David M. Taube, CPA, CFA, CFP®, CRI
Founder and President
2136 12th Place, N.W., Suite 100
Washington, D.C. 20009-7507
Phone: 202.550.7262
Fax: 480.247.5620
dtaube@kaloramawealth.com
www.kaloramawealth.com

Second-Quarter 2009 Market Review ~ Filling the Retirement Gap

July 2009 - Economic contraction, bank stress tests, debt and equity offerings, and rising unemployment leading to additional mortgage delinquencies and foreclosures could not dampen the bounce off the apparent (and hopeful) March 9th stock market bottom. Looking ahead to an eventual economic recovery, stocks continued to rebound until a mid-June reversal, providing for rallies in April and May, and a sideways move for June. Between the 12-year low on March 9th and June 12th, the Standard & Poor's 500-Stock Index surged nearly 40%. For the quarter, equities posted an across-the-board double-digit advance, leaving most broad indices in positive territory for the year.

With the U.S. economy shrinking by more than 6% in the first quarter, job losses are expected to persist indefinitely. In June, the World Bank announced a revision to its 2009 forecast for a shrinking global economy, down 2.9% versus a decline of 1.7% in March. Consistent with the ominous predictions, the Federal Reserve left short-term rates unchanged during the quarter. Despite the Fed's inactivity, with the U.S. government incurring and issuing large amounts of debt, the yield on the 10-year Treasury Note rose above 3.0% by the end of April and climbed to nearly 4.0% by mid June.

A significant move in long-term government bonds occurred in May after Standard & Poor's dropped its outlook for the triple-A credit rating on Britain's sovereign securities from "stable" to "negative." Contending with similar financial and economic issues as the U.S., S&P expressed concern that Britain's debt as a percentage of GDP will expand too much. This led to a warning from a well-known market pundit about a potential downgrade of the triple-A credit rating on U.S. government debt. By the end of June, the yield on the 10-year Treasury Note was 3.53%, up 87 and 131 basis points for the quarter and year-to-date, respectively (the yield as of July 13th was 3.36%).

Notwithstanding the falling Treasury prices, bond indices lodged wide-ranging advances for the quarter. Notably, Corporate High Yield rocketed ahead 23.1% and International Emerging Markets swelled 12.4%. With year-to-date returns of 30.4% and 17.7%, respectively, the two sectors have largely recovered what they unloaded in 2008 (26.2% and 14.8%, respectively).

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

	2Q:2009	YTD-2009	3-Year	5-Year	10-Year
Equity (Stock) Indices					
Domestic Large Cap					
Russell 1000 - Growth	16.32%	11.53%	-9.11%	-3.42%	-4.27%
Russell 1000 - Value	16.70%	-2.87%	-8.32%	-0.79%	1.36%
Russell 1000 - Blend	16.50%	4.32%	-8.66%	-2.04%	-1.09%
Domestic Small Cap					
Russell 2000 - Growth	23.38%	11.36%	-9.32%	-2.35%	-0.76%
Russell 2000 - Value	18.00%	-5.17%	-7.49%	0.27%	6.11%
Russell 2000 - Blend	20.69%	2.64%	-8.28%	-0.93%	3.02%
Real Estate (FTSE EPRA/NAREIT Global)	37.25%	8.44%	-11.20%	NA	NA
International					
MSCI EAFE Developed Large Cap	25.85%	8.42%	-6.92%	2.10%	1.18%
MSCI EAFE Developed Small Cap	34.54%	22.51%	-13.45%	1.51%	NA
MSCI Emerging Markets	34.84%	36.22%	-4.62%	8.02%	9.31%
Fixed-Income (Bond) Indices					
Barclays Capital					
Global Aggregate	4.93%	1.52%	6.95%	5.01%	5.22%
U.S. Aggregate	1.78%	1.90%	5.51%	4.65%	5.63%
U.S. Treasury TIPs	0.65%	6.21%	3.06%	4.07%	6.79%
U.S. Corporate High Yield	23.07%	30.43%	-5.60%	-0.80%	2.17%
Municipal	2.12%	6.43%	1.86%	2.71%	4.26%
International Emerging Markets	12.40%	17.74%	-0.46%	4.38%	9.62%

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

Filling the Retirement Gap

Last quarter's newsletter covered the pre-retirement accumulation period by reviewing the main factors which will determine your success in building a retirement nest-egg: time until retirement; the amount saved; and rate of return on your investments (see *Building Retirement Confidence in a Bear Grip* at www.kaloramawealth.com/news.html). This article focuses on the key variables which will determine how much of a nest egg you will need to fill the Retirement Gap between your income and level of spending in the post-retirement distribution period (from retirement to life expectancy).

