

# Insight

A QUARTERLY PERIODICAL DEDICATED TO HELPING YOU PREPARE FOR TOMORROW



## GETTING RETIREMENT RIGHT PART 1

### Preparing for Retirement

*Four simple steps can help you improve your long-term financial position.*

The prospect of leaving the work force and a regular paycheck might pose a difficult question: Am I ready to retire? Fortunately, the planning tools and action steps that can help you get ready are, for the most part, simple and straightforward.

#### 1. CREATE A SPENDING AND SAVINGS PLAN

At the core of a strong retirement plan is a spending and saving strategy that can help you live within your means today and, at the same time, prepare you for retirement.

**Envision the life you want.** Step back from the financial details and envision your post-career life. When do you want to phase out work? Do you plan to stay in your current home? How will you spend your time? See Part 2 for more on your life in retirement.

**Target your income.** Consider how much income you think you'll need in retirement. The general rule of thumb is to plan on replacing 75% of your preretirement income after you retire. As much as 50% of that preretirement income may come from investments, 20% from Social Security benefits, and the rest from other sources, such as a pension or part-time work.

**Aim to save.** Most people need to save at least 15% of their annual income to meet those savings targets, although your own target savings percentage may be higher if you're getting a late start.

#### 2. ESTABLISH AN ASSET ALLOCATION

The precise mix of stocks and bonds in your portfolio depends on how close you are to retirement. Investors more than 10 years from retirement should have a portfolio almost entirely allocated to diversified stocks, since they provide the long-term growth potential you need to stay ahead of inflation. Holding enough stocks is crucial even when you enter retirement—consider an allocation to stocks of 55% at age 65. As you go through your 70s and beyond, continue gradually shifting your allocation toward bonds and money market/stable investments and lowering your stock holdings.

#### 3. DIVERSIFY

Unless you invest in a target-date fund,\* you should hold a variety of investments that include a wide range of stocks and bonds. It's important to have exposure to domestic and international stocks within your portfolio—and to hold the stocks of small, mid-size, and large companies, too. If you have more than one bond fund option, make sure your bond allocation is diversified as well. Broad diversification can help insulate your portfolio from sharp declines in any one segment of the market. Of course, diversification cannot assure a profit or protect against loss in a declining market.

#### 4. REBALANCE REGULARLY

Volatility is inevitable in financial markets. It's important not to react to sudden surges or declines in the market by impulsively buying or selling funds. But keep in mind that your portfolio is

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likely to drift from your target asset allocation during these periods—and it can drift from targets over longer, calmer periods in the market without your being aware. Review your investments at least once a year to consider whether you need to rebalance back to your original target. Do this by selling assets that have become an overly large percentage of your portfolio and buying funds in those asset classes that have declined.

These are steps you can take throughout your life, even after you leave the work force. Once you're in your early 60s, however, there are specific and powerful ways to potentially improve your financial situation and increase your income. See Part 2 of this special retirement report.

\*Target-date funds (also called retirement date funds) are professionally managed funds that invest in a diversified selection of other mutual funds. The investment mix shifts as you near and then progress through retirement. The principal value of target-date funds is not guaranteed at any time, including at or after the target date, which is the approximate date when investors plan to retire. These funds typically invest in a broad range of underlying mutual funds that include stocks, bonds, and short-term investments and are subject to the risks of different areas of the market. In addition, the objectives of target-date funds typically change over time to become more conservative.



## GETTING RETIREMENT RIGHT PART 2

### Managing Retirement: Actions to help you transition into retirement and achieve the lifestyle you desire.

One way to improve your quality of life in retirement is to continue to work while starting to enjoy some of the experiences you've been dreaming about.

#### 1. TRANSITIONING INTO RETIREMENT

Continuing to work during your 60s has significant financial advantages: You'll be able to postpone withdrawing from your savings, which can give you additional years of tax-deferred, compounded potential growth in your retirement accounts. You may also benefit from continued employee benefits and delaying your Social Security payments.

#### 2. DELAY TAKING SOCIAL SECURITY

Although you may begin taking benefits at age 62, you can delay them until as late as age 70. Every year you wait between ages 62 and 70 increases your starting payment by approximately 7% to 8%, in addition to any inflation adjustments made by the Social Security Administration.

#### 3. DRAWING DOWN YOUR SAVINGS

Your aim should be to live comfortably while, at the same time, giving your savings a better chance of lasting until you're age 95. A trusted rule of thumb is to assume a 30-year time horizon, if you retire at age 65, and withdraw no more than 4% of your retirement assets in the first year you stop working. Then increase that dollar amount by 3% each subsequent year to keep pace with inflation.

