The Insurance Depot, Inc.

*Life Insurance and Annuity Specialists*

PO Box 1344 ▪ Sparta, NJ 07871
Phone: 973-726-6015 ▪ Fax: 973-726-6017
www.lifeandannuityexchange.com

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QUARTER 1, 2011

# Retirement in the New Economy

It appears in news headlines and in speeches, in policy discussions, and in water-cooler talk. It's the "new economy." The fact is that the recent recession has changed the way that we think about our money, today and into the future. It has changed the way we work, and it has changed the way we think about not working.

We all well know that this has been a very difficult few years. It's been a time of struggle and a time of worry. It's been a time of increasing unemployment and a time of decreasing home prices. It's been a time of great reflection as we pause to assess the recession's damage and how to move forward.

During this economic reckoning, financial uncertainty has impacted every generation. Young and old, we find ourselves asking, "What does this 'new economy' mean for my retirement?"


A study conducted last year by AgeWave and Harris Interactive titled, "Retirement at the Tipping Point: The Year That Changed Everything," looked into how the recession is impacting Americans' "retirement fears, hopes, attitudes, advice, and plans." They interviewed thousands of Americans across four generations to gather their data.

The results were somewhat predictable in that they unveiled overall trepidation and shifting plans, with a new outlook on the role of retirees in America. The results predict a new era of cautiousness after many saw their retirements, as they had planned them, change dramatically — or evaporate — when the Dow plunged 54% from its high in October 2007 to its low in March 2009 (though it has, of course, recovered substantially). Yet amidst all of that fear-based caution, there is also an underlying sense of hope.

Looking into the survey data further, we find:

**Retirement in the new economy**

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## Your 401(k) Contribution Amount

Before deciding how much to contribute to your 401(k) plan, find out three key figures:

**What is the maximum percentage of your pay that can be contributed?** The maximum legal limit that can be contributed in 2010 is $16,500 plus an additional $5,500 catch-up contribution for participants age 50 and over, if permitted by the plan. However, most employers set limits in terms of a percentage of your pay to comply with government regulations.

**How much of your contribution is matched by your employer?** Employers are not required to provide matching contributions, but many do. A common match is 50 cents for every dollar contributed, but many other variations also exist.

**Up to what percentage of your pay does your employer match?** Most plans only match contributions up to a certain percentage of your pay. For instance, the plan may only match contributions up to a maximum of 6% of your pay.

**How much should you contribute to your 401(k) plan?** If at all possible, contribute the maximum allowed. At a minimum, contribute enough to receive the maximum matching contribution. ❍❍❍

## Retirement

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**may mean working longer**. Nearly 60% of Americans have lost money in mutual funds, 401(k) plans, or the stock market. For many, recouping those losses means pushing back retirement and working longer.

Respondents of the AgeWave/Harris Interactive survey believe it will take an average of seven years for their investments to recover. The report cites that "today's preretirees say they will need to postpone their retirement 4.2 years on average, which would be the first time in history that retirement age significantly increased in America."

**Retirement in the new economy means worrying about the cost of health care.** The biggest financial concern among respondents age 55 or older is being able to afford medical expenses during retirement. For them, it is the biggest unknown. Medicare coverage, though helpful, is limited. Retirees are considering supplemental insurance, known as "medigap," as the financial burden of health care can quickly deplete a person's retirement fund.

Nearly 70% of Americans over the age of 65 will need some long-term care, such as home care, assisted living, or nursing home care. In 2008, the average annual cost for a room in a private nursing home was $76,460 a year (Source: Genworth Financial, 2009).

**Retirement in the new economy means being more fiscally responsible.** Only 4% of respondents strongly agreed that Americans behave in a financially responsible manner. An astounding 81% said that to "live within your means" was the most important financial advice parents could pass on to their children.

**Retirement in the new economy means stabilizing your funds.** Generally, you should have a larger share of your investments in equities the further you are from retirement; as you approach retirement, you should gradually decrease your equity investments and increase your bond and fixed-income assets — shifting from growth toward income generation. In other words, dialing down the risk in your portfolio as you approach retirement is important (though many investors will need both income ***and*** growth investments, even during retirement, to live comfortably).

