

# Retirement Weekly

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## On deck

President Bush is expected to unveil plans to create Retirement Savings Accounts (RSAs) and Lifetime Savings Accounts (LSAs) in his State of the Union later this month.

The new RSA would replace existing Roth IRAs and tax-deductible Individual Retirement Accounts (IRAs). Like Roths, RSAs would be funded with after-tax dollars, earnings would grow tax-free and assets would be withdrawn tax-free upon retirement. The new RSAs wouldn't have income restrictions as do Roth and traditional IRAs.

The LSA also would be funded with after-tax dollars and earnings would grow tax-free. But assets could be withdrawn tax-free for any purpose, be it college tuition, medical costs or for a vacation.

So what should seniors do? Maximize what you put into existing savings vehicles, says Fidelity's Doug Fisher. It's an election year so don't count on reforms from Congress. **RW**

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## Ready, set, retire

### 5 steps you must take before you retire

We all make mistakes, but when it comes to planning for retirement, you want to avoid as many as you can. Resources, both time and money, are in shorter supply the older you get, and options grow more limited, too.

Whether you're on the cusp of retirement or 20 years away, taking the following steps can help you improve the odds of living in comfort in retirement.

**Plan:** Failing to plan in advance for retirement is a huge mistake. "Four out of five people about to retire do so without a formal, written plan," says Cynthia Eagan, director of retirement income services at Fidelity Investments.

The cost of not planning can be great. "If you haven't quantified



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## Income-producers for 2004

Retirees in search of income in 2004 might have better options than in years past. No less a sage than Bill Gross, managing director of PIMCO, is calling for a rise in inflation this year and that could spell good news for yield and income shoppers.

At present, Gross is telling investors to invest in what he calls "reflatables" and securities that borrow at 1 percent instead of lend at it. Reflatables, as Gross describes in his December Investor Outlook, include:

- Commodities and tangible assets;
- Foreign currencies;
- Real estate;
- TIPS; and
- Global bonds and equities denominated in non-dollar currencies.

## The Income Investor

As for securities that borrow instead of lend at 1 percent, his favorites include closed-end municipal bond and equity funds. He is especially fond of closed-end municipal bond funds that borrow

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## Tips of the Week

### A senior cash-management account

Fidelity Investments, which has designs on capturing the so-called retirement income distribution market (see page 1 story), plans to soon launch an all-in-one cash-management account designed specifically for seniors. Cynthia Eagan, director of Fidelity's retirement income services, says the account will provide seniors the chance to manage income from Social Security and pensions, as well as the distributions from their retirement accounts.

**Fidelity.com**

Speaking of income, Fidelity this week launched the Strategic Dividend & Income Fund. It invests primarily in value-oriented, dividend-paying equities, as well as preferred stocks, convertibles and REITS.

### Benefits for short-timer seniors

Seniors who get lured back into the workforce for a high-profile, short-term assignment or get asked to serve as a company director might ask for a new type of benefit called a Short-Term Deferred Compensation (STDC) plan. An STDC is a creative form of a nonqualified deferred compensation plan in which the benefits are "accrued" or "earned" over a relatively short period of employment, says Brian McKenna of Travelers Life & Annuity. Writing in *National Underwriter*, a trade magazine for the insurance industry, McKenna says the STDC plans can be used as a supplement or alternative to salary or bonuses, stock plans, or long-term deferred compensation plans.

The downside to STDCs: The compensation is mostly an unsecured promise to pay and if the employer goes belly up, the employee loses his or her money. Also, a nonqualified deferred compensation plan doesn't meet ERISA requirements such as those for 401(k) plans. How you design and fund a STDC will depend on the terms of the employer's existing deferred compensation plan, if one exists. Seniors should talk to a nonqualified deferred compensation expert before signing up for a STDC.

### Web site of the week

OK, call me a wonk. But if you're the type who can appreciate the value of a good working paper about life annuities and phased-withdrawal plans or behavioral finance, check out the Pension Research Council's Web site

— <http://rider.wharton.upenn.edu/~prc/prc.html>. Directed by Olivia Mitchell at University of Pennsylvania's Wharton School, the council is committed to generating debate on key policy issues affecting pensions and other employee benefits. And that it does. It published 20 working papers in 2003, all of which are free to those who want to rub elbows (at least electronically) with the nation's retirement thought leaders.

