Dwayne M. Dills, CPA, PC
Financial Advisor and Certified Public Accountant
1278 B • Hendersonville Road • Asheville, NC 28801
Phone: 828-398-0258 • Fax: 828-274-7020

Financial Briefs

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The Basics of Retirement Planning

Year after year, having enough money for retirement consistently comes up as number one among Americans' long-term financial concerns. Consider:

- The Employee Benefits Research Institute reports that nearly half of all Americans (47%) aren't confident they'll be able to afford living comfortably in retirement, up from 29% in 2007.
- A survey by Allianz Life in 2012 found that 28% of Baby Boomers age 55 to 65 are worried they won't be able to cover their basic living expenses in retirement, and that 43% don't plan to focus on retirement planning until they're five years or less away from retirement.
- A Wells Fargo survey released in October 2012 found that 30% of middle-class Americans believe that to retire comfortably, they'll have to keep working until they're 80 years old.

Here are the basic steps involved in creating a retirement plan. The objective is to introduce you to the retirement planning process so you can be confident that there is a way to map out your future.

Step 1: Set a Goal

Everybody has dreams about retirement: beginning a life of leisure, traveling, dining out, visits with relatives and friends, or whiling away the hours. There's nothing wrong with dreaming; in fact, it's necessary to give your life direction. But in the world of financial planning, dreams aren't goals. The difference is that a financial goal is a measurable objective, with two components: a *precise amount of money* to be available at a *specific future date*.

For retirement, then, choose a date. It's okay if you're not actually sure if you can retire by that date. This is the one data point where you're encouraged to state your

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How Much Can You Withdraw in Retirement?

It's probably one of the most important decisions you'll make when you retire — how much to withdraw annually from your retirement assets. Take out too much every year and you may have to seriously reduce your living standard late in life or even deplete your assets. Take out too little and you may unnecessarily reduce your standard of living.

Several factors need to be considered when calculating your withdrawal rate, including your life expectancy, expected long-term rate of return, expected inflation rate, and how much principal you want remaining at the end of your life. Keep these points in mind:

- **Your life expectancy.** While it's easy enough to find out your actuarial life expectancy, life expectancies are only averages. Approximately half the population will live longer than those tables suggest. How long close relatives lived and how healthy you are can help you gauge your life expectancy. Just to be safe, you might want to add five or 10 years to that age.
- **Rate of return.** Expected rates of return are often derived from historical rates of return and your current investment allocation. Historical rates of return are averages of returns over a period of time. You might want to be more conservative than that, assuming a rate of return lower than long-term averages.
- **Expected inflation.** While inflation has been relatively tame recently, even inflation of 3% can have a dramatic impact on your money's purchasing power over a long retirement. For instance, at 3% inflation, $1 is worth 74¢ after 10 years, 55¢ after 20 years, and 41¢ after 30 years.

So what is a reasonable percentage to withdraw on an annual basis?

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Retirement Planning

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wish, because the realistic date will really be affected by the second part of the goal: the annual income you want to live on. And how do you decide that? Forget about inflation and use your current household income as a guide. A rule of thumb says that you can maintain the same lifestyle you currently enjoy at anywhere from 60% to 80% of your current income. You can also use current dollars and adjust later for future inflation.

Step 2: Determine Your Defined Annual Retirement Benefits

For most people, defined annual retirement benefits include Social Security income and perhaps a company pension. You can get an estimate of your Social Security benefits by contacting the Social Security Administration or visiting their website. For your projected pension income, contact your employer's human resources department. You could also include in this sum any predictable income you may expect to receive.

Step 3: Calculate Your Income Gap

Subtract your total defined retirement benefits in Step 2 from the retirement income you defined in Step 1. This is your income gap — the amount of annual income you're going to have to generate from your own savings or other investments.

Step 4: Determine the Approximate Size of the Retirement Fund You're Going to Need

Divide your income gap by the rate at which you plan to draw from your nest egg every year in retirement, expressed as a percentage. Many experts suggest a number between 3% and 4% — a rate that aims at keeping retirees from running out of money over the long run.

Step 5: Calculate How Much Your Current Savings Balance Needs to Grow Each Year

First, tally up the current balances of all the accounts you intend to use to fund your retirement. Second, add into that sum any lump sums you can expect to receive between now and the day you retire. This can include inheritances, the sale of a business, or the sale of any other hard assets, like real estate.

Now subtract this total amount from the nest egg amount you calculated in Step 4 and divide by the number of years you will continue to work. The resulting number represents the average amount of growth your retirement accounts will need until you retire.

Step 6: Determine Where the Growth Will Come From

This is the point at which you can determine if you're on track to meet or exceed your goal, or if it's unrealistic and you need to change some of the variables. For a start, reduce the average annual growth amount you defined in Step 5 by the amount you are already saving per year. The remainder is the amount that you will have to earn from investment returns.

To get a very rough idea of the rate of return you'll need, divide that remainder by your current lump sum. The rate you actually need will be less, if it's in a tax-deferred account, because compounding will make the effective growth rate a bit higher. Finally, add in an estimated rate of inflation.