**Retirement in the new economy means finding a new purpose.** The majority of Americans — 60% — now say they view retirement to be "a new, exciting chapter in life" and 70% ***want*** to work in retirement as a way to contribute to their community and remain stimulated. It seems that a longer life span now means a longer work span...out of choice as well as necessity.

What's more, we want retirees to work. Nearly 75% of all survey respondents think our country would benefit if retirees were more involved in contributing their skills and experience to community and civic life.

There is no doubt that the recession created anxiety across the nation. As we all take a deep breath and assess our retirement funds, we assess with a new outlook. If you'd like some help assessing your retirement plans, please call. ❍❍❍

## Who Gets Paid More?

In the past, public sector wages were lower than private sector wages, so the public sector offered generous benefits to attract and retain workers. But recent data from the U.S. Bureau of Labor Statistics (BLS) indicates that the situation has changed dramatically.

Currently, 16.4% of all workers are employed in the public sector — 2.0% for the federal government, 3.7% for state governments, and 10.6% for local governments. As of September 2008, average total compensation, including benefits, was $27.07 per hour in the private sector and $39.18 per hour in the public sector.

Differences between the two sectors help explain some of the wage disparity. Over 40% of public sector workers are represented by a union while less than 10% of private sector workers are. The average employee tenure is twice as long in the public sector.

The occupation mix is also very different between the two sectors. Approximately two-thirds of public sector jobs are professional and administrative while 51% of private sector jobs are. Also, retail and food service jobs, which tend to be part-time, low-paying jobs, account for 20% of private sector jobs but only 2% of public sector jobs (Source: The Federal Reserve Bank of Chicago, May 2009).

Benefit costs differ substantially, with the public sector paying $13.41 per hour and the private sector paying $7.93 per hour for benefits. The difference results primarily from health and retirement benefits, which are more prevalent in the public sector.

It is generally believed that the decrease in private sector benefits over the years is in large part a response to economic pressures and global labor trends. Whether the public sector will find benefit costs so overwhelming that they will follow suit remains to be seen. ❍❍❍

# The Basics of Growth and Value Investing

The two basic investing styles are growth and value. While one style tends to perform better at any given time, the dominant style varies over time. The basic elements of each style include:

## Growth Investing

Growth investors look for stocks with above-average growth in sales and earnings, typically at a 15% or higher annual rate. These are typically stocks of younger companies in a rapid growth stage of development, although larger companies can also qualify as growth companies. Growth companies tend to have higher price/earnings (P/E) ratios with little or no dividends, since earnings are typically used to finance future growth. As growth stocks gain favor, investors tend to bid their prices up to lofty levels. Thus, the price/earnings ratios of growth companies can be two or three times higher than the overall market. Earnings projections largely drive the value of these companies, so earnings disappointments can dramatically impact their value.

When searching for appropriate growth stocks, you should be looking for a fast-growing company that you feel will be able to sustain that growth for an extended period of time.

## Value Investing

Value investors emphasize stocks with market values that are low based on earnings, dividends, or assets. Companies in this category typically include those in out-of-favor industries, turnaround or troubled companies, or mature and stable companies with modest growth expectations. Dividend yield may be higher than average since the stock price is low. Signals that a company may be turning around include insider buying, improving profit margins, increasing earnings estimates, or higher trading volumes. Value investors must typically exhibit patience, since it can take a while for the market to realize a particular stock's value.

When searching for value stocks, you should look for a company with depressed earnings and a stock price that you feel will recover soon.

## Which Style Performs Better?

Growth stocks typically do well when the economy is growing and the stock market is rising, while value stocks typically do well when the stock market is peaking or falling. Many investors are naturally drawn to a growth investing style since growth stocks usually have exciting news, capturing much press attention. Value companies often receive unfavorable press, requiring more resolve on the investor's part to continue holding them.