The site also sells books on retirement issues. No, *Retirement for Dummies* is not in the collection. Rather, you'll find *The Pension Challenge: Risk Transfers* and *Retirement Income Security* and *Innovations in Retirement Financing*. **RW**

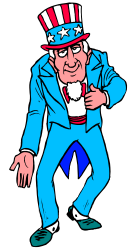


## 10-4, 1040 Central

The IRS this week rolled out a new service called 1040 Central at its Web site — <http://www.irs.gov>. The IRS says the 130 million taxpayers who are expected to file a return this year will find the latest tax law changes, tax tips, news releases, and frequently asked questions. Plus, investors will find new rates on capital gains and dividends and a revised Schedule D.

But wait, there's more. The new service also features "After You File," which includes the ever-fun-to-use "Where's My Refund?" that allows taxpayers to track the status of their refund. For the record, some of the major 2003 tax law changes that affect seniors include:

- Expanded 10 percent and 15 percent income tax brackets.
- Lowered tax rates to 25 percent, 28 percent, 33 percent and 35 percent.
- Increased standard deduction to \$4,750 for single taxpayers, \$7,000 for head of household and \$9,500 for couples filing as married filing jointly. The increase in the standard deduction for couples whose filing status is married filing jointly eliminates the so-called "marriage penalty."



## The first of many redemption fees for fund firms

Putnam Investment, in an effort to curb market timing in its funds, this week said it was raising the redemption fee on fund sales to 2 percent beginning this quarter. The fee will be charged on any fund shares in retail accounts held directly on the funds' transfer agency system that are exchanged or sold within five days of purchase. The fee will also apply to redemptions on all Putnam-administered 401(k) plans. Putnam settled securities fraud charges with the SEC in November. The ICI, the mutual fund industry's lobbying group, is advising all fund firms to adopt 2 percent redemption fees.

## Estate tax fallout

Less than 1 percent of all estates will be taxable in 2004 under the new law that increases the federal estate-tax exemption to \$1.5 million per individual. And those 1 percent will be hard at work trying to increase the value of their non-marketable assets.

That's because people who inherit assets get a step-up in basis upon the death of the owner. A higher value could mean a lower income-tax bill for the new owner of the asset when he or she sells it. Seniors who intend to pass on a non-marketable asset should get an appraisal of the asset to establish its new basis. **RW**

### Best of CBS MarketWatch

- **Retirees face unique challenges in overcoming debt**  
<http://cbs.marketwatch.com/news/story.asp?guid=%7B2192C354%2D130C%2D4654%2DBF9B%2D4CA144111B99%7D>
- **How you help the IRS**  
<http://cbs.marketwatch.com/news/story.asp?guid=%7B96166574%2D3155%2D4254%2D98DC%2DE6920ABC6073%7D>
- **Plan to avoid inheritance pitfalls**  
<http://cbs.marketwatch.com/news/story.asp?guid=%7BC1C7BDA2%2D2618%2D42A0%2D82A3%2D806E2FEC6F8B%7D>
- **Resolved: Do a better job with finances**  
<http://cbs.marketwatch.com/news/story.asp?guid=%7B571EEB57%2DBDAA%2D459F%2D9BD4%2DA7897541690E%7D>

## Ask Mike

### Should my wife take Social Security at 62?

**Q:** My wife and I are 61 years young and are in good health. She retired as a teacher at 59 and has not worked since. Each year her Social Security statement of estimated benefits goes DOWN because of zero income years since she retired. She will be 62 this June. I continue to work at a salary level exceeding the Social Security max and have exceeded the max for almost all of my working life. The BIG question is should she take Social Security at 62 to stop the continuing reduction in benefits, or will the fact that I am still working offset her reduction in benefits? Comments? — M.R.

**A:** It's a common misconception that a person can receive benefits based upon a spouse's account alone (unless you never contributed into the Social Security system). Think of you and your wife's accounts as two glasses of water. The amount in her glass can never be taken away from her, but you can take from your glass and add to hers and Social Security will always refill your glass to what it was.

