And we still worry about retirement --- some are already retired --- some who will be retiring shortly and some who are years away.

Many of us fear even looking at our 401(k) investment statements. Some say we are now in the worst bear market since the 1930s. One year ago, the Wall Street professionals were saying there would not be a recession in 2009 and that our financial markets would stabilize in 2009 --- and these are the experts!!!!.

What we know as investors is that we are seeing the worst contraction in our investments. But, as Fortune magazine stated about one year ago --- November, 2008--- we should not be “thrashing about.” Instead we should be “focusing on some of the simple planning rules that have proven to make a big difference.” What are they?

“Don’t let excessive fees eat into your returns. Do diversify your portfolio mix with fixed income and other assets, and reduce the risk in your portfolio as you get closer to retirement.” Fortune adds that you should consistently rebalance your portfolio and add some new money over time, in good markets and bad “so that you dollar cost average --- buying more when prices are low and less when they are high.”

Your retirement may be years away but thinking about or planning for it shouldn’t be. We would like to bring our workshops to your work site. Talk to the people in your benefits – compensation – H R office about our workshops and ask them to get in touch with us so that we can bring our sessions to your workplace. If you would like to take a look at our brochure which details what we do in our three sessions--- 101, 201 and 301, go to our website at retirementplanningconsultants.com.

Quotable Quote: “ Do you know how much your mutual funds really cost you each year? Morningstar's "Instant X-Ray" feature (click on "Tools" at www.morningstar.com) will break down your funds' fees into hard dollar figures and compare them with the average costs of similar funds. Boot out any funds with above-average expenses along with poorly performing actively managed funds, and replace them with low-cost index funds or exchange-traded funds.” Kiplingers Personal Finance, 11/2009

Investing: Actively Managed Mutual Funds or Index Funds?

Do you invest your money in actively managed funds or index funds? The results of a new study from Professors Eugene Fama and Kenneth French indicate that investors to continue to send their money to actively managed funds in the hope that the managers will be able to beat less-costly index funds are going to lose out almost of the time.

Fama and French state that it is effectively impossible to tell whether a manager has performed well due to luck or skill and that means that it is also impossible for an investor to know for sure.

Fama and Kenneth French, professor of finance at Dartmouth College Tuck School of Business, ran 10,000 simulations of what investors could expect from actively managed funds. They found that outside the top 3% of funds, active management lags results that would be delivered due simply to chance.

"The simulations tell us that for the vast majority of actively managed funds, true [abnormal expected return] is probably negative; that is, the fund managers do not have enough skill to produce risk-adjusted expected returns that cover their costs," wrote the professors in the study.

Fama and French's study, "Luck Versus Skill in the Cross Section of Mutual Fund Returns," looked at the returns of 3,156 U.S. stock mutual funds from January 1984 to September 2006. It included mutual funds that were liquidated and any fund launched before September 2001 that reached more than \$5 million in assets. [Find a copy of the report at the Social Science Research Network.](#)

The fact that some funds beat the simulations does suggest that by picking the right funds investors can consistently outperform the market. But there's just one problem, according to the professors: "[T]he good funds are indistinguishable from the lucky bad funds that land in the top percentiles."

That leaves picking the right fund a matter of guesswork. So even if investors stick with the top performers, they're running a risk because the manager's good results could be based on luck. "You're taking the chance of being with somebody's who's not just lucky, but actually bad," added Fama.

The presence of both good funds and lucky bad funds means it's likely that investors focused on top performers will end up with returns close to the market. "In other words, going forward we expect that a portfolio of low-cost index funds will perform about as well as a portfolio of the top three percentiles of past active winners, and better than the rest of the active fund universe."

In an interview, Fama cautioned that this doesn't mean all index funds are viable options -- there are index funds that charge high fees, for example. Investors should stick to low-cost and efficiently managed index funds, he said, naming Vanguard Group's offerings as among the best.

Fama suggested that the continued faith in active management is due to both the fund industry's marketing efforts and the complicity of fund ratings agencies, whose existence is based on the assumption they can identify the best funds. But when it comes to picking the future winners, Fama is skeptical. "I don't think anybody can do that," he said.

The World of Index Funds : Broad U.S. Funds

<u>Fund Name/Ticker</u>	<u>2009 Return¹</u>	<u>Assets (Billions)</u>	<u>Annual Expenses</u>	<u>Minimum initial investment</u>	<u>Index tracked</u>
Fidelity Spartan Total Market FSTMX	26.80%	\$8.50	0.10%	\$10,000	Dow Jones U.S. Total Stock Market
Vanguard Total Stock Market VTSMX	27.10%	\$108.80	0.16%	\$3,000	MSCI U.S. Broad Market
Fidelity Spartan 500 Index Inv. FSMKX	25.50%	\$12.90	0.10%	\$10,000	Standard & Poor's 500
iShares S&P 500 Index ² IVV	25.50%	\$21.60	0.09%	N.A.	Standard & Poor's 500
Schwab S&P 500 Index Select SWPPX	25.30%	\$8.70	0.19% ⁴	\$100	Standard & Poor's 500
SPDRs ² SPY	25.30%	\$77.20	0.09%	N.A.	Standard & Poor's 500
T. Rowe Price Equity Index 500 PREIX	25.30%	\$10.40	0.35%	\$2,500	Standard & Poor's 500
Vanguard 500 Index Investor VFINX	25.50%	\$87.30	0.16%	\$3,000	Standard & Poor's 500
iShares Russell 1000 Index ² IWB	27.00%	\$5.10	0.15%	N.A.	Russell 1000
iShares Russell 3000 Index ² IWV	26.60%	\$3.10	0.20%	N.A.	Russell 3000
PowerShares QQQ ² QQQQ	49.90%	\$17.00	0.20%	N.A.	Nasdaq 100
PowerShares FTSE RAFI U.S. 1000 PRF	42.00%	\$0.50	0.58%	N.A.	FTSE RAFI U.S. 1000
Vanguard Extended Market VEXMX	32.50%	\$11.30	0.25%	\$3,000	Standard & Poor's Completion

