The Sheridan Road Map

The Best Route to Financial Success

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Raiding the 401(k) Nest Egg

Amid volatile markets and a possible recession, many workers are making more conservative fund choices, investing less and taking 'hardship' withdrawals.

Jim Wharton, a 65-year-old store manager for Sears Holding Corp., invested his 401(k) plan in conservative stock and bond funds, and for years they held up well. But in October, as the stock market began to gyrate, Mr. Wharton decided he would rather sit on the sidelines. He shifted his entire 401(k) balance into a stable-value fund—a low-risk, low-yield fund.

Mr. Wharton isn't the only jittery 401(k) investor. Just as the federal 2006 Pension Protection Act is pushing more employees into 401(k) retirement-savings plans by encouraging employers to automatically enroll new workers, the subprime-mortgage crisis is making many savers anxious and leaving others struggling to pay bills. Some participants are dumping stocks for cash or decreasing 401(k) contributions from their paychecks. Although some do see the market's downturn as an opportunity for bargain hunting and gained from April's rally, others are wondering if they should stop contributing.

A more worrisome trend is the surge in borrowing from these retirement plans. At the end of last year, 18% of workers had loans outstanding from their plans, up from 11% in 2006, according to a February survey of 2,011 full-time employees by the Transamerica Center for Retirement Studies, a nonprofit corporation funded by Aegon NV's Transamerica Life Insurance Co. With home prices falling nationwide, the loans may be a sign that cash-strapped consumers are raiding their nest eggs to stay afloat, no longer able to tap their houses for cash.

Last year, Fidelity Investments in Boston, and T. Rowe Price Group Inc. in Baltimore, saw increases of 17% and 10%, respectively, from 2006 in 401(k) "hardship withdrawals," which allow employees to take money out of their account for emergencies such as a looming foreclosure. Unlike regular 401(k) loans, hardship withdrawals don't have to be paid back, but they are subject to taxes and penalties.

Timing the Market. The developments come as the number of workers counting on 401(k)s and individual retirement accounts to be their main source of income in retirement continues to grow. Employers of all sizes continue to retreat from traditional pension plans. Last year, 52% of workers with annual incomes of $50,000 to $100,000 said they planned to rely primarily on 401(k) plans and IRAs to pay for living expenses in retirement, up from 46% in 2006, according to the Transamerica survey. The percentage counting on Social Security also increased, to 19% from 13%, while those counting on a company-funded pension plan dropped to 11% from 18%.

Financial advisers say it is a good time for workers to assess their risk tolerance. But experts generally caution against changing investment strategy during market volatility—or trying to figure out which sector might see a recovery first.

Three times this year, the Dow Jones Industrial Average has jumped more than 3% in a single day. With moves like these, investors on the sidelines run the risk of missing the year's biggest gains; indeed, the Dow gained 4.5% in April, to narrow its loss to 3.4% year to date, through April 30, and 9.5% since its record close in October.

Piling into Treasury-bond funds isn't without risk, either. Many market pros think the bonds have become overpriced, and the danger is they could lose value if a lot of investors

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suddenly decide to sell their holdings.

Retirement accounts typically are heavily weighted toward stock mutual funds. But the total stock allocation among 401(k) participants declined to 63% in March from 68% a year earlier, according to the most recent Hewitt 401(k) index. Hewitt Associates Inc., a Lincolnshire, IL consulting firm attributes the decline largely to an unusually heavy volume of transfers—the most since the index began in 1997—into three fixed-income classes: money-market, bond and stable-value funds, which typically invest in bonds and interest-bearing contracts backed by insurance companies or other firms.

Even some younger workers, who have years to recover from market downturns, are finding they don't have the appetite for risk they thought they had.

Paring Contributions. Overall, 401(k) participation rates rose in 2007, with 74% of employees who have access to the plans investing in them, compared with 72% in 2006, according to Hewitt . But some employers are starting to see workers reduce allocations of pretax income to their accounts. In a recent informal survey by the National Association of Government Defined Contribution Administrators Inc. in Lexington, KY, nearly a quarter of 170 local governments that sponsor 401(k) plans reported that participants were lowering contributions because of economic stress or fears about the downturn.