Although it may appear a technicality, what actually happens is that a person receives a benefit from their own account first and one only looks to a spouse's account if a benefit could be higher. Why does this technicality matter? We'll talk more in a moment, but just think of your wife's retirement account as separate from your own.

Pure and simple, her benefit based on her own account is fixed now, unless she returns to work.

You cannot change your wife's benefit based upon her own account by her electing to retire early. That account is based upon her 35 highest wage-earning years. The reason your wife's estimates are going down is that the Social Security Administration (SSA) assumes that when it makes its projections that she was going to continue to work and earn a comparable wage until age 62. The projection that Social Security is making is distorting the fact that her primary insurance amount, the fancy term for the amount you receive at age 65, is calculated based upon the highest 35 years. I think that once she records two consecutive years of zero earnings, you might find that the benefit stabilizes.

After looking at her or his own account, a person can receive an additional benefit based on a spouse's account so long as 50 percent of the spouse's monthly payment is more than their own monthly benefit.

Your spouse cannot begin to collect on your account until you begin to collect on your account. If you retire at the earliest possible time, you lose 20 percent of your benefit based on your account. If you rely on your spouse's account, your reduction for taking it at the earliest time is 25 percent.

Your wife's Social Security benefit is calculated on her 35 highest years of earnings. If she worked less than 35 years, the years in which she had no earnings will be factored in to bring her to the 35-year total. If she chooses to start drawing Social Security at age 62, she will see a reduction in her monthly payments of 0.555 percent per month times the number of months early due to the fact that she is tapping into the system before her full retirement age. For example, if she was supposed to receive \$1,000 at full



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## Ask Mike

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retirement age of 65, then it would be reduced by 20 percent (36 months early times 0.555). Hence she would get \$800 a month. She cannot affect the \$1,000 amount, unless she begins to work again. In addition, her overall benefit will be permanently reduced. See the chart below for detailed information on reduction formulas.

Now the question turns to you. The fact that you continue to work and earn over the Social Security maximum amount may increase the amount of monthly benefits your spouse is entitled to based upon your earning record when you retire. The SSA says your spouse at her full retirement age can receive a benefit equal to one-half of your full retirement amount. According to the American Institute of Certified Public Accountants, your wife's individual retirement benefit and her spousal benefit are computed separately. The fact that she may draw early Social Security payments will not affect her spousal benefits computation, but they will be reduced because she retired early. If her monthly payment is less than what she is eligible under her spousal benefit, then the SSA will make sure that she gets a combination of benefits that equals the higher amount.

So let's say your wife starts drawing monthly retirement checks at age 62 at a reduced amount of \$800 based on her account. At age 65 you retire and start receiving monthly payments of \$1,800. Your wife will be eligible to receive one half of your \$1,800 payment. Social Security will provide her a benefit check of \$800 from her account plus an additional \$100 from your record. Put simply, your wife will benefit from your continued earnings, even if she chooses to take her own Social Security payments at age 62. Your wife can also do some planning herself, using the earnings shown on her *Statement* to calculate other estimates. Here's how: Visit <http://www.socialsecurity.gov> and click on *Plan your retirement* and *Calculate your benefits*. **RW**

Social Security Benefits				
	<i>Retiring worker</i>	<i>Spouse of surviving retired worker</i>	<i>Healthy surviving spouse</i>	<i>Disabled surviving spouse aged 50 to 60</i>
<b>1. Benefit at normal retirement age</b>	PIA	50% of spouse's PIA	100% of spouse's PIA	100% of spouses PIA
<b>2. Minimum early retirement age</b>	62	62	60	50
<b>3. Reduction formula</b>	0.55556% x PIA x number of months early	0.34722% x PIA x number of months early	0.475% x PIA x number of months early	28.5% if PIA until age 60, then regular surviving spouse amount
<b>4. Reduced benefit amount</b>	PIA minus amount in step 3	50% x PIA minus amount in step 3	PIA minus amount in step 3	PIA minus amount in step 3

Source: Financial Decision Making at Retirement

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## The Income Investor

### Closed-end muni bond funds: good bet for '04

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money at short-term interest rates and then use "mild leverage to increase total portfolio yields and returns," Gross says.

