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Balance Is Better – Make It Happen!

Balance is a word we hear tossed around a lot these days. We want work-life balance, which can reduce our stress levels; we try to eat balanced meals, thereby keeping our bodies sound; and we try to balance our to-do list against our need for rest and relaxation.

Better balance can lead to better health—physically, emotionally, spiritually, and even financially. We can all agree that balance is important; so why do we often find it so difficult to apply balance to matters of finance?

According to behavioral scientists, it's because we're human. Rationality isn't always uppermost in our minds when we make money decisions. Instead, we may rely on emotion, like our need for security, the recommendation of someone we trust, or the excitement of an investment's recent experience.

Unfortunately, this method of making investment decisions doesn't usually mean success—especially when compared to implementing and sticking to a balanced, rational approach. As we move through the fall season and head toward a new year, now is a great time to re-evaluate your investments, keeping the idea of balance firmly in mind. Investors should remember that, while diversification neither assures a profit nor guarantees against losses, it is a widely accepted investment strategy that may help meet financial goals.

So many investment choices … how can you decide?

Usually, people can choose from many different investment options in their retirement plans. There may be stock funds, bond funds, cash equivalents like money market funds, or others—a nice variety that could keep their portfolio healthy and strong.

Each of the three major categories of investments (stocks, bonds, and cash equivalents) carries its own potential risks and rewards. You may be able to invest in some or all of them through your retirement plan. As you make investment decisions, you should be aware of some basic information about each of these categories.

Stocks. Historically, stocks have the greatest potential for growth, but they can and do experience losses. The value of stocks may rise as the economy grows strong. But, as we experienced during the recent recession, stocks may also suffer significant drops in value. This up-and-down tendency is known as volatility. Investors who can accept a high degree of volatility, and who have a long time to recover if their stock investments drop, may be rewarded in the long run with higher investment returns.

Bonds. Bonds are often less volatile than stocks, but they also carry certain risks, because they are tied to credit ratings and interest rates. When these change, bonds may be impacted. Bonds may experience lower investment returns than stocks or cash, too. Some bonds (known as "junk" bonds or high-yield bonds) promise higher returns, but may actually carry a high level of risk.

Cash equivalents. This category includes money market funds, Treasury bills, and certificates of deposit. Although they may seem to be extremely safe, they too carry risk. By investing too much of your retirement savings in a cash equivalent, you may miss out on the potentially higher returns of the other investment categories.

While each of these investments carries some risk, the good news is that by investing a portion of your retirement account in several different categories, you can spread out that risk. Doing so may smooth the ups and downs of investing in a single category. Your finances may stay healthier, because the investments are balanced.

Investing always involves risk. That's why taking a balanced approach is so important: Returns on the three major categories of investments have not historically moved in unison, all going up or down at the same time.

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How can you achieve balance?

First, remember that the right balance now may not be the right balance later. When you decide how to invest your retirement account, don't use a "one and done" strategy. Add a review of your retirement plan to your annual to-do list. Why? Because our needs and goals change as we age. An investment strategy that is appropriate for a 25-year-old may not be the best for someone who is 50. The mix of stocks, bonds and cash equivalents that works well to help a younger person grow their account in the early years may lean toward more risk —and, possibly, greater returns. But someone who is nearing retirement may want to consider a more conservative approach by exchanging some of the greater potential returns of stock funds for the greater potential security offered by other investment categories. Periodically reviewing the balance in your investments can help you stay on track.

Your personal balancing act: Consider risk tolerance and time

The exact mix of investments you choose depends on two basic things and how they work together. The first is your personal tolerance for risk, and the second is the amount of time you have available before you need the money.

Your ability to tolerate risk is something only you can decide. Risk tolerance, in a nutshell, is about your level of comfort with exchanging the possibility of losing some (or all) of your investment for the potential of higher investment returns. Someone with a high risk tolerance is willing to take that chance, and someone with a low risk tolerance prefers investments that are safer but have lower potential earnings.

