

QUARTERLY RETIREMENT REVIEW

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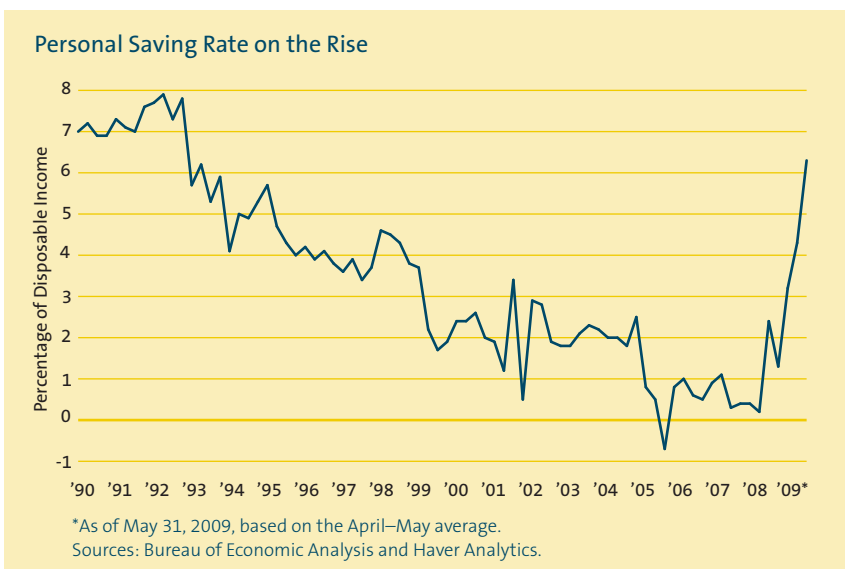
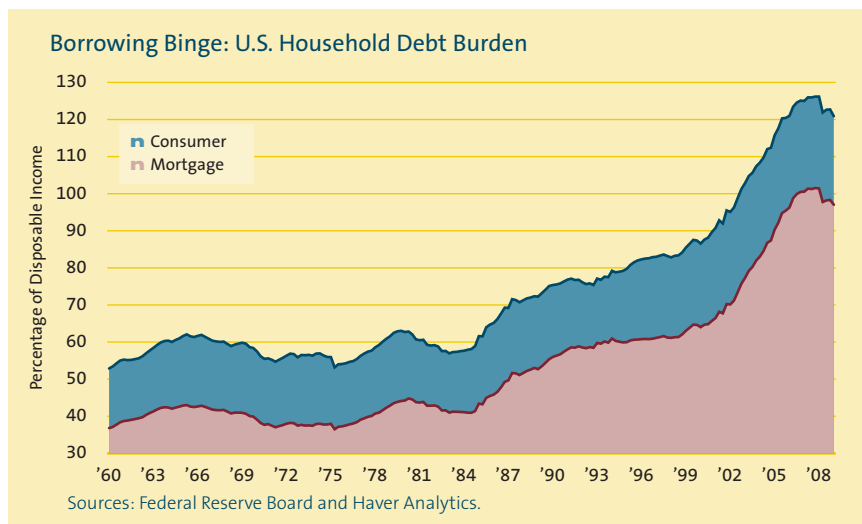
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A SLUGGISH ECONOMIC RECOVERY

Any discussion about an economic recovery for our nation needs to start with the consumer's financial health. Our economy is a consumer driven economy and any recovery we experience from the recent recession is going to be anemic if the U.S. consumer is so heavily leveraged with debt that this key for growth is missing. As the chart to the right shows, however, the deleveraging has already begun.



CONSUMERS ARE SAVING, NOT SPENDING

Consumers are continuing to pay down debt and are saving more than ever before.

In our opinion, the deleveraging process is going to carry us well into 2010. As the private sector retrenches, the federal government's unprecedented stimulus programs are filling this consumer spending



shortfall with public borrowing and credit creation. Once the recovery takes hold, however, a timely unwinding of these policies will be needed to keep inflation concerns on the back burner.

The Fed's unprecedented program of monetary stimulus is working along several tracks to

promote a return to growth that should reduce deflation risks. The U.S. government has put in place a broad and expanding array of lending programs aimed at improving the flow of credit, including in the interbank lending, commercial paper, and asset-backed securities markets.

Partly as a result of these

lending programs, we are in transition from recession to recovery. We expect sluggish growth to emerge in the second half of this year, we are looking ahead to an end to the housing recession, a further rise in the personal savings rate, a slower pace of decline in business fixed investment, and subdued inflation.

BEAR MARKETS: AN OPPORTUNITY FOR YOUNG INVESTORS

Would you rather start investing for retirement during a bull market or a bear market?

After the historically poor performance of equities in this decade, marked by two ferocious bear markets with overall losses greater than any other time since the Great Depression, some young investors might consider reducing or even eliminating their exposure to stocks.

They may be surprised, however, to learn that, in the

past, such downturns have presented investors with rare opportunities to benefit from healthy future returns.

Historically, bear markets have provided a substantial advantage for investors who are decades away from retirement. Those who began to systematically invest in equities in past severe bear markets were significantly better off 30 years later than investors who began investing in bull markets.

Young investors who began

investing at the start of this decade may be discouraged, but they could have two powerful forces in their favor: the cyclicity of markets and the ability to accumulate a lot of mutual fund shares early in their career.

Actually, studies have suggested that investors who were able to maintain their investment programs throughout a prolonged period of weak performance were poised to benefit considerably when markets recovered.

THE SEQUENCE MATTERS

To further illustrate the potential opportunity of bear markets, recent studies also examined how returns could differ if a bear market or weak decade is followed by a bull market or strong decade, and vice versa.

