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The Pretirement Press

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When most people think about Employee Benefits, especially during the current political debate over the healthcare system and the recent happenings in financial markets, they think of their health insurance and their retirement plan. Of course these are two important components to any benefits plan, but for many people, the benefits provided by their employer or their small business can include much more. As summer unwinds and we move into benefits enrollment season for many, this issue will discuss healthcare options, life insurance, disability, 401k's, flexible spending plans, and a host of other potential benefits. Since benefits vary greatly by employer, clients are encouraged to contact us directly if you have questions regarding your specific benefits enrollment and how it fits with your overall financial plan. As always, this issue will also conclude with the customary financial market update. Now, for your benefits… ■

Healthy Wealthy & Wise

In 2009, average health insurance costs were projected to rise by another 6-7% to $8,863 per person. While the average employer pays for ~75% of those costs as an employee benefit, it still leaves ~$2k in premiums to be paid by the individual. With corporate profits under pressure, more healthcare regulation, and possible changes in the laws that provide for non-taxability of employer sponsored health plans, it seems reasonable to expect that more of those costs will be passed on to the employee in the future. One way to control some of these costs is by making sure you're selecting the lowest cost plan that is suitable for you. Most plans can be broken down to four basic costs: the amount you have to pay until insurance coverage starts (deductible), the % of the bill your insurer will pay after you meet the deductible (co-insurance), the maximum amount you could pay each year (out-of-pocket max), and your premium (cost of the insurance). If you're healthy, it may make sense to select a plan that has higher costs when you need care (deductible, copays, coinsurance, etc.) as long as there is still an out-of-pocket maximum that you can afford in the event of catastrophe. In return, you get a policy with a lower premium. For example, take the following plans:

Plan	Deductible	Coinsurance	Out-Of-Pocket Max	Per Pay Period Premium (paid every 2 weeks)
1	$ 500	85%	$ 5,000	$ 115.38
2	$ 1,000	80%	$ 5,000	$ 86.54
3	$ 3,000	100%	$ 3,000	$ 48.08

Many people would be tempted to go with plan #2 which has a "reasonable" premium (compared to #1), and a deductible that's not too high. But, with plan #3, you'd be saving $1,000 per year in premiums and your maximum out of pocket cost is $3,000 instead of $5,000, which might make it best for you. Working through a few scenarios with your advisor can help you find the best plan for your situation. Of course flexibility of the plan (open, PPO network, HMO network), covered services, and other characteristics also play a role in the plan's value to you. Whatever type of plan you decide on, taking an active role in understanding your options and their costs is most likely to provide the biggest benefit. ■

The Top 10: Employee Benefits Mistakes

1) Holding too much employer equity (see *Buyer Beware* below).

2) Not contributing enough to your retirement plan to get the full employer match. For example, if your employer matches 50% of the first 6% you contribute, then contributing less than 6% of your salary is turning down free money.

3) Picking your retirement plan funds based on their recent performance, or using the "a little bit of each" strategy. Even the fund managers will tell you "past performance is not an indicator of future results" yet many people still use this as their primary guide for selection. Studies have shown that the two biggest contributors to a successful investment plan are minimizing fees and setting an appropriate asset allocation (% stocks vs. % bonds). These are also the two beiggest components in the PWA approach to 401k management.

4) Being self-employed and assuming you can't have those things typically covered by employee benefits at tax-advantaged and/or group rates (see *Small Business, Big Needs* below).

5) Believing that putting all your retirement money in a Target Date Retirement Funds will manage your retirement savings appropriately. (see *Hot Topics: Target Date Funds in Your 401k* below)

6) Not enrolling in company paid or company subsidized benefits like short and long-term disability. Many employers provide these benefits at no cost or substantially reduced cost to employees, but require you to enroll annually in order to get the benefit.

7) Over-paying on health insurance premiums to avoid a deductible. For some reason, it hurts more to pay doctor bills than to pay insurance premiums as a deduction from a paycheck. Logically though, what matters is the total annual amount spent on healthcare and that can often be obtained through a low-premium, high-deductible, low-out-of-pocket max plan. See *Health Wealthy & Wise* above.

8) Assuming life insurance through your employer will remain active and at the same premium if your employment is terminated. While the rules are different by state and by plan, in many cases your life insurance can be terminated by your insurer or your premium can increase significantly when your employment terminates and you attempt to port the policy to individual coverage. This means that if you your health deteriorates and you want to leave your employer, you may not qualify for insurance on your own (the good-old "you're uninsurable" response, or you have to pay a lot more for it. In most cases, we recommend accepting employer insurance provided at no cost, but purchasing optional insurance through an independent insurer.

9) Having children in daycare and not participating in a dependent care flexible spending plan (see *Did You Know: Lower Taxes w/ Flex Spending* below)

10) Contributing too much to your retirement plan. Yes, this is possible and we've seen people do it more than once. Contributions to a 401k at the same time you're significantly increasing high interest debt (like a 20% credit card) or large contributions to a 401k prior to establishing an appropriate emergency fund are usually not financially sound. ■

Did You Know: Lower Your Taxes With Flexible Spending Plans

Many employers allow their employees to participate in a Healthcare Flexible Spending Plan and / or a Dependent Care Flexible Spending Plan. These plans allow you to contribute tax-deductible dollars from your paycheck into an account you can then use to pay for medical or childcare expenses. The example below shows how the plans can save you money (using dependent care as the example, but a similar calculation can be done for medical expenses).