The time you have left to invest should be one factor in determining your risk tolerance; many people feel more comfortable with riskier investments (stocks versus cash, for example) when they are younger. That's because they have many years, or even decades, to recover if their investments don't perform well.

If your retirement plan includes a lifecycle fund, sometimes called a target date fund, your investments in the fund will be automatically rebalanced as the years go by. You choose a lifecycle fund based on the year you expect to retire, and the fund managers invest for you considering the number of years remaining until that date is reached. In the early years, the investments may lean toward more risk, and move steadily toward more conservative instruments as the years go by. Of course, the principal balance of a target date fund is not guaranteed at any time, including at the target date.

Here are a few questions to help you think through your risk tolerance:

1. **When it comes to making investment decisions, how knowledgeable are you?**
   - Very,
   - Somewhat, or
   - Not very.
2. **Which of the following best describes your investment philosophy?**
   - I'm a worrier, so I like to be conservative;
   - Taking on more risk is the only way to achieve potentially higher returns; or
   - I like to take my time and investigate my options.
3. **Which of the following best describes your attitude toward investing for retirement?**
   - I want my retirement savings to grow but am only comfortable with a medium amount of risk;
   - I tend to worry that the value of my retirement savings will go down; or
   - I want my retirement savings to grow as much as possible, and am willing to take on higher risk for potentially higher returns.

Your answers to these questions may give you some insight into your own investing personality. Then you can use that information to help develop your personal investing strategy.

The danger of taking too little risk

It would be a mistake to assume that investing only in very low-risk categories is always safest. Remember, all investments involve risk. By choosing investments that have little or no investment risk, you actually increase the risk that you won't achieve your retirement goals. That's because your investments may not keep pace with inflation—much like burying money in the backyard. You won't experience much (or any) growth, and your buying power will likely erode over time. When you "dig up" your cash, it will be unlikely to meet your savings goal.

By diversifying your investments, you may benefit from positive returns on one type of investment, while being insulated from some of the negative returns of another.[1] Your overall investment portfolio may experience less volatility than it would if you invested in only one category, contributing to your financial health.

So review your investments with an eye toward balance. Include a variety of investments in your overall portfolio, and don't be afraid to make needed adjustments. When you achieve balance in this important area of your life, you may find that the result is well worth your effort!

1 Diversification does not ensure a profit or protect against loss.

Seriously?! Teaching **Teens** Good **Money Habits**

Before your teenagers start working or head off to college, put them on the road to financial literacy.

Do your teenagers know how to manage their money? Many young people are no longer starting out their adult lives in a traditional job with a pension. That's why it's critically important for them to form good money habits for saving, spending and investing. Here are six ways to instill good money skills in your teens for college and beyond—even if you, yourself, are still working on becoming more financially savvy.

1. **Start early** – When your kids are in elementary school, consider establishing an allowance for doing certain chores around the house. And to help children begin to learn the value of saving and compounding interest, set up savings accounts for them when they are in first grade. Although the small amount of interest they earn may not be that impressive, they will be getting in the habit of regularly depositing a portion of their birthday money and earnings.

2. **Get them involved in household finances** – Most teens are blissfully unaware of what it costs to keep the lights on, pay for cable TV, or take a week's vacation. Invite them to join you at the end of the month and view your checkbook entries—not only for paying for the items that benefit them directly, but for long-term obligations such as retirement contributions and mortgage payments.

3. **Encourage financial responsibility** – One of the best ways to hold teenagers accountable for their choices is to have them pay for such items as their mobile phone subscriptions or movie downloads. Budgeting lessons are also important—try giving them a back-to-school allowance and letting them buy their school supplies and clothes on their own. Even if they wind up buying a pair of trendy sneakers rather than enough socks or notebooks, the stakes are pretty low, and the consequences of their decisions will be immediately visible.

