QUARTERLY RETIREMENT REVIEW

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WORKING LONGER BEFORE RETIREMENT

There can be no doubt that Americans have experienced a severe decline to their retirement savings over the past several years. The uncertainty of a U.S. recovery from the recession just experienced, and the financial problems now being experienced in Europe have proven to be major headwinds to many retirement accounts. For that reason we think that workers who might be planning to retire, near-term, should give consideration to working for a few more years in order to replenish some of their account losses. The results of continuing to work, even for a few more years, can be impressive, and may be one of the wisest decisions you make during your working life. As a matter of fact, it would be very difficult to find any single decision that would contribute more to your potential retirement security than even a few more years of employment.

The chart on the next page shows the retirement income advantage of working and saving longer and delaying Social Security each year beyond age 62, assuming that you invest 25%, 15% or none of your wages each year. This chart also shows how an average 60-year-old couple could increase their potential retirement income from combined investments and Social Security benefits by delaying Social Security and contributing or not contributing, starting at age 62.

Obviously, if you decide to work longer you will be giving your retirement account more time to grow and, as a side benefit, you will have reduced the number of years your retirement account will have to support you during retirement.

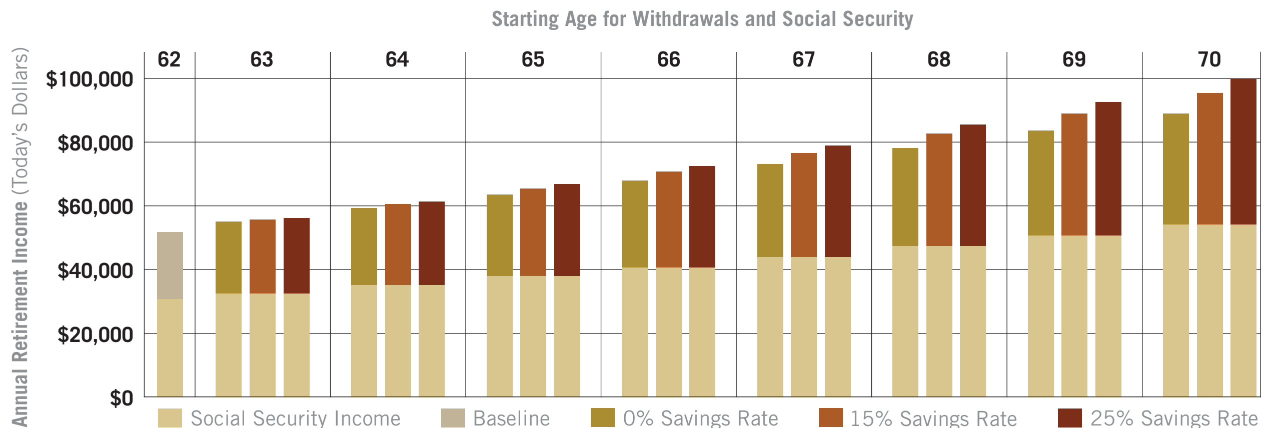
We would also encourage potential retirees to think about the amount of money available they might have for withdrawal each year after retirement. Part of this potential increase could be found in the Social Security schedule of payments. For example, you should be able to increase your Social Security retirement income by about 7% to 8% for each year that you delay initiating

withdrawals. When you consider this increase, coupled with any annual Cost of Living Adjustments (COLAs), the amount could be substantial. COLAs have been noticeably absent in the past few years, however, when made in the past, these inflation adjustments were increasing Social Security income by approximately 10% per year.

While most financial advisors would never advise you to cut back on your retirement fund contributions, even if you have decided to work a few extra years, you may be able to enjoy a larger spendable income during those extra years of work if you contribute less to your retirement account. Potential retirees should remember, however, that if they decide to work longer and, at the same time, cut back on savings that the benefits of working longer might be reduced by continued stock market volatility. There is also a psychological barrier (disappointment) that might have to be crossed by anyone who has made the decision to work longer. Nevertheless, we would encourage potential retirees to remember that if they work a little longer they are likely to come out ahead financially, and may have a richer and more rewarding retirement than they would otherwise expect.

Working Longer and Delaying Social Security

The chart below shows the increase in total retirement income for a couple from both working and saving longer and delaying Social Security each year beyond age 62, depending on whether they invest 25%, 15%, or none of their wages each year.

