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The Independent Financial Group

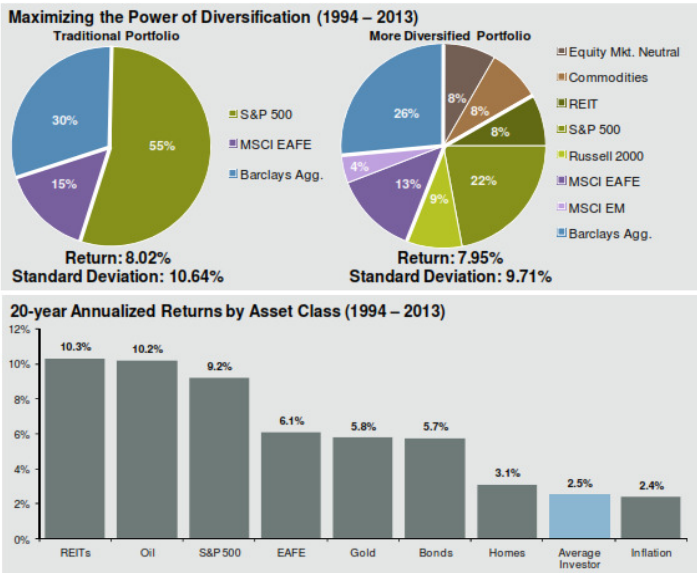
Afraid of the News? Let's Review.

As I write this, the markets have just sold-off after reaching a new high. In fact, the market has been selling off for a few days. If history is any guide – and it seems that is has in the past – market increases invariably follow downturns and downturns always seem to follow new highs.

It's history. It makes good conversation, but it means little to the investor who is planning to retire soon.

Imagine the investor – let's call him George - who turned 64 in November 2007, ready to retire after a long 30-year career. During all those years, the market ups and downs represented little more than an intellectual exercise. After all, every time the market was down, he was buying more shares for the same money – this was good! And, now, George is ready to take the leap into retirement with a $2.5 million 401(k) nest-egg that's been accumulated. Our investor feels good! The S&P has just hit an all-time high of 1565 on October 9th. He's only one year from retirement and ready to travel.

The next day, on November 8th, he arrives at work with a smile only to notice that no one else is smiling. They tell him the news: The market has just taken a dive. He feels sick. A little quick math reveals that he could lose 9% of his life savings by the end of the day! Three days ago, he had $2.5 million! He's just lost $238,750 in one day! His broker tells him not to worry and ignore all the noise.



But, a couple weeks later he can't bear the suspense and looks at his 401(k) account. His $2.5 million account has now shrunk to $1,727,000. He checks the S&P 500 and finds it's dropped another 20%. It isn't long before he realizes he's lost over $1 million in just the last year – all right on the edge of retirement.

On his 65th birthday – the last working day of his career – the market hits a new low: The S&P closed at 752.44 – down 52% from it's October 2007 high. He's lost more than half what he spent 30-years accumulating.

He sells. Even if he earns only 1% in a money market fund, it's better than losing. But, what George doesn't realize is that all those taxes he thought he was saving over 30 years really weren't saved at all – only delayed. With an account that now holds less than 50% of its November 2007 value, he'll still have to pay taxes on every dollar he withdraws, which means something over $500,000 of the money that's left belongs to the government.[iii]

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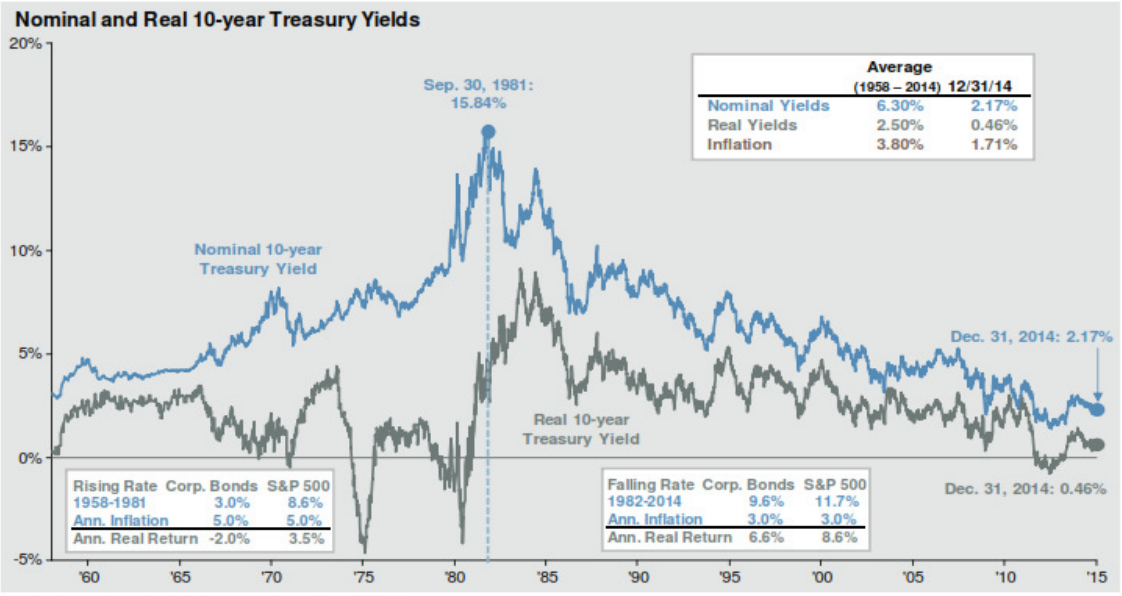
Familiar? As you can see from the chart on the previous page, the average investor doesn't appear to even come close to the indexes they follow. In fact, the average investor is barely beating inflation – except, not really: Inflation doesn't pay taxes.

