# Quarterly Report

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## Year In Review - 2011

The past year reminded investors that they should hope for the best, prepare for the worst, and be thankful when reality does not match their fears. This review shows how sensational headlines shape our perceptions when it comes to investing.

Wes entered 2011 with hopes that the world economy would continue recovering from a long and painful recession. Equity markets had posted two straight years of positive performance, central banks remained committed to pro-growth monetary policy, and major developed nations were focused on reducing debt.

By mid-year, however, optimism faded as troubling events around the world dominated headlines. The devastating earthquake and tsunami in Japan, political unrest in the Middle East, rising oil prices, the S&P US credit downgrade, the threat of another global recession, and an escalating debt crisis in Europe all weighed heavily on markets. As stock market volatility returned to global financial crisis levels, investors faced a major test of their discipline and staying power.

Although US stocks experienced some of the highest volatility in years, the broad US market delivered flat performance in 2011. Developed markets logged negative returns, and emerging markets had mixed performance, with most countries also under-performing the US. The

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## What Should Your Retirement Portfolio Look Like?

Everyone reading this is either retired or striving to be retired someday. Understanding how we design a retirement portfolio will increase your financial confidence about retirement – now and into the future.

People relate more to "income" in retirement than they do to a dollar amount attached to their retirement account balances. Of course, the two are related. Let's look at how they are related and develop a framework for translating that account balance into retirement income that you can use. Portfolio management in retirement means turning a retirement account balance into a "Paycheck Portfolio."[1] Thus, portfolio income is created to be a paycheck that provides the retiree with a secure cash flow. With this comes the confidence and peace of mind necessary to fully enjoy the retirement they worked so hard and long to reach.

How much money do you need on an annual basis? Here's an example. If you are accustomed to earning $150,000 per year and want to maintain your lifestyle at this level, you will need less in retirement to reach the same spending level. You will no longer be adding $23,000 per year to your 401k. You will also no longer be paying approximately 7.5% in payroll taxes. That leaves $115,750. Let's assume you qualify for Social Security benefits of $15,750 per year. You need an even $100,000 from your investments. This could be subject to income taxes just like your income – if the money is coming out of an IRA for example.

You can translate that $100,000 per year into a target retirement account balance of $2,500,000 using a 4% rule- of-thumb safe withdrawal rate (calculated

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**Recommended Reading**

For people wanting to explore their own personal relationship with money we recommend:

**The Soul of Money:** Reclaiming the Wealth of Our Inner Resources

By: Lynne Twist and Teresa Barker

When the stock market goes down, the news sticks in our memory with an emotional charge.

Good news gets less attention and is quickly forgotten.

Who remembers hearing this on the news last March? "Strong returns in January and February gave the US equity market its best first quarter since 1998!"

# Retirement Portfolio

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As $100,000/.o4). This $100,000 must be adjusted for inflation each year so that you receive $100,000 the first year, $104,500 the next year, $109,202 the third, etc. In order to create this growing annual income, the retirement account <u>needs</u> to earn an average annual return of around 8%. This is not optional. A diversified portfolio is most likely to achieve this rate of return over a 20 to 30 year period and to succeed in the retirement objective. Leaving the money in the bank earning interest leads to certain failure. The portfolio must contain a significant equity component and, with it, a significant amount of market risk. How to manage this risk and achieve the retirement objective is the art and science of retirement portfolio design.

The biggest strategy we use to manage stock market risk is to match the equity investments to a time horizon that exceeds ten years. Stock market returns are much more consistent over a long period of time than over any short period. Predictability of stock market behavior increases as the time period increases. This is the empirical, "science" aspect of portfolio design. A person needs to understand that they should never depend on stock market performance to provide for any immediate or short term financial need. This becomes gambling, not investing.

Any retirement portfolio can be thought of as having three sub-portfolio components: a Cash Portfolio for liquidity, an Income Portfolio for income, and a Growth Portfolio to

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# Year In Review 2011

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bright spots were in the fixed income arena, where a flight to quality triggered by the euro debt crisis and US downgrade boosted returns on US government securities, inflation-protected bonds and municipal bonds. The US Stock Market Performance Chart (below) features some of the year's most highly publicized events in the context of the Russell 3000 Index, a broad indicator of US stock market performance. These events are not offered as an explanation of market performance, but as an illustration that the volatile news environment can challenge even the most disciplined long-term investors.

