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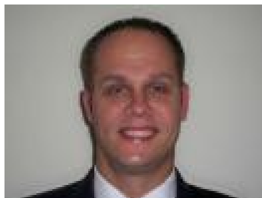
THE FINANCIAL FORMULA

Giving You The Financial Information You Need

January 2013



Welcome to 2013's first edition of The Financial Formula! Please let me know if you have any questions/thoughts - enjoy the newsletter!

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In the search to achieve greater diversification and boost portfolio yields, many investors are finding foreign bonds and foreign bond funds attractive.

Will You Outlive Your Assets?

The first step in tackling longevity risk is to figure out how much you can realistically afford to withdraw each year from your personal savings and investments.

Many Americans do not realize that one of the greatest risks to their financial security in retirement may be outliving their money. According to pension mortality tables, at least one member of a 65-year-old couple has a 72% chance of living to age 85 and a 45% chance of living to age 90.[1] This suggests that many of us will need to plan carefully to ensure that we don't outlast our assets.

The first step in tackling longevity risk is to figure out how much you can realistically afford to withdraw each year from your personal savings and investments. You can tap the expertise of a qualified financial professional to assist you with this task or you can use an online calculator to help you estimate how long your money might last.

One strategy to help make your money last is to withdraw a conservative 4% to 5% of your principal each year. However, your annual withdrawal amount will depend on a number of factors, including the overall amount of your retirement pot, your estimated length of retirement, annual market conditions and inflation rate, and your financial goals. For example, do you wish to spend down all of your assets or pass along part of your wealth to family or a charity?

Tips to Consider

No matter what your goals, there are ways to potentially make the most out of your nest egg. Here are a few suggestions.

- **Start a cash reserves fund.** You'll likely need ready access to a cash reserve to help pay for daily expenditures. A common rule of thumb is to keep at least 12 months of living expenses in an interest-bearing savings account, though your needs may vary. Then, consider refilling your cash reserve bucket on an annual basis by selectively liquidating different longer-term investments, timing gains and losses to offset one another whenever possible.
- **Be aware of interest rates.** Responding to the current interest rate environment is one way to potentially squeeze more income from your savings and stretch out the money you've accumulated for retirement. For example, if rates are trending upward, you might consider keeping more money in short-term certificates of deposit (CDs).[2] The opposite strategy may be employed when rates appear to be declining.
- **Look into income-generating investments.** Most retirees need their investments to generate income. Bonds and dividend-paying stocks may help fill this need. "Laddering" of bonds -- purchasing bonds with varying maturity dates at different times -- can potentially create a steady income stream while helping reduce long-term interest exposure. Dividend-paying stocks potentially offer the opportunity for supplemental income by paying part of their earnings to shareholders on a regular basis.[4] Additionally, investing an equity-income mutual fund, which generally holds many dividend-paying stocks, may help reduce risk compared with investing in a handful of individual stocks.[5]

[1]*Source: Social Security Administration, Period Life Table, April 2012.*

[2]Certificates of deposit (CDs) offer a guaranteed rate of return, guaranteed principal and interest, and are generally insured by the FDIC, but do not necessarily protect against the rising cost of living.

[3]Diversification does not ensure a profit or protect against a loss.

[4]Companies that offer dividend-paying stock cannot guarantee that they will always be able to pay or increase their dividend payments.

[5]Investing in mutual funds involves risk, including loss of principal.

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Many preretirees falsely believe that there is nothing they can do to build retirement assets, and as a result, do nothing.

Entering your 50s and behind in your retirement planning goals? Don't fret. You've still got time to get your financial plan back on track.

There are many steps that older investors can take to better prepare themselves financially for retirement. Here are six tips that may help you make the most of your final working years.