There is a difference between nominal (raw numbers) and real (after inflation) returns.

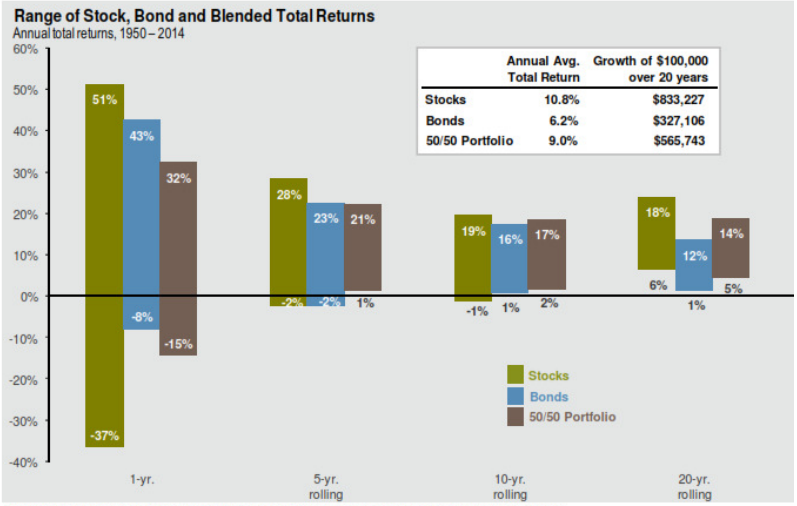


Source: Federal Reserve, BLS, J.P. Morgan Asset Management.
Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core CPI inflation for that month except for December 2014, where real yields are calculated by subtracting out November 2014 year-over-year core inflation. All returns above reflect annualized total returns, which

The important information here is contained in the two smaller boxes at the bottom of this chart. It shows the real and nominal returns for corporate bonds and the S&P 500 index during periods of rising rates (left side box) and falling rates (right side box). If you believe that we're headed for a period of rising rates, the information in the left had box, while not predictive, might be instructive when compared to the periods of falling rates. Remember, these figures are before taxes.

Of course, like George in our story, all of this is academic until facing retirement. Here's one of the traps he didn't realize – and maybe his advisor never told him:

It's contained in a this chart many professionals love to 'trot-out' in front of their clients. It suggests that time reduces portfolio volatility – compare stocks held 20 years vs. 1 year.



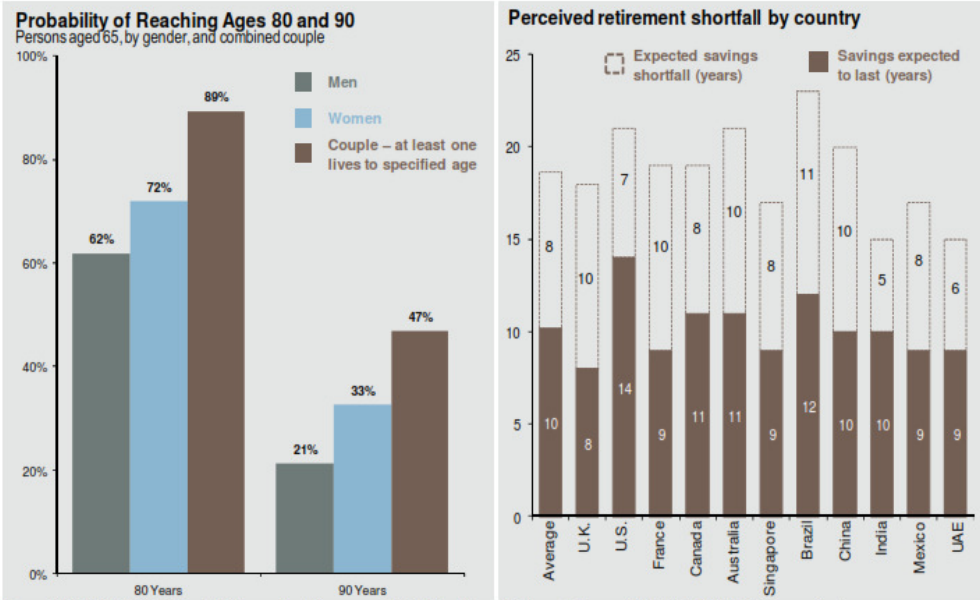
Sources: Barclays Capital, FactSet, Robert Shiller, Strategas/Ibbotson, Federal Reserve, J.P. Morgan Asset Management.
Returns shown are based on calendar year returns from 1950 to 2014. Growth of $100,000 is based on annual average total returns from 1950-2014.
Guide to the Markets – U.S.

