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First-Quarter 2009 Market Review ~ Building Retirement Confidence in a Bear Grip

April 2009 - On the heels of plunging prices in 2008, the ship of stocks continued to sink in January and February. Then March came in like a growling bear and went out like a limping bull. Markets seem to have bottomed at 12-year lows on March 9th, when the year-to-date tally, as measured by the S&P 500-Stock Index, was a collapse of 25.1%. This was on top of 2008's trouncing of 38.5%. Despite rising job losses, falling home prices, and unsettled credit markets, stocks staged a rebound between March 10th and the end of the month with a gain of nearly 18%. But the stage was set for the quarter, as most broad indices posted double-digit declines.

With the World Bank predicting the global economy will contract in 2009 for the first time since the 1940s, central banks and governments around the globe lowered interest rates and enacted spending packages to stimulate economies. In its continued effort to address the banking crises, the U.S. Federal Reserve announced a $1 trillion plan to inject liquidity into the financial system by buying $750 billion of mortgage-backed securities, on top of $500 billion previously announced in December, and $300 billion of long-term treasury securities. This sent 30-year home-mortgage rates below 5.0%, spurring a wave of refinancings and putting more money in consumers' pockets.

Perhaps signaling renewed acceptance of risk, during the quarter investors pushed up Corporate High Yield, International Emerging Market, and Municipal bond prices by between 4% and 6%. Broader bond indices were affected by lower U.S. Treasury prices. After hitting record lows at the end of 2008 with a low "2-handle," the 10-year Treasury Note backed up to over 3% by mid March. Although the Fed left short-term rates unchanged at its March meeting, and the 10-year Note dropped to 2.5% after the $1 trillion-plan announcement, the 10-year Treasury Note closed the quarter at 2.66%, up 44 basis points from year end (the yield as of April 17th was 2.95%).

Below are rates of return for selected market indices for the first quarter of 2009, full-year 2008, and the three, five, and 10-year compound annual returns as of December 31, 2008.

Equity (Stock) Indices	1Q:2009	2008	3-Year	5-Year	10-Year
Domestic Large Cap					
Russell 1000 - Growth	-4.12%	-38.44%	-9.11%	-3.42%	-4.27%
Russell 1000 - Value	-16.77%	-36.85%	-8.32%	-0.79%	1.36%
Russell 1000 - Blend	-10.45%	-37.60%	-8.66%	-2.04%	-1.09%
Domestic Small Cap					
Russell 2000 - Growth	-9.74%	-38.54%	-9.32%	-2.35%	-0.76%
Russell 2000 - Value	-19.64%	-28.92%	-7.49%	0.27%	6.11%
Russell 2000 - Blend	-14.95%	-33.79%	-8.28%	-0.93%	3.02%
Real Estate (FTSE EPRA/NAREIT Global)	-22.09%	-47.72%	-11.53%	1.96%	6.57%
International					
MSCI EAFE Developed Large Cap	-13.85%	-43.06%	-6.92%	2.10%	1.18%
MSCI EAFE Developed Small Cap	-9.47%	-46.78%	-13.45%	1.51%	NA
MSCI Emerging Markets	1.02%	-53.18%	-4.62%	8.02%	9.31%

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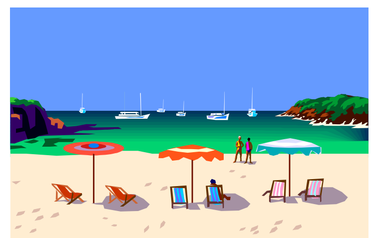
Fixed-Income (Bond) Indices	1Q:2009	2008	3-Year	5-Year	10-Year
Barclays Capital					
Global Aggregate	-3.25%	4.79%	6.95%	5.01%	5.22%
U.S. Aggregate	0.12%	5.24%	5.51%	4.65%	5.63%
U.S. Treasury TIPs	5.52%	-2.35%	3.06%	4.07%	6.79%
U.S. Corporate High Yield	5.98%	-26.16%	-5.60%	-0.80%	2.17%
Municipal	4.22%	-2.47%	1.86%	2.71%	4.26%
International Emerging Markets	4.75%	-14.75%	-0.46%	4.38%	9.62%

Source: www.russell.com, www.nareit.com, www.mscibarra.com, www.lehman.com

Building Retirement Confidence in a Bear Grip



Ahhhh, retirement! Once upon a time the word conjured up visions of swaying palm trees and beautiful seas on the horizon. But with 401(k)s shrinking into 201(k)s as of late, many future retirees are worried about not having enough money. For those without proper planning, the swaying trees may be the result of a hurricane or the ocean view may be from a deck chair on the Titanic.

According to a February 2009 analysis of 401(k) plan participants by the Employee Benefit Research Institute (EBRI), individuals with account balances greater than $200,000 suffered average losses of more than 25% in 2008. In its Retirement Confidence Survey® released on April 14, 2009, EBRI found that American workers' confidence in being able to afford a comfortable retirement continued to decrease in the past year. The proportion of workers "very confident" about having enough money for a "comfortable retirement" sank to 13%, declining from a former low of 18% in 2008 and 27% in 2007. The percentage is the lowest since the question was first posed in the survey in 1993.