Returns through November 16, 2009

Quotable Quote: Not making any portfolio changes as shares peaked in 2007 was a big reason many retirees had hefty stock stakes when the market crashed in 2008--- nearly four in 10 employees ages 56 – 65 had more than 80% of their 401(k)s in stock, according to the Employee Benefits Research Institute. And it's likely they had losses of 30% to 40% as a result." Money, Jan/Feb 2010

Is Your Investor Education Working?

So, how's that 401(k) investment education working out? According to some recent survey results, we have a few problems.

First there is the latest Retirement Confidence Survey by the Employee Benefit Research Institute, which shows that while 73% of workers saving for retirement used written educational material they received from their employer or employer's retirement plan provider, only 15% found it the most helpful material in saving for retirement.

Then we have a John Hancock survey in which 42% of defined contribution participants indicated they have little or no investment knowledge, and that about 50% believe they possess the skills required to manage their portfolios, but would rather spend time doing other things.

How about String Financial's survey in the third quarter of 2008 which found that more than higher education doesn't translate to absorbing investment education? It found that more than one-third of respondents with a four-year college degree were not familiar with dollar-cost averaging, nearly one-quarter were not familiar with asset allocation and 12% were unfamiliar with the concept of compound interest.

And then we have the research conducted by DALBAR, a firm that develops standards for, and provides research, ratings and rankings to the mutual fund, broker/dealer, discount brokerage, life insurance and banking industries.

For the past 15 years, DALBAR has issued a report that examines the returns investors actually realize and the behaviors that produce those returns. The 2009 report shows that equity, fixed income and asset allocation fund investors experienced average annual losses for all time periods examined except the longest (20 year) time frame - and even those positive returns did not keep pace with the average inflation rate.

Then you can take a look at how investor education relates to 401(k) plans. While the S&P 500 earned an average return of 8.41% from 1988 to 2008, the average equity investor earned a mere 1.87%, meaning that the cost of uninformed investing was 6.54% per year over that time period.

So if the objective is to increase the potential for adequate retirement income and investment education programs don't seem to be working, then maybe we should be

looking at the 6.54% differential not as what DALBAR refers to as the "cost of uninformed investing," but rather as the "cost of going it alone."

So, what is the semi – really frustrated 401(k) investor --- you, me, your co-worker, your neighbor, etc.--- supposed to do? One approach could be to move to where a growing number of investors are placing their investments --- index investing. Why? DALBAR's update of its Quantitative Analysis of Investor Behavior (QAIB) study found that while the S&P 500 has returned 8.35% over a 20 year period ending in 2008, the average equity investor earned just 1.87%, which was less than the inflation rate of 2.89%. Bond investors fared no better. They earned returns of just 0.77% compared to 7.43% for the index.

The DALBAR update isn't surprising. The QAIB has consistently shown a large gap between the returns investors actually earn and the return they could have easily earned with a buy-and-hold strategy.

Other studies have confirmed DALBAR's findings. John Bogle in *The Little Book of Commonsense Investing* calls it the grand illusion — the returns reported by mutual funds aren't actually earned by fund investors. He estimates the over a 25 year period ending in 2005, the average mutual fund investor earned 7.3% compared to the 12.3% for the benchmark. The shortfall isn't limited to active fund investors. Bogle also notes that index fund investors earned 10.8%, a full 1.5% shortfall compared to the index over the same 25 year period.

Based on the figures from the Dalbar study, the average stock fund investor would be better off putting his money in bank certificates of deposit the past 20 years. If you follow this conservative route, though, you must resist the temptation to jump back into the market when prices go back up.

A more sensible course of action to tame risk and still seek the potentially higher long-term returns of stocks is what Dalbar calls the "time-honored tactic" of dollar-cost averaging, or investing the same amount of money at regular intervals. This strategy does not ensure a profit but guarantees you buy more shares when prices are low and fewer when they are high.

"Dollar-cost averaging allows investors to slowly make their way back into the markets, and can even make market swings work to their advantage," the Dalbar study said.

Dalbar adds that the average investor moving in and out of stock funds would have seen \$10,000 of total invested principal grow to \$13,646 over the 20 years. But somebody faithfully investing \$41.67 every month would have accumulated \$17,037. Quotable Quote: *"Although only 11% of mutual fund assets are in index funds, the proportion is rising. And a recent survey of institutional investors (such as pension funds and endowments) by Greenwich Associates found that one in five moved money from actively managed funds into index funds in the past year." Kiplinger's Personal Finance, 9/2009*

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