While saving for retirement is still the top financial priority for households with incomes above $100,000, it is no longer the case among many people with annual incomes of $50,000 to $100,000, according to the Transamerica survey. This year's survey found that 37% in that group said their biggest priority is paying off their debt, up from 20% a year ago. Saving for retirement was cited by only 23% of those surveyed.

Proponents of the Pension Protection Act say it raises participation in 401(k) plans through automatic enrollment, thus helping workers save more. It also shields companies from lawsuits if they select certain combination stock-and-bond mutual funds as "default" investments for workers who fail to pick their own funds.

In the past, employers typically used money-market or stable-value funds as default funds. Now they often use target-date funds, which automatically shuffle a mix of stocks, bonds and cash based on an employee's planned retirement date. In a 2007 Hewitt survey of 302 large U.S. companies, half used target-date funds as defaults.

The shift means that some employees may have been automatically enrolled in riskier target-date funds just in time for the market turmoil. From early October through April, target-date funds for those retiring in 2030 or later were down an average of 8.7%, according to Morningstar Inc.

Michael Doshier, vice president of Fidelity's retirement-services division, says employees must be notified before being switched to a new fund and have the option of switching out.

If consulted about 401(k) strategy, many advisers say they urge clients to think long-term, particularly with many retirees expected to live into their 80s.

Counterintuitive Move. Many are asking, "Should I stop contributing for now?" says Gregory Ostrowski, of Scarborough Group Inc., Annapolis, MD. "It's one of the most counterintuitive things in the world, but these are relatively the best times to contribute new money because you're taking advantage of a sale," says Mr. Ostrowski.

Jennifer Levitz • The Wall Street Journal, May 5, 2008

B/Ds Dealing With Dwindling Numbers of Advisers

The number of financial advisers in the is U.S. has declined by 10,000 since 2005

The change occurred despite favorable demographic trends, according to the latest Cerulli Edge Advisor Edition—Recruiting Edition. "It seems surprising that an industry so remarkably poised to take advantage of the massive demographic shift of retiring Baby Boomers would actually be shrinking."

Not only are there fewer advisers active currently, those still working, and those entering the market, "are graying rapidly," Cerulli says. During the 1980s, more than 62% of advisers were under age 30 when they entered the industry; during the 2000s only 53% of new advisers were under age 30 when they started. Further, in 2007, only 3% of financial advisers were under the age of 30.

Part of the aging of the adviser population is because it has become a second-career for professionals, Cerulli notes. Many people coming into the profession were from related fields: Of the 78% of advisers for whom being a financial adviser was not their first career, 15.1% were in sales in another industry, 7.3% were insurance agents, and 6.5% were accountants or CPAs. The largest group, 31.7%, responded "other."

Cerulli research indicates that individuals in virtually any profession can end up as financial advisers. The diversity of previous careers is best exemplified by two survey participants (both of whom have books of business greater than $200 million in AUM) whose previous professions were "Chinese food take-out container salesperson" and "trader in the scrap steel industry."

In order to combat this trend, Cerulli notes that the industry needs to focus on programs that attract new advisers to become a part of existing teams.

Alison Cooke • Plan Advisor, May 1, 2008

College Planning Is New Advisory Niche

More than 1,300 are now certified to help parents tackle the admissions and funding challenge

Many high school seniors will be selecting the college they will attend next fall. Surprisingly, a small but growing number of financial planners and advisers are helping them make that decision.

"College planning can also be a great value-added for a practice," said Troy Onink, co-author with Lloyd Paradiso of *Strategy & Simplicity for Private School & College Funding*, which will be published next month by his company, Stratagee.com, a strategy and research firm based in Russell, PA.

"It can help client-building and client relations," Mr. Onink said. "College planning can bring in business that's a new source of assets under management and well as planning fees."

College planning "is one of the few recession-proof businesses in America," according to Rick Darvis, a co-founder and president of The National Institute of Certified College Planners.