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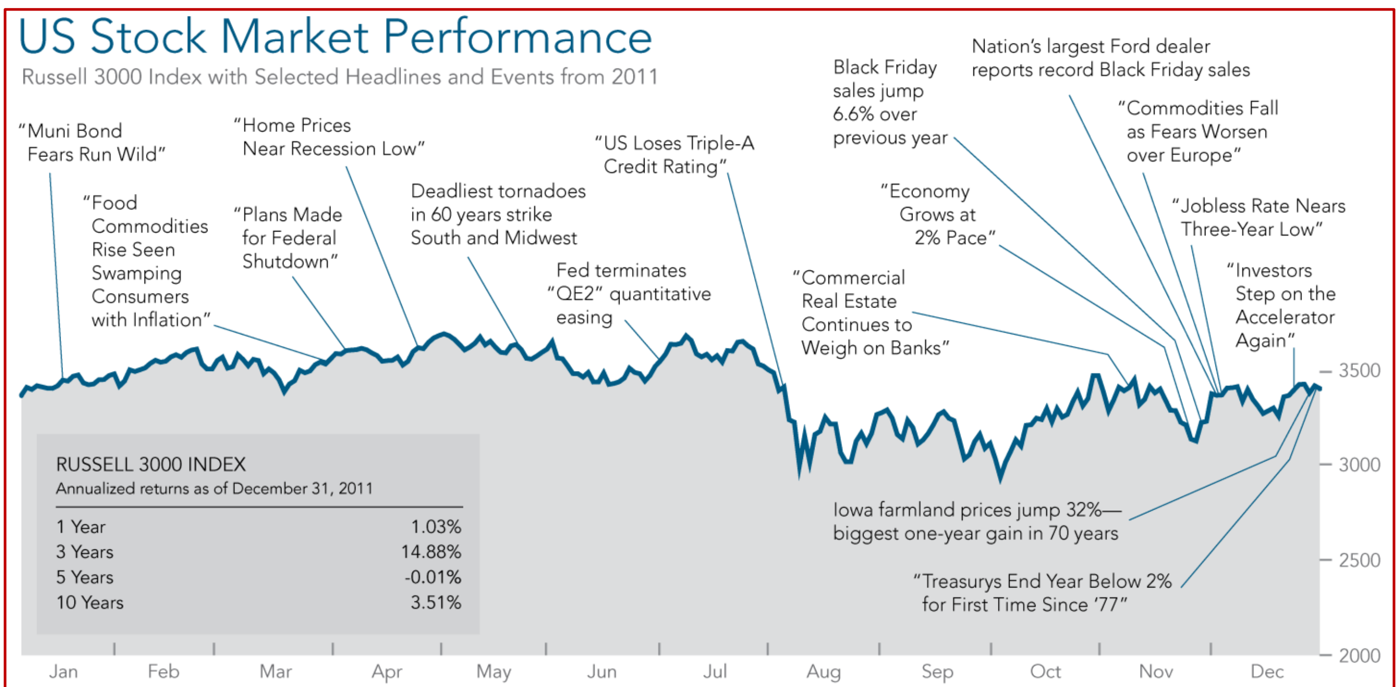


Source: Russell Investment Group.
In US Dollars. Index is not available for direct investment. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

# Retirement Portfolio

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to create higher future income. The starting point in portfolio construction is the stock/bond split – proportion of stocks and proportion of bonds. A good starting point in this decision is 60% stocks and 40% bonds and cash. Thus the retirement portfolio is split into three:

| | | |
|---|---|---|
| **Cash Portfolio** | **5%** | **$ 125,000** |
| **Income Portfolio** | **35%** | **$ 875,000** |
| **Growth Portfolio** | **60%** | **$1,500,000** |

The Cash and Income portfolios can be invested in a series of individual bonds that will provide a very high degree of safety and certainty about the first eight to ten years of retirement income. The Growth Portfolio, even for people at or in retirement, is still being invested 'for later.' This separation removes the sense of immediacy from the Growth Portfolio, dis-connecting it from current events and grounding it in a long term perspective.

The series of bonds in the Income Portfolio are selected to provide the targeted cash flow required for each of the eight to ten years. Each year, the face value and interest payments from the bonds will supply the cash needed for that year's withdrawal. There is extremely little risk or uncertainty associated with the Income Portfolio.

At the end of each year, when one year of the Income Portfolio has been spent, the advisor reviews the portfolio to ask the question: Roll or Don't Roll? If the Growth Portfolio out-performed the Income Portfolio, then some stocks will be sold to purchase bonds for an additional future year of income. If the Growth Portfolio under-performs the Income

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Investing based on news headlines or economic events of the day requires knowing

