

Reinventing RETIREMENT

Your Retirement Planning Newsletter

Fourth Quarter 2016

Protect the Nest: A Four-Point Plan for Making Your Savings Last

Like most investors, you may be concerned about outliving your money. To sustain your savings during retirement, consider strategies that may help address the following four money-diminishing factors:

1. Longer life expectancies

In May 2016, scientists attended a Harvard conference to discuss a groundbreaking new idea — fabricating a human genome from scratch. Using a gene-editing technology called CRISPR¹, scientists believe they may be able to eliminate inherited diseases and even slow the aging process. If you are under 30, you may be part of the first generation in history that could be promised immortality.

While this technology may seem like Hollywood science fiction, it points out a very real fact: We are likely to live longer, and may need our money to last longer than we ever thought. This is particularly true for women, who tend to earn less than men and are more likely to struggle financially after retirement.²

Investing for long-term growth remains imperative, which is why stock funds — whose returns historically have outpaced those of all major asset classes — deserve a place in most portfolios.

2. Inflation

Inflation is the rate at which the buying power of a dollar erodes each year. To maintain a reasonable standard of living over time, your investments may need to match or outpace inflation. That's another reason to buy stocks. They historically have produced the highest returns (but also the most risk) of all major asset classes.³



3. Market returns

Over time, investing generates stable rates of return: Common stocks have returned about 11% a year, on average with dividends reinvested, since 1926; bonds have earned about 5.5%.⁴ But both stocks and bonds have had many years producing lower, even negative, returns. Within shorter time frames, however, returns can be choppy, and you may need to build some uncertainty into your return expectations.

Inflation's Impact

The cost of a cup of coffee



Sources: 1986 prices are based on Kmotion Research. 2016 prices are based on general averages. Projections for 2046 prices assume a 3% annual inflation rate.

The Rule of 72

To determine how many years it will take to double your money, choose a rate of return and divide it into 72.⁵

Rate of Return	Rule of 72 (Years)
6%	12 Years
8%	9 Years
10%	7.2 Years
12%	6 Years

¹ Clustered regularly interspaced short palindromic repeats. Source: "Will We Be the Last Generation to Die?" Boston Globe, July 11, 2016.

² "Shortchanged in Retirement: Continuing Challenges to Women's Financial Future," National Institute on Retirement Security, March 2016.

³ Past performance is no guarantee of future results. All investing involves risk, including loss of principal.

⁴ Source: <http://www.bankrate.com/finance/retirement/stocks-bonds-and-mutual-funds-1.aspx>.

⁵ This hypothetical illustration is intended to illustrate the concept of investment compounding and is not predictive of any investment return.

Take a Keen Interest When Rates Rise

Interest rates affect homeowners and credit card holders. But they also can have an indirect impact on the stock market.

Interest rates generally refer to the Federal Reserve's funds rate — the cost that banks are charged to borrow money from other U.S. banks. The Fed controls interest rates mostly as a way to ensure that inflation does not get too high (inflation has an eroding effect on your purchasing power). Too much inflation means rising prices and consumers having less buying power, which economists say can lead to business stagnation and higher unemployment.

When the Fed increases interest rates, it makes it more expensive to borrow money, which can have a moderating effect on prices. Interest rate hikes also have direct and indirect effects on most financial products, from credit cards and mortgages to stocks and bonds.

Because higher rates make it more expensive for consumers to borrow, consumer spending tends to slow. As a result, businesses may experience lower revenues and profits, and may decide to borrow less money to plow back into their companies.

Rising rates can indirectly harm the prices of certain stocks, which generally are valued based on future earnings. If enough businesses cut back on business spending due to decreased

revenues, entire stock market indexes like the Dow Jones Industrial Average or S&P 500 can go down. In addition, since stocks are considered to be riskier than bonds, some investors will see rising interest rates as a signal to sell stocks and buy government securities such as Treasury bonds, which may offer a more stable rate of current return. That, too, can cause stock prices to go lower.

In fact, since 1913, U.S. stocks have gained an annual average of 9.3% when interest rates fell, but only 2.3% in periods when rates rose, according to a recent finance study cited in *The Wall Street Journal*. Bonds, by contrast, returned an average of 3.6% annually in periods when rates fell, but only 0.3% when rates rose.⁷



Keep in mind that all of these factors are interrelated, and that one can never say with certainty that an interest rate hike by the Fed always leads to lower stock prices. Keeping a portfolio that's well-diversified among stocks, bonds and cash could be an effective way to offset the market forces outside of your control, including interest-rate movements and stock-market declines.

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Continued from Page 1

4. Health care costs

Likely your biggest expense as you age, health care is estimated to cost a healthy 65-year-old couple \$266,600 in Medicare premiums alone, according to one study.⁶ This doesn't include out-of-pocket expenses or long-term care, dental or vision insurance. Earmarking a large chunk of your nest egg for health care expenses may make sense.

A savings plan that takes these four factors into account can give you greater confidence that your savings can last well into your retirement years.

⁶ Health View Services, 2015 Retirement Health Care Costs Data Report, December 2015.

⁷ Jason Zweig, "Sorry, You're Just Going to Have to Save More Money," *The Wall Street Journal*, July 13, 2016. Returns include the effects of inflation. Past performance does not predict future results; <http://blogs.wsj.com/moneybeat/2016/07/13/sorry-youre-just-going-to-have-to-save-more-money%E2%80%8B/>.