This has only been a rough sketch of retirement planning, and it leaves out the final parts: creating and executing an investment strategy and monitoring it year by year. To come closer to the mark, please call so we can discuss your specific situation.

Avoid This Mistake

Finding a way to live decades in retirement without worrying about running out of money can seem like an overwhelming task. That goal depends on many variables and assumptions. If you're wrong on even one of those variables, funding your retirement could be in danger.

With all the potential for missteps, what is the one mistake you want to avoid at all costs? Dipping into your retirement savings. Unfortunately, since the funds in your 401(k) plan or individual retirement account (IRA) belong to you, they often seem like a tempting place to get funds needed for other purposes.

Tax laws don't help, since they often provide tax-advantaged ways for you to access those funds. Loans from 401(k) plans are not taxable events. When leaving an employer, you can withdraw money from your 401(k) plan (you will have to pay income taxes and possibly a 10% early withdrawal penalty). Contributions to Roth IRAs can be withdrawn at any time with no tax consequences. Withdrawals from traditional IRAs before the age of 59½ can be made under certain circumstances, such as to purchase a home or to pay for a child's college education, without paying the 10% tax penalty.

Saving for retirement is a difficult task for most people, without making it more difficult by using retirement funds for other purposes. Even if the amount seems small, don't withdraw funds from your retirement account. While it probably won't add significantly to your lifestyle now, it can grow to significant sums over the long term. For instance, assume you have $10,000 in your 401(k) plan. If you withdraw the funds and are in the 25% tax bracket, you'll have $6,500 left after paying income taxes and the 10% federal tax penalty. Keep the funds invested earning 8% annually on a tax-deferred basis, and your funds could grow to $100,627 after 30 years, before paying any income taxes. *(This example is provided for illustrative purposes only and is not intended to project the performance of a specific investment.)*

No matter how much you think you need the money now, don't touch your retirement funds for anything other than retirement. Please call if you'd like to discuss this in more detail.

How Much Can You?

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To be conservative, it is typically recommended that you only withdraw modest amounts, especially in the early years of your retirement. A common rule of thumb is to withdraw no more than 4% in your first year of retirement, adjusting that amount for inflation in later years.

Consider these tips when deciding how much to withdraw from your retirement funds:

- **Use a modest withdrawal percentage to ensure you don't deplete your assets.** While you should certainly go through the process of determining how much to withdraw based on your unique circumstances, be prepared for modest withdrawal percentages. With a $1,000,000 portfolio, a 4% withdrawal equals $40,000.
- **Stocks should remain a significant component of your portfolio after retirement.** While the recent stock fluctuations have been difficult to deal with, especially for recent retirees, stocks should still remain a significant component of your portfolio. Always consider your risk tolerance before altering your portfolio.
- **Review your calculations every year.** This is especially important during your early retirement years. If you're depleting your assets too rapidly, you can make changes to your portfolio, reduce your expenses, or consider going back to work.
- **Work as long as you can.** Supporting yourself for a retirement that could span 25 or 30 years requires huge sums of money. Consider working at least a couple of years longer than originally planned. During those years, you can continue to build your retirement assets and delay making withdrawals from those assets. Once you retire, consider working at least part-time to reduce your withdrawals from your retirement assets.

Please call if you'd like help with this decision.

The Perilous State of Pension Plans

If you're among the minority of American workers who are still covered by a pension plan, take note: state and private pensions all across the country are under financial stress and may not be able to pay out promised benefits in full.

Pension plans have taken a beating from the same sources as defined-benefit plans: the economy and turbulent investment returns over the last several years. Unlike defined-contribution plans, whose asset levels depend mostly on employee contributions, pension plans depend entirely on employer contributions. But the formula for employer funding depends on the promises it has made for specific annual lifetime payouts related to the number of qualified employees, how much they make (often in their final five, highest-earning years), and how long they worked for the company.

If assets are equal to the amount of promised payments owed to workers, the pension is said to be "fully funded." If the asset level is higher than the fund's current obligations, the fund is said to be "overfunded;" and if the asset levels aren't sufficient to meet the funds obligations, it's said to be "underfunded."

Pensions that are underfunded are a problem for company sponsors, because it means that the company is going to have to contribute more to catch up. Poor investment returns and drastic reductions in tax revenues have hit state and municipal employee pensions particularly hard.

These difficulties help explain why the number of pension plans decreased so drastically over the last 30 years. According to the U.S. Department of Labor, the number of defined-benefit pension plans peaked in 1983 at 175,000; in 2009, the latest year for which figures are available, the number was 47,000 — a 73% decline. It was mirrored by the growth in the number of defined-contribution plans like 401(k) plans — from 472,000 to 660,000 over the same period (a 40% increase). And while more than 60% of the American workers covered by a retirement plan were enrolled only in a pension plan in the late 1970s, today that number stands at under 10%.

The real problem is the number of pension plans still in place that are underfunded. The risk is that underfunded pension plans will be terminated, either voluntarily or through sponsor bankruptcy, and pay out reduced benefits, even if the pension is backed by the federal Pension Benefit Guaranty Corporation.