The survey, conducted by EBRI and Mathew Greenwald & Associates through random telephone interviews with 1,257 individuals, also revealed that the percentage of "somewhat confident" workers slipped to 41% from 43%. Citing uncertainty about the economy, inflation, and the cost of living, the share of workers who are "not too confident" and "not at all confident" they can save enough to retire comfortably jumped to 44% from 37%.

With a "Bear Grip" choking portfolio returns, this article reviews the main factors you can control to influence your success in building a retirement nest-egg. They include: time until retirement; the amount saved; and rate of return on your investments. All three have a positive relationship with your retirement nest-egg; the higher the factor, the greater the potential future value of your investments.

Time until Retirement

The smartest financial decision you can make is to begin saving and investing now! The earlier you begin, the more time your money has to increase in value. A key feature of retirement plans is tax deferral, in which the payment of tax on the growth and/or income generated from your investments is deferred to the future when distributions are taken. The sooner you start, the greater the benefit from the power of compounding returns and tax deferral.

Retirement planning typically includes an assumption about retirement age. If you enjoy good health and your work, extending this date even a few years would provide additional time for your capital to grow. On the other hand, assuming you will continue working in your seventies and eighties is not a retirement plan. Neither is dying young. But isn't "70" the "new 50"?

Amount Saved

The greater the amount saved and invested, the more you will have in the future. A general guideline for how much to save and invest is at least 10% to 15% of annual income. Consistently setting aside this amount from the time you start working until retirement should provide a sufficient nest egg to maintain your standard of living. If you are getting a late start, you will need to set aside a larger percentage each year.

Maintaining your current lifestyle in retirement will require the accumulation of enough capital to generate a retirement income comparable to what you earn during your working years. After you retire, it will not be any easier to reduce your standard of living. If you think it will be easy, do it now to save and invest the difference.

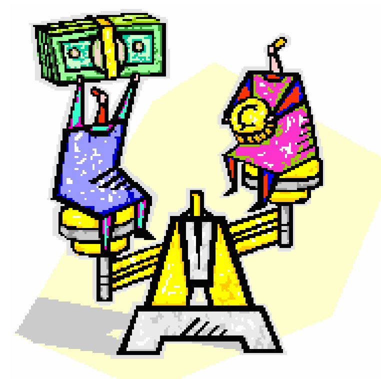
The tax-deferral feature of retirement plans has a couple of catches: annual contribution dollar limits and the taxation of future distributions at ordinary income tax rates (versus the lower tax rates usually applied to capital growth). The conventional thinking is that you will be in a lower tax bracket when you retire. However, the likelihood of higher tax rates in the future due to government budget deficits and/or your success in accumulating a large nest egg, turns this strategy on its head.

Whether you have more or less available than the annual limits to save, you should not solely invest your savings in retirement plans. Tax deferral does not mean tax free. The typical 401(k) and IRA is nothing more than a joint account with the IRS. To avoid this tax trap, diversify your assets by how they will be taxed by investing in taxable and tax-free accounts. You can control when to take capital gains in a taxable account, while Roth IRAs and Roth 401(k)s provide for tax-free growth and distributions.

Portfolio Rate of Return

Your portfolio rate of return will mostly depend on how your investments are allocated among various asset classes. Although past performance does not guarantee future results, historically, stocks have provided the highest rate of return. Returns have averaged 10% to 12% for stocks, 6% to 8% for bonds, with inflation running about 3% to 5%. Even with 2008's backslide, as measured by the S&P 500-Stock Index (total return series), stocks have returned an average of more than 10% over the past 25 years. This period includes at least three significant crashes: 1987, the 2000-2002 tech-bubble pop, and the recent real estate-induced debacle.

Although diversification is a long-term strategy, a prudent asset allocation strategy should not be static. To stay ahead of inflation, your asset allocation should start with a considerable equity bias and gradually become more conservative as you get older. Notably, the EBRI analysis of 401(k)s revealed that nearly 25% of participants near retirement (ages 56 to 65) had more than 90% of their account balance in stocks at the end of 2007.



The widely touted “buy and hold” strategy has the potential to both destroy wealth and limit future returns. The alternative is “buy and rebalance” to reduce over-weighted or outperforming assets and reallocate to under-weighted or out-of-favor sectors. Periodically rebalancing the portfolio forces an investor to “sell high and buy low.”

A portfolio invested in a 60% stock and 40% bond allocation at the beginning of 2003 in the S&P 500 (total return series) and the Barclays Capital (formerly Lehman Brothers) U.S. Aggregate Bond Index, respectively, would have had an allocation of 69% stocks and 31% bonds at the end of 2007. The overall loss for 2008 would have been nearly 24%. If the portfolio had been rebalanced to 60% stocks and 40% bonds at the end of 2007, the 2008 loss would have been about 20%, 4% less by adjusting the portfolio to the target asset allocation.

Further emphasizing the need to periodically rebalance, a 60% stock/40% bond portfolio on January 1, 2008, would have become 47% stocks/53% bonds at year end. By not shifting the portfolio back into stocks, an investor would reduce the potential returns from a future rebound.

This article covered the pre-retirement accumulation period by reviewing the factors which will determine your success in building a retirement nest-egg. In a future article we will explore the post-retirement spending period (from retirement to life expectancy) by discussing variables which will establish how much capital you will need to retire.

If you are not confident about having enough money for a comfortable retirement, Kalorama Wealth Strategies can help you prepare a plan to determine the capital you will need. For more information, please see our web site at www.kaloramawealth.com.

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