By way of background, closed-end municipal bond funds typically invest in a portfolio of federal, state and municipal bonds. Like open-end municipal bond funds, closed-end municipal bond funds come in a variety of shapes and sizes. Some invest in bonds of a particular state like New York or California. Some just invest in bonds with long-term maturities.

Thomas Herzfeld, a closed-end fund expert, says there are about 300 closed-end funds trading on the exchanges today. Many trade at a discount to their net asset value, typically 5 percent. In some cases, Gross says, closed-end municipal bond funds produce current income upwards of 7 percent — about 2.5 percent more than the yield on the U.S. 10-Year Note.

As with most investments, closed-end municipal bond funds have their share of drawbacks, says Morningstar's Eric Jacobson.

Information about these funds can be difficult to find. That's a problem since many funds contain bonds that are callable. When bonds in a closed-end fund are called, the fund's net asset value will overreact. Demand for closed-end municipal bond funds can be low. That means bid-ask spreads can be wide. And, closed-end municipal bond funds, especially those that use leverage, trade differently than other closed-end funds. That makes it hard to know if you are buying something at a reasonable price.

Still, Jacobson says closed-end municipal bond funds can be a useful addition to a well-balanced portfolio, especially when interest rates are stable or falling. Herzfeld says Eaton Vance Insured Municipal Fund (EIM; current yield: 6.6 percent) and Seligman Quality Municipal Fund (SQF; current yield: 5.68 percent) are among his favorites. We'll talk about Gross' other favorites in weeks to come. **RW**

#### Resources

- **Closed-end Fund Association**  
<http://www.closed-endfunds.com/default.asp>
- **Investment Company Institute**  
[http://www.ici.org/funds/mem/list\\_closed-end.html#TopOfPage](http://www.ici.org/funds/mem/list_closed-end.html#TopOfPage)
- **Thomas J. Herzfeld Advisors**  
<http://www.herzfeld.com/>
- **Investing in Bonds**  
<http://www.investinginbonds.com>
- **Nuveen Investments**  
<http://www.nuveen.com/>
- **PIMCO**  
<http://www.pimco.com/>
- **Eaton Vance**  
<http://www.eatonvance.com/>

#### A reader writes

**Q:** You featured Vanguard Total Bond Market Index as a solid favorite in the Dec. 16 issue "Stacking out a Middle Ground." Vanguard is not available to my wife in her 403(b) account. What about Fidelity U.S. Bond Index as a substitute or is there another preferred Vanguard or TIAA-CREF account you would recommend? — R.S.

**A:** The Fidelity U.S. Bond Index fund is a good substitute, as is any TIAA-CREF fund with an investment objective similar to that of the Vanguard Total Bond Market Index fund.

## Ready, set, retire (in comfort)

(Continued from page 1)

what you want, then you have a dream rather than a goal," says Stephen Leimberg, author of *Tools and Techniques of Employee Benefit and Retirement Planning*. Fail to plan accordingly "and those dreams can become a nightmare."

**Budget:** The basis for any financial plan is a budget. Unfortunately, most people nearing or in retirement fail to adequately estimate expenses and overestimate how much money they can withdraw from their retirement funds. "There is no recourse to fix errors," says Jim Stone, professor of retirement planning at the College for Financial Planning. "There's no way to fix it if you pull out too much money."

Eagan suggests estimating all your retirement expenses and dividing them into the essential (food, housing, health care, etc.) and discretionary (travel, entertainment). Next, draw up an inventory of all your sources of reliable and predictable income (Social Security and pensions, for instance) and an inventory of financial and real assets (mutual funds and real estate, for instance) that could be used to produce income during retirement.

Next, Eagan recommends matching essential expenses against reliable and predictable sources of income. If there's a shortfall, you have a few options: increase savings, adjust your investment-risk profile and extend your time horizon. Or, you could segregate a portion of your financial assets to fund the shortfall. Or, you might consider a guaranteed-income product such as an annuity.

It's important to determine how expenses such as health care and long-term care may change over 30-plus years of retirement, and whether you'll have income to pay for your changing lifestyle, Eagan says.