George was in his 30th! But he

had only one year to go. Which

part of this chart do you think most relevant for him? I'm not suggesting he should have avoided stocks, or even that his allocation may have been flawed, which is possible; but, a return to the first chart is worth a look. Individual investors typically don't seem to do well when stuff hits the fan and often, the problem isn't with the investments, it's often investor behavior.

But, retirees like George can't crawl in a hole! Many – even among the wealthy – are concerned with running out of money; it's all relative – spending and taxes, combined with inflation, can eat-up even the largest nest-eggs over long periods of time.



Source: (Left) SSA 2010 Life Tables, J.P. Morgan Asset Management. (Right) "The Future of Retirement: A new reality" study by HSBC, J.P. Morgan Asset Management. Figures represent the expected portion of retirement that will not be covered by retirement savings based on survey data.
Guide to the Markets – U.S.
Data as of 12/31/14.

As you can see from the chart at left, the probability of a 65-year-old reaching age 90 is higher than you might think – and that includes those with chronic or terminal situations. If you're in good health, you numbers are likely higher. But, while our perceived retirement shortfall (chart at right) seems to compare favorably with other countries, that may be due to reduced life expectancies or other factors. Regardless, as you can see, the seven-year average shortfall for the U.S. depicted here looks a little low to me.

Controlling the Two Variables That Can Be Controlled

We can't control the markets; but, we can control a few other things. Expenses are one – and they get a lot of press; but, George's problem wasn't expenses, despite what some young journalism major may have tried to lead him to believe. George's problems: Behavior and taxes.

Behavior can be controlled through education and making sure his asset allocation is consistent with his loss capacity – a little different from risk assessment. Taxes can be controlled by having a tax allocation strategy that, frankly, George should have put in-place back around age 50! Unfortunately, like many well-intentioned people, George believed what he'd read or heard in the consumer media and from friends: Max-out the 401(k), stay invested, and you'll live happily ever after. Chances are, like many, he waited until he was 60 or even 65 before ever sitting down with an advisor.

While valuable planning can be accomplished as one nears retirement, ,planning FOR retirement means getting ducks lined-up well in advance – and "immunizing" retirement assets from many of the bad things that can happen in retirement: Market losses, higher taxes, and reactive behavior.

Conference Room Briefings

Fairly soon I'll be conducting a series of Conference Room Briefings in – you guessed it – the IFG conference room in Simi Valley. Obviously, we're limited by the number of seats available; but there will be alternate dates available. These briefings will be educational in nature, but they will feature strategies and even product (types, not specific) ideas for addressing retirement issues. They'll also feature guest speakers – other professionals from law, accounting, etc. – from time to time.

For those of you unable to attend the Briefings in person – schedule conflicts, etc. – I'll also be conducting some webinars, as well. The office Briefings will be more fun – and you'll enjoy or little office 'Café' - but, the webinars are also an option. Enjoy!

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Jim Lorenzen is a CERTIFIED FINANCIAL PLANNER® professional and An Accredited Investment Fiduciary® serving private clients since 1991. Opinions expressed are those of the author and do not represent the opinions of IFG any IFG affiliate or associated entity.The Independent Financial Group is a fee-only registered investment advisor with clients located across the U.S. He is also licensed for insurance as an independent agent under California license 0C00742. Jim can be reached at 805.265.5416 or (from outside California) at 800.257.6659. The Independent Financial Group does not provide legal or tax advice and nothing contained herein should be construed as securities or investment advice, nor an opinion regarding the appropriateness of any investment to the individual reader. The general information provided should not be acted upon without obtaining specific legal, tax, and investment advice from an appropriate licensed professional.

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[i] *Assuming a combined 30% state and federal income tax bracket.*

[ii] *I've paraphrased this story from chapter 8, A Story About Tom, in Patrick Kelly's excellent book, The Retirement Miracle, published by Bluewater Press. I recommend it.*