4. **Allow them to learn money lessons by car shopping and buying** – Before you buy a car for your teen for her 16th birthday, have her do the research online to compare prices, mileage, safety and projected repair costs. You might also assign your teen responsibility for calling various insurance agents to see what coverage will cost.

5. **Limit their use of credit** – Managing credit card debt is a serious problem for many consumers, but young cardholders may find it especially challenging. The use of prepaid cards in high school—available to those under age 18—can help establish good spending habits for your son or daughter, especially when taking a school trip or traveling on his or her own. Plus, parents can monitor what the kids are spending their money on.

6. **Consider a teen retirement account** – It seems increasingly likely that your kids will have to rely on their own savings and investments to help cover expenses when they retire. Although that day is a long time away, having time on their side to save and invest is a distinct advantage for young people. Once your teen gets his or her first real job, suggest setting aside a portion of earnings (say, 10% or 15%) in a Roth IRA. To make opening an account more compelling, offer to match a portion of your child's contributions for some period of time.

A Roth IRA allows an account holder to contribute a portion of his paycheck after taxes. You can use the Roth IRA to teach your teen about the stock market, risk, and the importance of having a long time horizon to recover from periodic market setbacks.

The National Endowment for Financial Education has a wealth of resources, which can help educate your teen or college student, that can be downloaded for free at www.smartaboutmoney.org.

Retirement in Motion

TIPS AND RESOURCES THAT EVERYONE CAN USE

Boomers on the Brink

Build up cash before you stop working

In 2008-09 many new retirees suffered losses just as they were beginning to take retirement withdrawals. You should consider establishing a cash cushion of a full year of living expenses several years before retiring. By having funds stashed in a bank savings account or CDs, you won't feel pressured to cash out during market downturns, which are seldom conveniently timed.

Quarterly Reminder

A change of 1% in savings can make a big difference

It is a good idea to increase retirement-plan contributions whenever possible. Even boosting deferrals by just 1% a year adds up over time.

Let's say you are 30 years old, make $30,000 a year, and contribute 9% of your salary into your plan, or $2,700 a year. If your account compounds at 8% a year, your savings would grow to an impressive $516,124 in 35 years. However, by upping your contributions to 10%, your savings would grow to $573,471, giving you $57,347 more to spend in retirement.[2]

Tools & Techniques

Plan for taxes now to lessen the impact later

Even if retirement is 10 years away, you can begin to devise a tax strategy.

Depending on your situation, it may be better for you to take money from regular taxable accounts before tapping tax-deferred accounts. Or you may prefer to take out money from your IRA and 401(k) before spending down your taxable assets, especially if you think tax rates will be higher in the future. Consider enlisting the assistance of online tools or retaining a financial planner to determine the best order of withdrawals for you. You can find a basic withdrawal calculator at http://www.dinkytown.net/java/RetirementWithdrawal.html.

Q&A

How much will I need to take from required minimum distributions (RMDs)?

Investors in qualified retirement accounts must usually take RMDs starting the year in which they turn 70½. The RMD is based on the amount held in the retirement account and the account owner's remaining life expectancy, according to tables published by the IRS. All else being equal, RMDs generally rise as a percentage of the portfolio as you get older and your remaining life expectancy decreases.

Be careful of a tax trap: If you fail to withdraw enough to meet the RMD by the end of a given year, you could face a tax of up to 50% on the shortfall. For more information, visit www.irs.gov/Retirement-Plans/Retirement-Plans-FAQs-regarding-Required-Minimum-Distributions.

Corner on the Market

Basic financial terms to know

Risk/return trade-off

Risk may be defined as either the amount of up-and-down values your money will experience along the way or the possibility of winding up with less than you started with in a given investment. In order to achieve a higher investment return, you likely will have to take greater risk. Your goal should be to invest for the greatest return given the level of risk you're willing to take.

2 Source: bankrate.com

Kmotion, Inc., P.O. Box 1456, Tualatin, OR 97062; www.kmotion.com

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