The most important things to consider in estimating how much of a nest egg will be needed for retirement include your sources of income, such as Social Security and pensions, and future cost of living. The four primary sources of income in retirement include Social Security, employer retirement plans, individual retirement plans, and other non-retirement accounts. You can obtain estimates of the income you would receive from Social Security and pensions. Social Security is designed to replace 42% of average annual income from working years, with the proportion higher for low-income workers and reduced for high-income individuals.

In the past, many retirees also received income from a “traditional” employer pension plan. However, according to the Employee Benefit Research Institute (EBRI), less than 17% of private-sector workers are active participants in “traditional” defined benefit pensions, down from more than 40% in 1975. At the same time, active participants in 401(k)-type plans has grown from under 16% in 1975 to nearly 42%. With the employer shift from “traditional” defined benefit pensions to 401(k)-type plans, most retirees will depend on their savings for future retirement income.

Unless you have a generous employer pension plan, chances are you will have a gap between your income from Social Security and cost of living. This Retirement Gap will need to be filled by converting your retirement and non-retirement accounts into a paycheck during retirement. To calculate the Retirement Gap, you will need to put together a retirement spending plan: estimate your future costs for household, food, transportation, insurance, healthcare, personal care, entertainment, travel, and miscellaneous.

Lifestyle decisions will play a major role in your spending: where do you want to live and what will you be doing with all your free time? How frequently will you be taking vacations? A typical retiree will need to replace 70 to 80 percent of current living expenses to maintain their standard of living during retirement.

With your estimate of income and spending, you can then begin to compute how much of a nest egg you may need to fill the Retirement Gap. Notably, EBRI’s 2009 Retirement Confidence Survey® revealed that only 44% of workers and/or their spouse have tried to calculate how much of a nest egg they will need by the time they retire. An equal percentage guessed at how much they will need to save for a comfortable retirement.

Similar to the pre-retirement accumulation period, variables to consider for the post-retirement spending period include the amount saved, rate of return, and time. However, the time element shifts from the period of time until retirement, which can be predicted with some certainty, to life expectancy or longevity, which is very uncertain.

Longevity is a crucial consideration in estimating how long your nest egg will need to last. Many retirement plans are based upon a 30-year period. According to the National Center for Health Statistics, people reaching age 65 in 2006 had an average life expectancy of 84, or 19 years. However, average life expectancy is a poor planning variable since half of retirees will live longer, some well over 30 years. If doorways were constructed to accommodate the average person, most men would bump their heads. Many women would run out of money with an average retirement projection.

Demographics can significantly influence life expectancy. Not only do women typically live longer than men, but so do those who have enough money to plan. If you are reading this article, you will probably live longer on average than those who do not. Those within 25 years of retirement should plan to have enough resources for a comfortable lifestyle until at least age 100. With medical advances, the probability of living for 100 years with an excellent quality of life continues to rise, and the chances of reaching 110 are increasing. A 30-year retirement may be sufficient, but you should plan for your nest egg to last until at least age 100.

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.

Thank you for your business, trust, and referrals. Please feel free to provide a copy of this newsletter to friends and colleagues who can benefit from information about investing and financial planning. If I can be of any assistance to you or anyone you know, please do not hesitate to contact me.

Fee-Only Investment Advisory And Financial Planning

David M. Taube, CPA, CFA, CFP®, CRI
2136 12th Place, N.W., Suite 100, Washington, D.C. 20009
Phone: (202) 550-7262 **Fax: (480) 247-5620**
dtaube@kaloramawealth.com **www.kaloramawealth.com**