**What** is going to happen,

**When** it will happen, and

**How** it will impact the market.

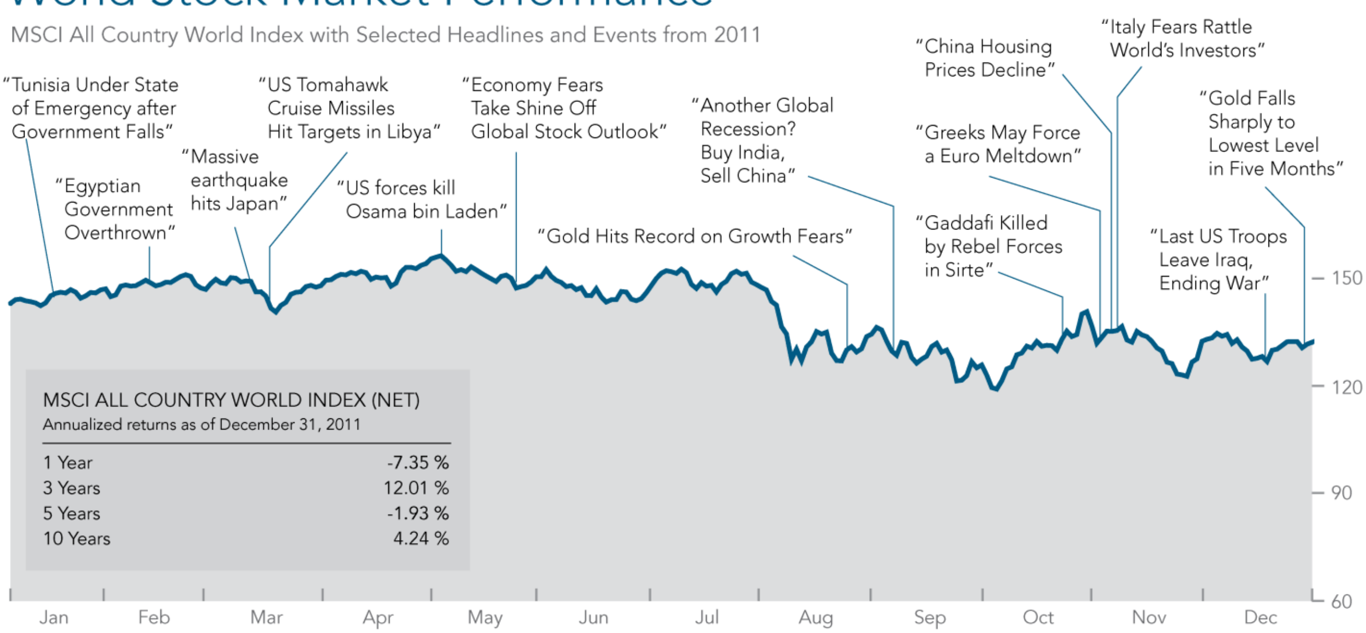
It is not possible to translate short-term news into a sound long-term investment management program.

# Year In Review 2011

The World Stock Market Performance Chart (below) offers a snapshot of global stock market performance as measured by the MSCI All Country World Index. Headlines from publications around the world are featured. Throughout the year, investors could find a host of reasons to avoid stocks and wait for more positive news before returning to the market. We cannot, however, wait for the world to sort itself out to be investors. If we did, we would wait forever and our financial goals would never be reached. **Continued on Page 4**

## World Stock Market Performance

MSCI All Country World Index with Selected Headlines and Events from 2011




Source: MSCI.
In US Dollars. Index is not available for direct investment. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

**The Retirement Portfolio**[2]

The retirement portfolio is split into two components. The Income Portfolio is a targeted portfolio of bonds selected to create 8 to 10 years of certain income. The Growth Portfolio is a broadly diversified stock portfolio invested for the future – with a time horizon of eight to thirty years.


Each year, the Growth Portfolio is evaluated to determine if stocks should be sold to purchse bonds. The new bonds will mature in eight to ten years and will replace the Year 1 money that was just spent.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Investors in US equities had to endure a heavy dose of uncertainty for their moderate gains. The S&P 500 Index reflected this volatility by closing up or down over 2% on thirty-five days in 2011, compared to twenty-two days in 2010. By contrast, before the global financial crisis the index did not have a single day with a 2% or more movement in 2005, and had only two days in 2006.

In our memories, the dramatic negative days leave an intense lasting impression not ever matched by the days when the market spikes up. Who remembers hearing this on the news? "Strong returns in January and February gave the US equity market its best first quarter since 1998!"

What does this review tell us about the future? Absolutely nothing. There is no information in this review of last year that can tell us what is going to happen this year. Sensible, goal-driven investing is what we practice despite the headlines, not because of them.

**End**

# Retirement Portfolio

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Portfolio, then stocks will not be sold in that year. The investor has 7 – 9 years that they can wait for the Growth Portfolio to create profits that can be used to replace income. This is a new way to apply a rebalancing process. When rebalancing, the original asset allocation of the portfolio is restored on an annual or quarterly basis. With either process, the methodology imposes a discipline on the portfolio that requires the investor to sell assets that are relatively high and buy assets that are relatively low. This is exactly the opposite of what our emotional reactions tell us to do. The methodology imposes a structure that supports financial success year after year.

Creating a portfolio structure that emphasizes the income to be spent in retirement has many benefits. Knowing that eight to ten years of income is "safe," investors can give stock investments time to shine. The annual review methodology supports buying low and selling high. Most of all, having a strategically designed retirement portfolio means fully enjoying your retirement years.

**End**

ENDNOTES

[1]From Asset Dedication, LLC
[2]From Asset Dedication, LLC
www.AssetDedication.com