**Withdrawal Sequence.** Taxable accounts should, generally speaking, be your first priority. Leaving assets in tax-deferred and tax-free accounts untouched for as long as possible will help to maintain the tax-advantaged treatment of those assets and give you more time for tax-deferred growth potential.

#### THE ROAD AHEAD

Finding the right balance of work and play is the ideal way to ease into full retirement later in life. By enjoying yourself in your 60s, supported by continued work and employer benefits, you can pursue your dreams with confidence and add a new, positive, and exciting dimension to your life.

### DID YOU KNOW?

*Twenty-three percent of T. Rowe Price plan participant respondents to a recent survey said that they would give up buying lunch in order to save more for retirement.\* To discover how turning small expenses into savings could have a positive impact on your retirement, check out the "Finding the Money" video located in the website message center at [rps.troweprice.com](http://rps.troweprice.com). Simply click on the "You have messages" icon from the homepage.*

\*Participant Pulse Survey, October 25, 2011 – December 1, 2011



## GAUGING THE ECONOMY: SURVEYS SHOW IMPROVEMENT

*The first weeks of the year included the news that more Americans are feeling better about their job security, savings, debt, and net worth.*

The percentage of people feeling insecure about their job fell to 17% in January from 28% in November 2011, according to Bankrate's Financial Security Index. And the Consumer Sentiment Index produced by Thomson Reuters and the University of Michigan stood in early February at 72.5 on a scale of 100, up from 69.9 at the end of December. The index averaged 89 in the five years leading up to the recession of 2008-2009. The commonly used economic indicator assesses near-term consumer attitudes on business climate, personal finance, and spending—and it is widely regarded as a reliable forecast of near-term household spending.

### *Economic Indicators and Your Portfolio*

Nearly every week investors see a flow of data that tracks the economy and gauges its possible near-term direction. These reports are known as economic indicators: snapshots of parts of the economy at a particular moment. Viewed together, they can help economists and professionals, such as mutual fund portfolio managers, make decisions about investments.

The Employment Situation Summary, conducted by the Bureau of Labor Statistics, is another important economic indicator that's frequently in the news. It compiles data from a survey of households, businesses, and government agencies. The lowest unemployment rate in three years<sup>1</sup> contributed to the rise in consumer sentiment, which helps investors get a sense of spending in the months ahead. Positive consumer sentiment can increase optimism about corporate profits.

While economic indicators are important to help understand the current state of the economy, they are not a substitute for the rigorous fundamental research conducted by mutual fund managers on stocks and bonds for their portfolios—and they shouldn't guide your long-term investment decisions. Your focus should remain on your time horizon and maintaining a retirement portfolio that is properly allocated.

<sup>1</sup>Bureau of Labor Statistics.

## TELEPHONE NUMBERS

### **Deferred Compensation**

Plan Rules/Options Information

800-442-1300/ 217-782-7006

TDD/TTY: 800-526-0844

Internet: <http://www.state.il.us/cms/employee/defcom>

### **Recordkeeper**

T. Rowe Price Retirement Plan Services, Inc.

Account Value Information and Investment Changes:

888-457-5770 or TDD/TTY: 800-521-0325

Internet Access: 800-541-3022

Internet: <http://rps.troweprice.com>

## TEST YOUR KNOWLEDGE OF INTEREST RATES

### 1. INTEREST RATES:

- A. Measure a stock's value.
- B. Reflect consumer confidence.
- C. Are the prices charged by lenders for a loan.

### 2. THE FEDERAL FUNDS RATE:

- A. Limits the amount of money consumers can borrow.
- B. Influences how much banks lend.
- C. Influences the tax rate.

### 3. THE PRIME RATE IS A:

- A. Benchmark for most loans in the country.
- B. Grade of government debt.
- C. List of commodities and their prices.

## ANSWERS

**1. C.** A number of definitions apply to interest rate (or rates). In general, the term refers to the price (as a percentage of a loan) charged by a lender to a borrower. Differences in rates can reflect the amount of the loan, the time period for which a loan is made, or the perceived level of risk associated with the borrower.

**2. B.** The federal funds rate is the interest rate banks charge each other for overnight loans. The federal funds target rate is determined by the Federal Open Market Committee of the Federal Reserve. The FOMC supplies base money as required to have the *effective* federal funds rate trade near the federal funds *target* rate.

**3. A.** In the U.S., the prime rate (also known as the prime lending rate) is the interest rate banks charge their most creditworthy customers—generally large corporations. It is determined mostly by the federal funds rate, defined above. The prime rate also affects mortgage rates and personal loans.