Indeed, the skyrocketing cost of college, the fierce competition to get into schools and the difficulties of financing higher education, along with parents' anxieties, show no sign of abating.

In the past two years, NICCP membership has nearly doubled, rising to 700 last year, from 400 in 2005, Mr. Darvis said.

Over the same period, the NICCP has awarded 500 new certified college planning specialist designations, bringing the total to 1,300 since the organization was founded in 2002.

An opportunity to specialize in college planning has been enthusiastically received by many planners and advisers, but viewed with skepticism by others. And while some experts view college planning as an untapped opportunity for advisers, the specialty also has drawn harsh scrutiny from other college professionals.

Financial aid officers are wary of college planners "who overpromise what can be done for students or charge a fee to do what students and families, in cooperation with financial aid administrators, can do for free," said Philip Day, president and chief executive of the Washington-based National Association of Financial Aid Administrators.

"We are especially concerned about college planners who target low-income families," Mr. Day said. "Those families may be unaware that all of the resources they need to apply for federal and state financial aid are available free of charge through the student aid office at the college."

The NICCP, Mr. Darvis says, views itself as an educational organization that "doesn't charge parents one dime."

The organization "doesn't care" about financial aid, he said, because financial aid, he asserted, "is mostly debt."

"Anybody can get a loan. The question is, how do you pay it back?" Mr. Darvis asked. "We're concerned about proper financial planning," he said.

The NICCP advocates a variety of strategies designed to "reduce the financial impact of college [and allow parents] to maintain their lifestyle and long-term financial considerations," according to Ed Kinkopf, the organization's program manager.

Those strategies, said Mr. Darvis, include cash flow planning and utilizing tax incentives such as HOPE and Lifetime Learning earning tax credits and the Employee Educational Assistance Plan.

Reducing tax liability and paying for college with after-tax dollars, Mr. Darvis said, constitute one of the biggest opportunities for savings. He pointed out, for example, that the Internal Revenue Service allows business owners to hire their children who are attending college and then deduct the cost as a business expense.

Not a 529 fan. Surprisingly, Mr. Darvis isn't a huge fan of 529 college savings plans, which allow parents to save for college through a variety of investments and not pay taxes on earnings when the money is withdrawn.

The plans can be "part of the solution," he said, asserting that withdrawals from 529 accounts are "not automatically tax-free" if students receive other tax-free educational benefits.

Planners can receive a CCPS designation by passing three online tests after studying course material online, and paying a $1,485 fee, said Mr. Kinkopf. Most planners, he said, take six months or less to complete the course and receive the designation, and if they fail one of the tests they must retake it and pay an additional fee.

One of the challenges facing the NICCP is how many planners are willing to specialize in an area that has been traditionally perceived to be a small-ticket piece of business, in addition to being complex, with constantly changing rules.

"Those who do take the time to specialize in college planning can be well rewarded, said Mr. Onink.

"It's a market that's vastly overlooked," he said. "It's complex, and pulls from different disciplines, including investing assets, debt management, financial aid, college admissions and retirement planning."

