Taking the Long View (After a Long Year)

The Financial Markets in 2008: History in the Making

The 2008 economic collapse has been dramatic and wide-ranging. But for many, it's still hard to understand how a crisis that began primarily in the real estate market ended up impacting so many people's retirement savings.

What Happened?

A big part of the problem comes from the decision of Wall Street and other money managers several years ago to invest more heavily in the mortgages of individual homeowners. How? They used an investment called "mortgage-backed securities," which consolidate hundreds or thousands of individual mortgage loans into more manageable investments.

On the face of it, this seemed like an excellent idea. Because individual homeowners would be locked into paying off their mortgages for decades, the institutional owners of these mortgages could be assured reliable, long-term returns of 5%, 6%, 7% or more on their money. It didn't take long for mortgage-backed securities—along with newer, increasingly complex types of investments tied to these securities—to become very popular.

At the same time, low interest rates were leading more and more individuals to take out home mortgages, including many first-time home owners. Because lenders often did not hold on to these home loans—instead, immediately selling them to institutional investors—many lenders became more willing to give loans to individuals with limited or questionable credit. Eventually, many of these individuals found themselves unable to keep up with their mortgage payments. While these mortgage holders personally faced home foreclosure or bankruptcy, the institutional owners of the failed loans were seeing the value of their investments drop.

HOW THEY MEASURE THE MARKET

When you hear reports of how the market did in any day, you'll often hear about whether the Dow, S&P, and NASDAQ are up or down. Ever wonder what those are?

- **The Dow Jones Industrial Average:** This is the value of a price-weighted list of 30 large blue-chip companies, primarily industrials, including companies like General Electric and IBM.
- **The S&P 500:** This is a market-value-weighted price of the stocks of 500 of the largest companies that are actively traded in the U.S.
- **NASDAQ Composite:** The NASDAQ Composite is a market-value-weighted index of the 3,000 or so stocks and similar securities that are traded on the NASDAQ.

MARKET TIMING: NOT WORTH THE RISK

You may already know that it's a bad idea to try to "time" the market—that is, to buy or sell based on anticipated short-term swings of the market. This is because you can miss out on gains during days or weeks when the market is performing well. Here's an example:

- If you had $100 invested in the S&P 500 Index on October 1st, that $100 would have dropped to $77 at the end of November (a loss of 23%).
- However, if you "market-timed" and missed the best day of those two months, your $100 would have dropped to $69 (a loss of 31%). If you missed the best *five* days over that period, your $100 would have dropped to $55—a loss of 45%!

The lesson here? Keep your focus on your long-term investing goals. Chasing after quick returns could be hazardous to your financial health!

Spreading Uncertainty

In this volatile market climate, both institutional and individual investors began to panic. Companies whose portfolios included mortgage-backed investments (or invested in companies holding these investments) saw the value of their stock decline. Many affected companies found themselves unable to get new loans to purchase equipment or make other needed investments. From here, the aftershocks have seemed to multiply at a remarkable rate, with the bouncing stock market, corporate collapses, government intervention, and word of a coming—and eventually, declared—recession making front-page news every day.

These historic events have had a significant effect on the retirement security of millions of Americans invested in the stock and bond markets through their 401(k) plans. Even investors who have put their money in "safer" investments—such as government bonds that typically provide lower returns but less risk—have seen losses as the crisis has touched nearly every area of the economy.

Managing the Storm: Smart Strategies for Volatile Times

As an investor, you've likely heard the advice to "hold tight" and "stay the course"—in other words, to bear in mind that markets go through up and down cycles, and to avoid the natural impulse to sell your assets (and risk loss when the market recovers). While this may be sound guidance, it may not make you feel any better. Here are some reminders to help you stay focused and ride out the crisis in the strongest shape possible.

Save—or keep saving—in your 401(k). Given today's uncertain economic climate, maybe you've shifted your savings focus to your bank account and your day-to-day spending needs. But don't lose sight of the huge benefits your 401(k) plan provides: matching contributions paid by your employer, the ability to grow your savings tax-free until retirement, and potentially lowering your taxable income now because you're saving on a before-tax basis. Even better, by continuing to save now even when the markets are down, you're making purchases (through your plan) at a lower price than you did a year ago.