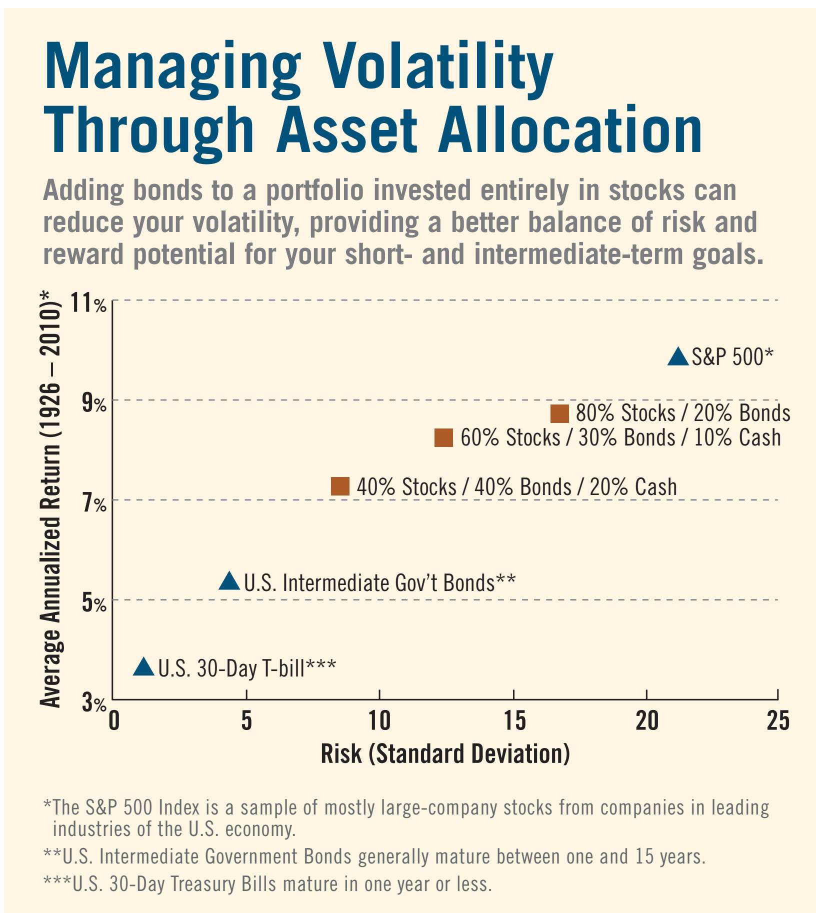


Baseline assumptions: Both spouses begin taking withdrawals from investments and their Social Security benefits at age 62 (they are the same age), having saved 15% of their salaries at ages 60 and 61. All income is expressed in current dollars at age 60, using a 3% discount rate. Each case assumes both spouses are currently age 60, are making 15% contributions at ages 60 and 61, and 0%, 15%, or 25% contributions annually thereafter. They will retire at the same time. The examples also assume a current annual salary of $100,000, increasing 3% annually; $500,000 in retirement savings at age 60, growing at 7% annually before retirement, 6% annually after retirement; initial savings withdrawals in the first year of retirement, based on retirement age, range from 3.5% at age 62 through 4.5% at age 70, each year of delay adding 0.1%; initial withdrawal amounts increased each year thereafter for inflation (3%). The Social Security payments were calculated in "inflated (future) dollars" using the Quick Calculator on the www.socialsecurity.gov web site and discounted 3% annually to current dollars at age 60. This chart is shown for illustrative purposes only and does not represent the performance of any specific security.

Source: T. Rowe Price.

FUTURE VOLATILITY

There is likely to be more volatility in the future and we may not know, at this time, where the source of that volatility might lie. Certainly, we cannot know exactly what issues the financial markets will be faced with in the future. We can only assume that they may be different from the ones we are currently facing. History continues to suggest that a well-diversified portfolio combined with an extended timeframe is the best protection against global market risks. For example, in the second quarter of this year, prices of oil and other commodities fell due to concerns among some investors that the asset classes were overvalued. Such an event, however, should prove to be short-term in nature and, over time, may prove to be inconsequential to the longer-term portfolio results. The chart below is an example of the effects that variations of stocks, bonds and cash have on risk, as measured by Standard Deviation.



Source: T.Rowe Price.

DEALING WITH THE VOLATILITY

Plan participants should make sure that they have the appropriate mix of asset classes in their retirement account. This mix should be reflective of the number of years the employee has to work before retirement, the amount of time the money will need to last and the participant's emotional ability to accept risk. Plan participants who are fifteen years or more away from retirement should consider overweighting their account with equities. As retirement becomes more near-term, it might be wise to consider adding more bonds to the portfolio. The addition of bonds could assist the investor in two ways: First, it is important to realize that bonds are usually less volatile than stocks, and they can act as a stabilizing force during times of stock market volatility. Next, bonds will normally increase the level of income to the portfolio, and can both assist and build the plan participant's portfolio cash allocation.

The question often asked is, "How do I arrive at the correct equity allocation in my retirement account?" One answer might be to invest in funds with exposure to all kinds of companies, large, small, domestic and international. If you spread the risk, your overall returns won't be dependent on any single equity allocation.

You might also want to use the same strategy with your bond holdings by investing in both domestic and international bond funds with different credit qualities and maturities. Diversification cannot assure a profit or protect against loss in a declining market, but it can help to smooth the volatility of your portfolio.

STAYING FOCUSED

Emotions run high when the stock market is volatile, and history shows that this may not be the best time to make significant changes to your retirement account. Actually, changes made during such times can prove to be particularly damaging due to the uncertain nature of asset prices and stock market momentum. Try to remain focused on your long-term investment strategy during such market periods, and resist any temptation to try to time the market's moves. It's also good to remember that by investing regularly, you will often find that short-term market fluctuations will have little impact on your long-term goals.

HAS ANYTHING CHANGED?

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