By Charles Paikert • Investment News, April 28, 2008

The U.S. Retirement Market, Third Quarter 2007

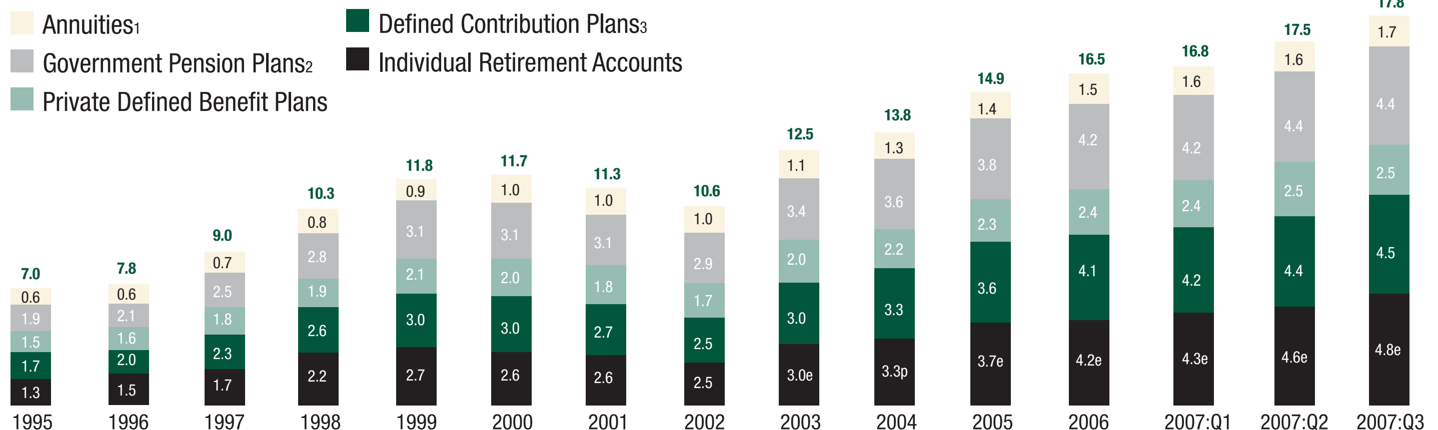
Key Findings

- **Total U.S. retirement assets climbed to $17.8 trillion as of Sept. 30, 2007, up from $17.5 trillion on June 30, 2007.** Retirement savings account for almost 40% of all household financial assets in the United States.
- **IRAs held $4.8 trillion at the end of the third quarter of 2007, up from $4.6 trillion at the end of the second quarter.** Mutual funds manage 47% of IRA assets.
- **Americans held $4.5 trillion in all employer-based defined contribution retirement plans, of which $3.1 trillion was held in 401(k) plans, on Sept. 30.** Those figures are up from $4.4 trillion and $3.0 trillion, respectively, on June 30.
- **Mutual funds managed $2.4 trillion in assets in 401(k), 403(b), and other defined contribution plans at the end of the third quarter, up from $2.3 trillion at the end of the second quarter.** Mutual funds manage 53% of defined contribution plan assets.
- **Lifecycle funds, which typically rebalance their portfolios to become more conservative and income-producing by a specified target date, continued to grow rapidly.** They managed $168 billion at the end of the third quarter of 2007, compared to $153 billion at the end of the second quarter. Almost 90% of assets in lifecycle funds are held in retirement accounts.
- **Lifestyle funds, which mix equity and fixed-income investments to maintain a predetermined risk level, managed $234 billion on Sept. 30, up from $221 billion on June 30.** Almost half of lifestyle fund assets are in retirement accounts.

Readers should refer to The ***U.S. Retirement Market, 2006*** *at http://www.ici.org/pdf/fm-v16n3.pdf for detailed information on the methodology, data sources, and interpretation of the Institute's reports on retirement assets.*

U.S. Retirement Assets Reach $17.8 Trillion

Trillions of dollars, end-of-period, 1994–2007:Q3



e=estimated p=preliminary

1 - Annuities include all fixed and variable annuity reserves at life insurance companies less annuities held by IRAs, 403(b) plans, 457 plans, and private pension funds (including 401(k) plans).

2 - Government pension plans include federal, state, and local pension plans. Federal pension plans include U.S. Treasury security holdings of the civil service retirement and disability fund, the military retirement fund, the judicial retirement funds, the Railroad Retirement Board, and the foreign service retirement and disability fund. These plans also include securities held in the National Railroad Retirement Investment Trust and Federal Employees Retirement System (FERS) Thrift Savings Plan (TSP).

3 - Defined contribution plans include private employer-sponsored defined contribution plans (including 401(k) plans), 403(b) plans, and 457 plans. note: Components may not add to the total because of rounding.

sources: Investment Company Institute, Federal Reserve Board, National Association of Government Defined Contribution Administrators, American Council of Life Insurers, and Internal Revenue Service Statistics of Income Division

Investment Company Institute, April 2008

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