## WHAT DOES BEING ON THE “WATCH LIST” MEAN?

It is important that you understand what it means to be on the watch list and, perhaps more importantly, what it does not mean. Being on the watch list, as the name would imply, simply means we believe there is good reason to watch this fund more closely. Being on the watch list does not mean you should immediately sell your fund shares. It is not unusual for a fund to appear on the list from time to time. It does not mean the fund is necessarily a bad investment. If we believe the fund no longer represents a suitable investment option, we will remove the fund from the Plan.

### Why are funds placed on the watch list?

Funds can be placed on the watch list for several reasons. Why a fund is on the watch list is more important than the mere fact that it is on the watch list. The most typical reasons are as follows:

1. **Performance**—The most common reason a fund is placed on the watch list is poor performance relative to its appropriate market benchmark and/or peer group. When signs of relative underperformance appear, we place a fund on the watch list.
2. **Risk**—Less obvious to many participants is the risk that a fund manager incurs. If a fund becomes too volatile, we will place it on the watch list.
3. **Risk-Adjusted Returns**—What returns has the fund manager been able to deliver relative to the risk the fund has incurred? If the manager is unable to deliver adequate returns for the risk taken, we will place the fund on the watch list.
4. **Portfolio Construction/Style Drift**—Is the fund manager investing the money in the way he or she said? If you invest part of your assets in an aggressive fund that is supposed to be investing in the stocks of small, growth-oriented companies, then you want the manager to do just that. We monitor the manager's portfolio and if the security holdings do not reflect what has been communicated, we place the fund on the watch list.
5. **Operations**—There are many operational reasons for placing a fund on the watch list. For example, the manager of the fund could leave. Remember, when you purchase shares of a mutual fund, what you are really doing is hiring a professional portfolio manager to invest your money. If that manager leaves, you should watch the fund closely. There could also be firm-level issues. These can include issues such as regulatory violations, turnover in senior management, or a merger or acquisition. Any of these operational issues will automatically place a fund on the watch list.

## WATCH LIST—THE STATE OF ILLINOIS DEFERRED COMPENSATION PLAN

### Current Watch List Summary

**The following funds are on the watch list  
as of 3/31/2012:**

**Ariel Fund** – The fund remains on watch list status due to longer-term underperformance. Performance in 2011 lagged due to stock selection in the financial sector as well as an overweight to consumer names; however, many of the same allocations are adding value to returns in 2012. In the first couple months of 2012, the fund has ranked in the 32nd percentile of its peer group posting a gain of +11%. The fund's performance was strong in 2009, ranking in the 5th percentile of its peer group as well as an equally favorable showing in the fourth quarter of 2010. Over the five-year trailing period, however, the fund's return underperforms the benchmark and ranks in the 78th percentile of its peer group. Ariel recently announced that Kenneth Kuhrt will join John Miller as portfolio managers of their small- and mid-cap strategies including the Ariel Fund, with John Rogers maintaining the lead portfolio manager position. This change was announced in their separate accounts and will most likely change in the mutual funds this year. Mr. Kuhrt has accumulated a seven-year working history at Ariel and is being promoted due to his contributions to the investment process. Kenneth also serves as portfolio manager on the micro-cap product and Ariel Discovery Fund. Participants seeking a similar investment strategy also have access to the Northern Small-Cap Value Fund, which invests in a small-cap value equity style.

**Invesco International Growth Fund** – The fund remains on watch list status due to a change in portfolio management. On Friday, June 10, 2011, Invesco announced the departure of long-term co-lead portfolio manager, Barrett Sides. Mr. Sides had worked alongside his counterpart co-lead portfolio manager, Clas Olson, since 1994. Mr. Olson assumed full lead portfolio manager responsibilities and will maintain this structure going forward. Over the years, Invesco has added investment professionals to the team, which now has nine portfolio managers and five analysts. The only investment professional who changed his coverage responsibilities was Clas Olson. He has final decision-making authority on investing activities in the Asia/Pacific region. They recently announced the addition of another investment team member, Michael Shaman. He will cover the Asia Pacific/Latin American region, which are the prior coverage areas of the departed co-portfolio manager. His prior work-related experience was as an equity analyst at Franklin Templeton, a well-known international equity investment manager. The performance track record, however, has been strong both recently and over the long term. The fund's 2011 annualized return ranks in the 11th percentile of its peer group and significantly outperforms the benchmark. However, due to the change in investment management, the fund will be closely monitored over the next year. An alternative fund for participants to select is the Janus Overseas Fund as it also invests in large-cap international stocks.