Bond Funds 101

There's a lot to like about income-oriented investments

Bond funds don't always get the attention that stocks get among investors. But fixed income investments are an important part of the capital markets that deserve to be included in most investors' portfolios. In fact, bond mutual funds have become an accepted way for U.S. households to invest in the bond market. In mid-2015, about 42% of such households owned at least one bond fund, according to the Investment Company Institute.⁸

When you buy stocks, you own. Bonds, you loan.

A bond is, very simply, an IOU — a loan by a bond holder to a government body or corporation. The borrower promises to pay back the bond holder the amount of the loan, plus interest, by a specific date (although some bonds can be retired before the maturity date). Generally considered safer than stocks, bonds can provide a steady amount of income in the form of fixed semiannual payments.



In general, bonds can be divided into various maturities (that is, the date when the borrower must pay back the loan plus interest): short term (1-3 years), intermediate term (4-10 years) and long term (10-plus years). The shorter the maturity, the less likely the bond will fluctuate in value. That's because the borrower's payments in the near term are generally considered to be more certain than promises to pay way into the future.

When interest rates rise, the price of a bond goes down. This is because people who are able to buy newer, higher-paying bonds will not find the current lower-yielding issues as attractive. If a bond is sold prior to maturity, the market price may be higher or lower than what the investor originally paid for the bond. This can lead to a capital gain or loss. However, if the bond holder holds the bond until the maturity date, he or she will get 100% of principal back, plus any accumulated interest.

Bond funds may help you diversify and lessen risk.

Unlike buying a collection of individual bonds and managing them yourself, owning a bond mutual fund that pools money from other investors offers several advantages:

- **Professional management:** Mutual funds hire experts who have special education and training in researching borrower companies. These professionals will buy and sell bonds on your behalf, based on the fund's investment objective.
- **Built-in diversification:** A fund's size allows it to own bonds from lots of issuers (governments, municipalities, highly rated companies, low-rated companies). If you were to buy individual bonds (many in \$10,000 denominations), you likely would find it difficult to assemble enough to achieve a diversified portfolio.
- **Small investment minimums:** Some bond funds cost just \$250 to get in, while others have no minimums if you commit to investing a small amount each month inside your retirement plan.
- **No specific maturity date:** In a fund, bonds are constantly bought and sold, so there is no need to worry about what to do with the cash when a bond matures, as you would as an individual



buyer. However, bond funds have a weighted average maturity date that is a composite of all bonds held in the portfolio. This means a bond fund could potentially be less sensitive to interest-rate movements than a single bond.

What do I need to know before investing?

Bond funds generally entail less risk than stock funds, but they also tend to offer less reward.⁹ In addition, bond funds are sensitive to economic forces, including interest-rate changes. When rates rise, you may want to favor bond funds that have low or intermediate duration, as the prices of the bonds may be less influenced by higher rates than longer-duration bonds would be. Still, because bond returns tend to move independently of stock returns, they may be an important diversifier for your portfolio.

⁸ ICI Research Perspective, "Characteristics of Mutual Fund Investors, 2015". http://www.icifactbook.org/ch6/16_fb_ch6

⁹ Investing in bonds and bond funds entails risk, including the risk of losing money. Bond-investing risks include interest rate risk, call risk, duration risk, refunding risk, and default and credit risk. For a helpful discussion of these risks, visit FINRA's website: <http://www.finra.org/investors/understanding-bond-risk>.

Retirement in Motion

Tips and resources that everyone can use

Owning stock funds for the long haul

If you are 50 or older, you may question whether you need to continue buying stocks in your portfolio. After all, stocks are risky, as we saw with steep losses in 2008 and 2009. But increased life expectancies and rising inflation are two important considerations that tilt the argument for stocks. The important questions for pre-retirees to answer are balance (how much to invest in stock funds, given your time horizon and risk appetite) and cash flow (how much money you need to live on once you retire).

Q&A

How can I tie my investing strategy to specific financial goals?

Goals-based investing is an investment methodology that is less focused on investment performance and more connected to meeting your personal or lifestyle goals. Whether saving for retirement, buying a vacation home, or building a legacy for the family, the methodology matches a specific strategy to each goal. Rather than have one savings “bucket” to address all spending needs, separate portfolios typically are created.

Quarterly Reminder

Time for a tuneup

If you haven't taken a look at your portfolio allocation in a while, year-end is a good time. Your needs for investment growth and/or income will change over time, as will your tolerance for risk. You should compare your current portfolio against your liquidity and income needs, risk tolerance and time frame. Make sure your allocation is aligned with those needs, and make adjustments to your asset mix if you sense it's out of balance.

Tools & Techniques

Measuring your investment comfort level

Your appetite for risk does not stay the same, nor does it likely move in a straight line in response to evolving personal circumstances, or changing economic and market conditions. Use this quick online questionnaire to help measure your current level of risk tolerance and determine how it might affect your investment portfolio's current allocation: <https://www.wellsfargo.com/investing/retirement/tools/risk-tolerance-quiz/>.

Corner on the Market

Basic financial terms to know

P/E Ratio – The price-to-earnings (P/E) ratio is a common, back-of-the-envelope way to measure and compare the value of one stock against another, or to an index. Specifically, it measures the current price of a share of stock against its per-share earnings. For example, suppose a company's share price is \$40, and its earnings over the last 12 months were \$2 per share. The P/E ratio for this stock could be easily calculated as $40/2$, or 20. The P/E ratio indicates the dollar amount an investor could expect to pay to receive one dollar of that company's earnings. In this example, the investor would pay \$20 for \$1 of the company's earnings.

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