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RETIREMENT REPORT

How Many Fixed Income Funds Belong in a Retirement Plan?

Diversification within a retirement plan includes access to a variety of asset classes – primarily cash equivalents, U.S. and international equities, and fixed income. As one of the more conservative asset classes, fixed income is primarily utilized to generate income with limited volatility, making it a somewhat more popular investment given the economic conditions of the past few years. While fixed income investments can post negative returns over certain periods, potential losses are lower when compared to equities. In addition, fixed income often adds a crucial diversification component to the portfolio's exposure to equities, actually enhancing the overall risk-return characteristics of the entire portfolio.

Often times our clients ask us how many fixed income options are appropriate for the plan's fund line-up. Our consulting philosophy supports utilizing a single, highly diversified fixed income fund (a "core fixed income" bond fund) to achieve all of the above mentioned objectives in a straight-forward manner. We feel this to be appropriate for the average defined contribution retirement plan. Essentially, the fixed income universe encompasses numerous types of securities including treasuries/agencies, mortgage-backed-securities, corporate, high yield, inflation-protected, emerging markets and foreign bonds. Offering several bond funds that focus on

different subsectors of the fixed income markets can often confuse plan participants and actually increase portfolio volatility when allocated incorrectly. Core fixed income bond funds (represented by the average intermediate-term bond fund in Morningstar) have typically exhibited less risk over the last ten years than six (of seven) security subsector types listed above. Giving an active manager the latitude to invest in various subsectors of the fixed income market allows him/her to take defensive positions when trouble is foreseen and to pursue opportunities when they arise.

Note: Diversification and asset allocation does not guarantee a profit, nor do they eliminate the risk of loss of principal.

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Increase Your Contribution in 2011

In the February Retirement Report, we included a sample memo for employers to share with participants about the Tax Relief, Unemployment Insurance Reauthorization and Job Creation Act of 2010. This month we wish to remind plan sponsors about the unique opportunity to encourage employees to increase (or begin) their contributions toward the company's retirement plan, as a result of this tax cut.

The new tax bill allows, among other things, for a one year reduction in workers' Social Security taxes from 6.2% to 4.2% for all earned wages up to \$106,800 for the 2011 tax year. For example, a worker earning \$50,000 will save \$1,000 and a \$100,000 earner will save \$2,000 in 2011. An increase in a participant's deferrals equal to that savings would further reduce taxable income and have a positive impact on amounts available at retirement. As a result of this tax change, a participant enrolling at a 3% deferral rate equates to less than a 1% reduction in net take-home pay for 2011 from an identical salary in 2010. If this amount is matched dollar-for-dollar, the new participant would experience approximately a 1% reduction in take-home pay and have a total contribution of 6% of salary. For a \$50,000 earner this would amount to a \$3,000 total contribution (employee + employer) for a reduction in take-home pay of less than \$10 per week.

Although not an end in itself, this opportunity would allow a new participant a terrific start, and an existing participant a great boost, toward a financially successful retirement. Assuming an average 7% annual net return this 3% deferral (if matched at 100%) would generate approximately \$283,000

of additional assets in 30 years for less than a \$10 reduction in weekly pay. Pretty impressive!

Checking the Right Box on the Form 5500



When you complete your annual Form 5500 you are asked to indicate if your intent is to comply with ERISA Section 404(c). Many times your 401(k) vendor (who typically prepares this form for you) will answer this question in the affirmative on your behalf; however, the "Yes" answer can be considered fraudulent by the DOL in the event the fiduciary did not research and document his or her understanding and acknowledgement of his or her fiduciary responsibilities. If you have not taken the necessary steps in identifying your plan's fiduciaries and documenting their responsibilities, please contact your Van Gilder Retirement Plans Team!

Retiree Issues: How Long Will the "Nest Egg" Last?

J.P. Morgan Asset Management recently released their "Retirement Insights: 2010 Guide to Retirement," focusing on important issues and considerations for retirees. Retirement needs continue to show that couples require nest eggs that last for perhaps two decades or more. As a result, the number of people still working during their "retirement" years are increasing. The reasons, categorized as "needs," include the following:

- 57% (keep working) to keep insurance benefits
- 47% (keep working) to make "ends meet"
- 38% (keep working) to buy extras

Others, however, retired earlier than planned for reasons beyond their control, including:

- 42% (retired early) for health problems or disability
- 34% (retired early) for changes at company (downsizing/closure)
- 22% (retired early) for work related reasons
- 18% (retired early) to care for spouse or family member

Another important consideration for retiree is the potential costs of healthcare in retirement. For retirees, without employer medical coverage, the present value of costs for retirees in 2008 was:

- For Men, \$156,000 to cover 50% of possible health outcomes, and \$331,000 to cover 90%
- For Women, \$217,000 to cover 50% of possible health outcomes, and \$390,000 to cover 90%

The present value for costs for retirees in 2018 is estimated at:

- For Men, \$261,000 to cover 50% of possible health outcomes, and \$555,000 to cover 90%
- For Women, \$364,000 to cover 50% of possible health outcomes, and \$654,000 to cover 90%

Regardless of where healthcare goes in the U.S., future retirees must consider its costs along with their other needs in retirement. For a copy of the J.P. Morgan report, please email us.

Communication Corner: Beneficiary Considerations

This month's sample participant memo reminds participants of the importance of keeping their beneficiary forms up to date.



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