Cynthia Eagan

Once essential costs are covered, Leimberg advises creating a systematic withdrawal plan for your financial assets that will produce income to fund discretionary expenses. A word to the wise and foolish alike: Most experts say retirees and pre-retirees are far too aggressive in calculating their withdrawal rates. While many experts suggest withdrawing no more than 4 percent of your financial assets per year, Stone suggests using a time value of money calculation to determine the fixed amount you can withdraw. "You need a rigorous number."

As a matter of course, reviewing your plan and budget annually — even in retirement — is a must-do, experts say.

It's also a good idea to consider the effects of inflation and taxes on both your income and your expenses, Leimberg says.

### Eight things you should do before you retire

- Determine your retirement expenses
- Review your insurance coverage
- Note Medicare milestones on your calendar
- Know when to apply for your Social Security benefits
- Develop a retirement income plan
- Select pension benefits and 401(k) distribution options
- Review wills, trusts, powers of attorney, and beneficiaries

Source: Fidelity Investments (<http://personal.fidelity.com/planning/retirement/retiree/content/8things.shtml.cvst>)

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## Ready, set, retire

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**Save:** This process of matching sources of income against retirement expenses produces in many cases a huge savings shortfall. That's why this process should create the incentive to increase your savings rate. Unfortunately, many pre-retirees still don't have a sense of time urgency when it comes to saving for retirement, Leimberg says.

The end result? They'll have to use financial assets to fund essential expenses or lower their hoped-for standard of living in retirement. Or they may have to keep working or return to work out of need, not want.

To counter this potential mistake, Leimberg advises signing up for any and all automatic investment-plan programs, especially your 401(k), and save till it hurts. He also suggests increasing your savings yearly instead of letting inertia set in.

**Insure risks:** Most older Americans think they live in a fairy tale world, Leimberg says. Unfortunately, that's not the case. "Life doesn't turn out happily ever after for many people," Leimberg says.

As part of your pre-retirement or retirement plan, he advises purchasing the adequate amount of insurance (disability and life) and the appropriate type of insurance (not just cancer).

**Keep working:** Sure, you want the good life sooner rather than later, but Stone says retiring too soon is probably the biggest mistake many retirees make. Keep working at least until you become eligible for Medicare, if not longer. At a minimum, work until you've gone through the process of creating a bullet-proof plan that works in bull and bear markets. **RW**

## Five key risks to lifetime income

### Longevity

- You need to plan for the possibility that you will live longer than you think.
- Make plans for the very real possibility of needing 30 to 40 years of post-retirement income.

### Inflation

- General inflation may not capture the impact on retirees of rising medical expenses.

### Asset Allocation

- Real danger that many anxious retirees may overreact to the just-past bear market by selling most or all of their equity holdings and aim to meet lifetime income needs solely with cash and fixed-income instruments.
- The key to long-term success can lie in a balanced asset portfolio — neither all stock, nor all bonds and cash.

### Excess Withdrawal

- Changing the annual rate of planned withdrawals can dramatically raise or lower that portfolio's prospects of lasting for a longer period of time.
- Many financial advisers report that they are actually having to "downsize" retirees budgets and lifestyle expectations.
- The risk of being put on a path to depletion rises steeply at withdrawal rates over 4 percent.

### Health Care Expenses

- Couples retiring today at age 65 who don't have an employer-funded retirement health plan will need current savings of \$160,000 to supplement Medicare and cover their out-of-pocket health-care costs.
- Health insurance is now one of the core elements of retirement security and funding such insurance should be considered an essential expense in the lifetime income planning process.

Source: Fidelity Investments' Viewpoint: Lifetime Income Planning

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### Got Questions, Get Answers

If you would like to have a financial question answered, or if you would like to be profiled in a Retirement Weekly Money Makeover, please e-mail your question or problem to [rpowell@marketwatch.com](mailto:rpowell@marketwatch.com).

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Thanks for spending time with **Retirement Weekly**.



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*Powell owns no shares of any investment mentioned in this week's issue. He currently provides consulting services to the Financial Planning Association and Major League Investments, in which he also holds a minority interest.*

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