1. **Catch up.** If you have access to a 401(k) or other workplace-sponsored plan, make the $5,500 catch-up contribution that is available to participants aged 50 and older. Note that you are first required to contribute the annual employee maximum, $17,500 for 2013, before making the catch-up contribution.
2. **Fund an IRA.** Investors aged 50 and older can contribute $6,500 annually (the $5,500 annual contribution plus an additional catch-up contribution of $1,000). An investor in his or her 50s who contributes the maximum amounts to both a 401(k) and an IRA could accelerate retirement savings by more than $25,000 a year.
3. **Consider dividends.** If you do not have access to a workplace-sponsored retirement plan, or you already contribute the maximum to your qualified retirement accounts, consider stocks that offer dividend reinvestment.[1] Reinvesting your dividends can help to grow your account balance over time.
4. **Make little cuts.** Consider how you can trim expenses while continuing to enjoy life. Some suggestions for quick savings: Eliminate or reduce premium cable channels that you do not watch, memberships that you do not use regularly, and frequent splurges on dining out or coffee runs. An extra $100 a month saved today could make a big difference down the road.
5. **Review strategies for postponing retirement.** You may be able to learn new skills that could increase your marketability to potential employers. Even a part-time job could reduce your need to deplete retirement assets.
6. **Don't give up.** Many preretirees falsely believe that there is nothing they can do to build retirement assets, and as a result, do nothing. Remember that you control how much you invest, and in many areas, how much you spend. Make a plan -- and stick with it.

[1]*Investing in stocks involves risk, including loss of principal.*

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Looking for Yields? Consider Foreign Bonds

Investors in the hunt for higher yields have to search far and wide and consider avenues they may not have investigated before. One investment type that may be worth a look is foreign bonds and foreign bond funds.[1]

Investing in foreign bonds can have a number of advantages, including that the returns from foreign bonds are typically higher than returns offered via U.S. Treasury securities. However, Treasury securities are guaranteed as to the timely payment of principal and interest, which cannot be guaranteed for many foreign bonds. What's more, the monetary and budget policies of many foreign nations are often unsynchronized with those of the United States, which can help your portfolio diversification.[2]

Sovereign bonds are generally among the safest investments in most countries.

There are many types of foreign bonds, both from government entities as well as corporations.

- **Eurobonds --** A eurobond is a bond issued and traded in a country other than the one in which its currency is denominated -- not always a European nation. Eurobonds give issuers the flexibility to choose the country in which to offer their bond according to that country's regulatory constraints. They are usually issued in more than one country of issue and traded across international financial markets. But they are unsecured, leaving bondholders without the first claim to the issuer's assets in case of default.
- **Global Bonds --** A global bond is a type of bond that is issued in multiple markets in different currencies. By issuing global bonds, a government or corporation is able to attract funds from a wider set of investors and potentially reduce its cost of borrowing.
- **Sovereign Debt --** Issued by national governments, sovereign bonds are generally among the safest investments in most countries. Even if countries are not particularly creditworthy, their sovereign bonds are usually safer than their other domestic alternatives.
- **Yankee Bonds** -- Yankee bonds are U.S. dollar-denominated bonds issued by foreign governments and corporations and sold in the United States. American investors can purchase the securities of foreign issuers without being subject to price swings caused by variations in currency exchange rates. As a result, Yankee bond prices are influenced primarily by changes in U.S. interest rates and the financial condition of the issuer.

Investment Risks

As with all types of investments, there are anumber of risks associated with foreign bonds.

- **Currency risk --** Any time you hold a foreign currency, you are subject to currency risk, which is the potential for loss due to fluctuations in exchange rates. Currency risk can literally turn a profit on a foreign investment into a loss.
- **Sovereign risk --** This is the risk of a government becoming unwilling or unable to meet its loan obligations, or reneging on loans it guarantees. This risk is especially present in emerging markets, where governments are more likely to be unstable.
- **Inflation risk --** As inflation rises, bonds that have already been issued lose value in the secondary market. In an inflationary environment, bonds issued more recently are usually more attractive because they'll often have higher interest rates, as central banks such as the U.S. Federal Reserve and European Central Bank often raise rates in response to inflation fears.
- **Interest rate risk --** As interest rates rise, bond prices fall as investors are able to realize greater yields by buying newly issued debt that reflects the higher interest rate.
- **Liquidity risk --** As with many U.S. corporate bonds, it can be difficult to find a buyer for an international government or corporate bond.

Which foreign bonds or bond funds best complement your portfolio will depend on a number of factors, including your existing holdings and appetite for risk.

[1]*Investing in mutual funds involves risk, including loss of principle.*

[2]*Diversification does not ensure a profit or protect against a loss.*

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