For example, an investor who contributed \$500 monthly to a retirement plan from 1970 to 1989 (\$120,000 in total) in a portfolio replicating the S&P 500 Index ended up with an account value of \$589,707. *(See chart on the next page.)*

The index had an annualized return of 11.5% during this period.

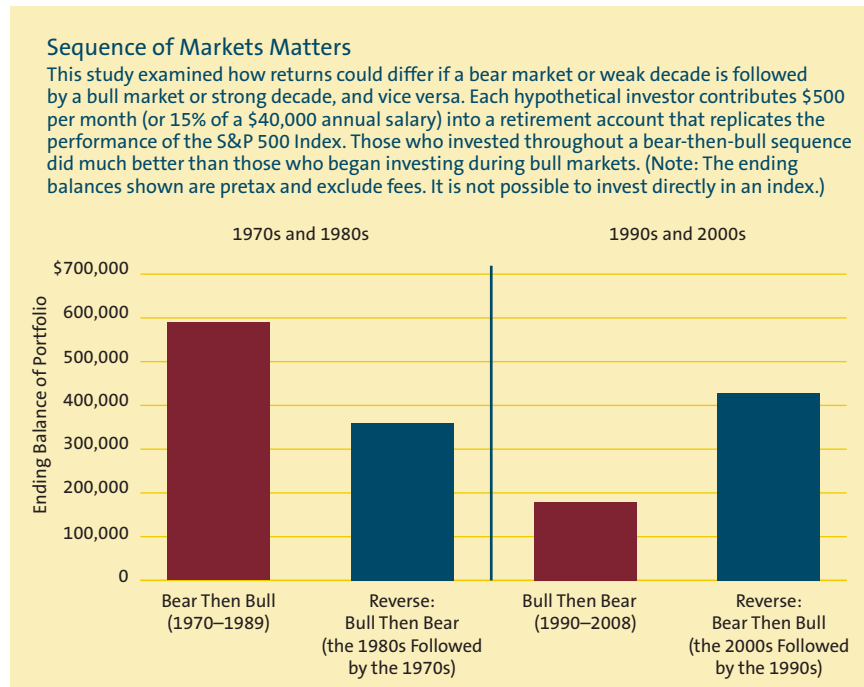
But what if the decades were reversed—incorporating the modest performance of the 1970s?



In that case, the account value at the end of the period was much less, \$358, 972, even though the index's annualized return for the 20-year period was still 11.5%.

Similar results were produced when the study compared the 19-year period from 1990 to 2008. The investor who began contributing in 1990 ended up with much less than half the balance compared with what he or she would have had if the decades were reversed—the weak returns from 2000 through 2008 followed by the exuberant gains from 1990 through 1999.

We have shown the effect of this sequencing in the chart:



RETIREMENT PLANNING PRINCIPLES

Each of these retirement planning risks could force you to withdraw more money in retirement than you expected, resulting in significant shortfalls and lifestyle changes, if you're not prepared.

So understanding and managing the following basic risks are vital to successful, long-term planning:

1. **Inertia:** Many investors prefer to delegate complex financial decisions or avoid them entirely. Too often, this results in not having a financial strategy or in following an inappropriate strategy; both of which can leave investors unprepared for retirement.
2. **Financial Shortfall:** According to the American Society of Actuaries, more than half of married couples retiring today at age 65 will have one spouse live to age 90, and almost one in four will have a spouse reach
3. **Volatility:** As recent events have clearly shown, stock market fluctuations can have a big impact on retirement portfolios. Investors retiring during a bear market, for example, could face long-term issues when it comes to sustaining retirement income. Just as they start taking withdrawals from their portfolio, those assets begin losing value, resulting in a double hit to their savings.
4. **Inflation:** Although inflation has averaged just 3% annually over the past 80 years, the purchasing power of \$100 at this inflation rate would be cut in half in just 23 years. And the inflation rate for some goods and services, such as medical care, has been rising faster than the average.



5. **Health:** Even average health care expenses can quickly deplete retirement savings without proper planning and insurance. According to the Employee Benefit Research Institute, a couple retiring today can expect to spend \$295,000 on health care insurance premiums and out-of-pocket medical expenses. Investors preparing for retirement should consider purchasing “Medigap” insurance to protect against unexpected catastrophic medical expenses that may not be covered by Medicare. The purchase of long-term care insurance also should be investigated early in the purchasing process.
6. **Taxes:** Massive monetary and fiscal stimulus efforts have resulted in huge budget deficits, adding to already large government debts. At some point, all levels of government may consider tax increases, leaving retirees with potentially higher tax obligations.
7. **Behavior:** Saving at an inadequate rate or spending excessively in retirement both can have a big impact on the long-term sustainability of assets. Even a small increase in annual withdrawals in retirement could dramatically reduce the number of years that retirement assets ultimately last.

ESTIMATED PROBABILITY SCENARIOS FOR VARIOUS WITHDRAWALS

What will it cost you to have the retirement life you dreamed off? A careful inventory of potential retirement income sources and expected expenses is essential for effective planning.

How Much Can You Withdraw in Retirement?

The estimated probability of maintaining several initial withdrawal amounts throughout a 30-year retirement without running out of money, depending on the investor’s asset allocation. This analysis assumes pretax withdrawals from tax-deferred assets and can be applied to any size retirement portfolio. In this study, the annual withdrawal amounts are increased by 3% for inflation.

First-Year Withdrawal Amount	30-Year Retirement Period Stock/Bond Mix			
	80/20	60/40	40/60	20/80
	Simulation Success Rate*			
7%	31%	22%	9%	1%
6	49	42	29	10
5	69	68	63	49
4	86	89	91	92

*The probability of having at least \$1 in the portfolio at the end of 30 years. The methodology and tax and withdrawal assumptions used for this analysis are explained on page 17.

Source: T. Rowe Price Associates.

Has anything changed?

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