So which style will excel in the future? Just as you can't predict where the market is headed, it is difficult to determine when each style will dominate. Thus, it may make more sense to include both styles in your portfolio. That way, no matter what style dominates, it will be represented in your portfolio.

Growth investing does not guarantee a profit or eliminate risk. The stocks of these companies can have relatively high valuations. Because of these high valuations, an investment in a growth stock can be more risky than an investment in a company with more modest growth expectations. Value investing involves the risk that the market may not recognize that securities are undervalued, and they may not appreciate as anticipated. ❍❍❍

# Three Basic Trusts

Three trusts are typically used in estate plans for married couples. Those trusts are:

✔ **A revocable living trust** — With a revocable living trust, ownership of assets is transferred to the trust while you are alive. You can keep any or all of the income, act as trustee, change the trust's provisions, or terminate the trust. You can provide for a successor trustee to take over if you become mentally or physically disabled. Assets in the trust are controlled by the trust agreement and are not subject to probate.

✔ **A bypass or credit shelter trust** — This trust is generally used to ensure both spouses take advantage of their estate tax exclusion amount, without directly transferring assets to other heirs until both spouses have died. Generally, assets equal to the estate tax exclusion amount are placed in trust after your death, but you can place less than that in the trust. Once the assets are placed in trust, your spouse can use the income and perhaps some of the principal, with the remaining assets transferred to heirs after your spouse's death.

✔ **A qualified terminable interest property (QTIP) trust** — If you have assets in excess of those going into the bypass trust, you can bequeath them directly to your spouse with no estate tax liability due to the unlimited marital deduction. However, some spouses want to control how their spouse disposes of those remaining assets, placing assets in excess of those in the bypass trust in the QTIP trust. Income from the trust is distributed to the surviving spouse during his/her lifetime. This qualifies for the unlimited marital deduction. After the surviving spouse's death, the principal is distributed to heirs designated by the first spouse. ❍❍❍

# The Impact of Declining Home Values

Since the end of 2006, U.S. households have experienced a $4 trillion loss in housing values, which is far less than the $10 trillion loss in stock market values that occurred after mid-2007 (Source: *The Regional Economist*, October 2009). However, many economists feel that declining home values have been more damaging to individuals for three reasons:

✔ Homeownership is widespread among households at most income levels. Approximately two-thirds of families own homes, while only about half own stocks, with most stocks owned by upper-income families.

✔ For most households, the value of their homes is significantly larger than the value of their stock portfolio. Before the recent declines, the median value of a home was $191,000 and the median value of stock holdings was $35,000.

✔ Homes are usually financed in part with mortgage debt. Borrowing to finance a home purchase magnifies the owner's gains and losses.

High rates of homeownership and mortgage borrowing are not new developments. What made this decline so severe, however, is that home prices rose so far so fast and then fell hard and fast. Also, the amount of mortgage debt taken on by millions of households now appears to have been excessive. Debt service rose from 10% of family income in 1989 to 12.5% in 2000 and 15% in 2007. Thus, home values declined more than at any time since the 1930s at a time when more households were vulnerable to the magnified effects of high leverage.

With most home values falling after 2006, homeowners with mortgages found their equity falling even faster. For those homeowners with mortgages, the average loss in home equity is close to 70%. ❍❍❍

# Changing Life Insurance Needs

**Just starting out** — Young, single adults may have little need for life insurance since they have no major debts and no one else counting on their income.

**Married with no children** — If it takes both salaries just to make ends meet, you may want to purchase insurance to replace your income.

**Two incomes with children** — This is typically the time when your insurance needs are the greatest, since several family members are depending on your income. The death of either spouse can create a financial hardship.

**Middle age with children** — You should reassess your insurance again as your children approach college age, since you may need to increase coverage to fund their educations.

**Children out of college** — Your need for life insurance may decrease when your children become independent. On the other hand, you may find you now have different needs for insurance.

Please call if you need help determining how much life insurance you require. ❍❍❍


The Insurance Depot, Inc.
Life Insurance and Annuity Specialists
PO Box 1344
Sparta, NJ 07871





FR2010-0820-0110