A recent survey by the investment bank Credit Suisse found that 97% of all corporate pensions are underfunded to the tune of some $500 billion. Meanwhile, *The New York Times* reported in July 2012 that all but 18 of the pension funds sponsored by America's largest companies — those listed on the S&P 500 Index — are underfunded.

Pension experts say that state government employee pension funds are in even worse shape. A 2010 study released by two Chicago-based university economists estimated that state pensions had $1.2 trillion in unfunded obligations; and by 2023, 23 state funds could run out of money. Since 2009, 45 states have cut back pension benefits for teachers, police, firefighters, and other public workers.

What does all of this mean? If you're covered by a pension, it means you shouldn't take for granted that the checks your employer currently promises to pay you will actually arrive in the amount promised. It also means that you should strongly consider starting or increasing your contributions to your own retirement plan, like an IRA.

Please call if you'd like to discuss this in more detail.

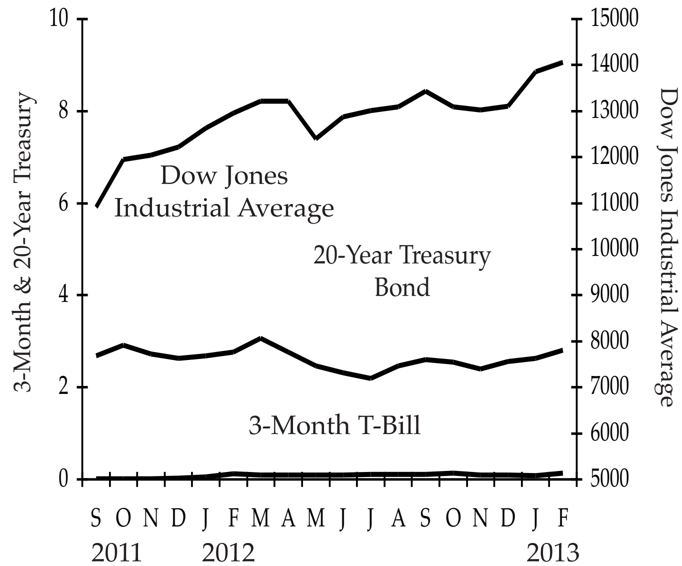
Business Data

Indicator	Month-end Dec-12	Jan-13	Feb-13	Dec-11	Feb-12
Prime rate	3.25	3.25	3.25	3.25	3.25
3-month T-bill yield	0.09	0.08	0.13	0.03	0.12
10-year T-note yield	1.80	1.87	2.01	1.95	1.97
20-year T-bond yield	2.56	2.63	2.81	2.63	2.76
Dow Jones Corp.	2.70	2.55	2.61	3.74	3.28
GDP (adj. annual rate)#	+1.30	+3.10	-0.10	+3.00	+3.00

	Month-end			% Change	
Indicator	Dec-12	Jan-13	Feb-13	YTD	12 Mon.
Dow Jones Industrials	13104.14	13860.58	14054.49	7.3%	8.5%
Standard & Poor's 500	1426.19	1498.11	1514.68	6.2%	10.9%
Nasdaq Composite	3019.51	3142.13	3160.19	4.7%	6.5%
Gold	1662.00	1664.75	1588.50	-4.4%	-10.3%
Unemployment rate@	7.80	7.80	7.90	1.3%	-4.8%
Consumer price index@	230.20	229.60	230.30	0.0%	1.6%
Index of leading ind.@	93.40	93.90	94.10	0.7%	-0.7%

— 2nd, 3rd, 4th quarter @ — Nov, Dec, Jan Sources: *Barron's, Wall Street Journal*
Past performance is not a guarantee of future results.

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield
September 2011 to February 2013



News and Announcements

Caught in the Middle

At a time when middle-aged couples should be saving for their own retirement, many find themselves caught in the middle of competing needs from two generations. Having started families later than past generations, their children may just now be entering college or could still be living at home. At the same time, aging parents may require financial assistance.

While you may have to allocate some resources to the needs of your parents and children, don't forget your own retirement. At a minimum, consider the following:

- Calculate how much you need for retirement and how much to save on an annual basis to reach that goal. Don't give up if that amount is beyond what you're able to save now. Start out saving what you can, resolving to significantly increase your savings once your parents' or children's needs have passed. Also consider changing your retirement plan, perhaps delaying your retirement date or reducing your financial needs.
- Take advantage of all retirement plans. Enroll in your company's 401(k), 403(b), or other defined-contribution plan as soon as you're eligible. Also consider investing in individual retirement accounts, either traditional or Roth. All provide a tax-advantaged way to save for retirement.
- Reconsider your views about retirement. Instead of a time of total leisure, consider working part-time at a less stressful job, starting your own business, or turning hobbies into paying jobs.

Don't feel guilty thinking about your own retirement when your parents and children still need your help. One of the best gifts you can give your children is the knowledge that you will be financially independent during retirement. Please call if you'd like help with your retirement plans.

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