Stick to your goals. Whatever the market is doing, you need to be guided by your own situation: your current income and savings, your time horizon to retirement, your risk tolerance, and how much money you expect to need when you stop working. For example, if your retirement is many years off, experts say investing primarily in stocks is still a sound strategy—because despite the market's current bad performance, you'll have time to ride out the lows. If you do feel the need to move your money right now, consider doing so slowly. Change your investments a bit at a time, and make sure that you're not over-investing in a single fund or asset class (again, using your personal situation as a guide). An unpredictable market like today's is the best argument for having a well-diversified portfolio.

Reconsider your plans for retirement. If you're nearing retirement, the current crisis has likely hit you especially hard and you may need to adjust your retirement plans. For many, working a while longer may be the right approach. Hopefully, that may help you ride out the current market, plus you'll also continue to add to your nest egg—not to mention keeping your coverage under your employer's health plan, if applicable. Another approach is to adjust your financial expectations. Are there ways to scale back your expenses? Do you have access to alternative sources of income? Will you need to take a part-time job? Consider working with a financial advisor to review your options. You can also go to **http://ssa.gov/estimator** to model your potential Social Security benefits based on your work history.

Retirement fact: For better or worse, more workers are expecting to stay on the job longer. In a recent survey by the Employee Benefit Research Institute, about 20% of workers age 19 to 39 said they expect to keep working at least until age 70.

QUICK REMINDERS: UPDATE YOUR CONTRIBUTIONS

It's 2009. Don't forget your 401(k) "to-dos." If you want to save to the maximum:

- Keep in mind that you can increase your 401(k) contributions to $16,500 a year.
- If you will be age 50 or older in 2009, you can save an extra $5,500 above the normal limits in "catch-up" contributions.

These limits out of your ballpark? Now may still be a good time to look at what you are saving and see if there is a little more you can do. Even saving an extra $10-$20 per month can add thousands to the value of your account over time.

RESOURCES AT YOUR FINGERTIPS

Don't forget these important resources you have for managing your retirement benefits:

- Your benefits Web site will allow you to review your account, learn more about the investments you have in the plan, and make any changes. Simply go to **http://resources.hewitt.com/srns**.
- Call the Personal Finance Center at **1-866-HFS-DESK (437-3375)** to speak with a personal finance specialist who can direct you to retirement planning information and resources available to you.

You're Feeling the Crunch. Is it Okay to Tap into Your Retirement Savings?

You've got a 401(k) and you are strapped for cash. When does it make sense to dip into the pot and use some of your money now to make ends meet? Well, that depends.

Your best bet is always to leave your retirement savings alone. Remember, any money that comes out of your account stops working for your retirement—something that will become more obvious when the market recovers. In addition, withdrawals can be costly. You're subject to taxes and, potentially, tax penalties. But if you are truly strapped for cash, remember these things:

- A loan is probably your best option because you are committing to replace what you took. Look at both your loan payments and your regular contributions—which you'll definitely want to keep making if you're getting a match—and figure out if you can afford that amount coming out of your future paychecks.
- Recognize that if you leave your job before the loan is paid back, you'll either have to find the money to pay the loan back right away or have it treated as a withdrawal—and pay all applicable taxes and penalties on the money you borrowed.

For severe financial needs, you may be able to take a hardship withdrawal from your account. Typically, this option is available only for defined hardships, such as foreclosure on your house or medical expenses not reimbursed through insurance. (You also may be required to have used up your other non-hardship options first, such as taking a loan or drawing on any other money in your account.) If you do take a hardship withdrawal, recognize that you'll need to pay taxes on any taxable money you take out, in addition to a 10% penalty if you are under age 59-1/2. Be aware that once this money is removed, it can't be put back into your 401(k) account.

If things are so bad that bankruptcy may be in your future, talk to a financial advisor before taking a hardship withdrawal. There are situations where your retirement plan assets are protected in the event of bankruptcy.