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	Without FSA	With FSA
Gross Income	$ 100,000	$ 100,000
Dependent Care Flexible Spending	$ -	$ 5,000
Other Pre-tax Deductions	$ 10,000	$ 10,000
Taxable Income	$ 90,000	$ 85,000
Tax Rate	$ 0	$ 0
Net Income	$ 63,000	$ 59,500
Childcare Expenses Paid Out of Pocket	$ 10,000	$ 5,000
Cash Flow After Childcare Expenses	$ 53,000	$ 54,500

In the example, $5k is contributed to the flexible spending account and that $5k is used along with $5k out-of pocket to pay for the $10k overall childcare bill. Because the tax benefits of contributing to the account, the net after-tax effect is a $1,500 savings simply by making an election to participate during benefits enrollment.

The IRS allows a maximum family contribution of $5k to a medical flexible spending account and $5k to a dependent care flexible spending account. Both of these accounts have a "use-it-or-lose-it" restriction, which means that any amounts contributed in one calendar year that are not spent by 3/15 of the following calendar year are forfeited. Therefore, it usually makes sense to determine the amount that you will definitely spend on medical and childcare costs (childcare usually more predictable) and contribute that amount to flexible spending account. Note that there are special rules as to what qualifies as a childcare expense (in-home care can count), or a healthcare expense (over-the-counter prescriptions and elective procedures can count but Congress is rethinking this) so discuss your situation with your advisor before enrolling.

From an administrative point of view, most plans are fairly easy to use. Medical plans frequently provide participants with a debit card that can be used to pay the out-of-pocket healthcare expenses. Payroll deductions go in and the debit card is used to spend the amount contributed. For childcare, withdrawals from the flexible spending account can be accomplished in a number of ways, the easiest of which is usually providing a statement of expenses to the provider who them reimburses you either through your employer's payroll or by sending you a check. With very little administrative effort, no cost, and potentially big tax savings, flexible spending plans are usually an easy way to keep an extra couple of thousand dollars every year. ■

In Focus: Contractors vs. Employees

The IRS is cracking down on employers who improperly define their employees as contractors to avoid having to pay Social Security, Medicare, unemployment, and workers' compensation taxes. This classification is also used by employers to avoid providing workers with benefits like a group medical plan. Contrary to popular belief, neither a worker nor an employer can just decide to be a contractor vs. an employee. Instead, the IRS has guidelines that define the classification based on the degree of the employer's control and the employee's independence. These guidelines determine the method of payment and taxation for the relationship and they fall into three major categories:

1) Behavioral: Does the company control or have the right to control what the worker does and how the worker does his or her job?

2) Financial: Are the business aspects of the worker's job controlled by the payer? (these include things like how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.)

3) Type of Relationship: Are there written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.)? Will the relationship continue and is the work performed a key aspect of the business?

Further details on each category can be found on the IRS website. If you are an employer that hires contractors, be warned. More and more employers are being investigated, and stiff penalties are being assessed for misclassification of resources. If you are a contractor, don't be surprised if your employer pushes you toward joining the company full-time. It could be for this very reason. ■

Buyer Beware: Employer Stock

Many public companies use their stock to compensate employees. Whether in the form of restricted shares (RSU's), options, or the ability to participate in employee share purchase plans (ESPP's), employer stock provides a benefit to employees as a substitute for cash (or additional cash above and beyond their salaries). While there are a number of positives and negatives to this compensation strategy, the biggest risk to the employee is accumulating a significant portion of their net worth in the company that they already rely on for their salary, raises, bonuses, and additional equity compensation. As we've seen now with Enron, WorldCom, Bear Stearns, Lehman Brothers, and a variety of dot-com companies, if something goes wrong in your company and you hold your assets in that company's stock, not only may you lose your job, but also your savings too (exactly at the time you need them).

> *"Formalizing a strategy that limits your exposure to employer stock is essential to avoiding a potentially catastrophic financial event..."*

From a financial planning perspective, it makes much more sense to diversify into a broad portfolio or individual investments that have a low correlation to the company that provides your well-being.

We use the following rules of thumb as a starting point for developing a strategy around how to handle clients' employer stock:

1) Under no circumstances should more than 10% of your liquid worth or 10% of your retirement funds be invested in your current employer's stock.

2) For restricted shares or employee share purchase shares, sell them when they become sellable (i.e. when vested or when holding requirements are met). Alternatively, sell them after they've met the requirement for long-term capital gains (usually after one-year).

3) For employee stock options the sell decision is more complicated as there is a large trade-off to holding on to them.

- Positive: Limited downside, but unlimited upside appreciation. This effect begins to fade as the option gets further in the money and as expiration approaches.
- Negative: May act just like an undiversified holding in your employer's stock. This effect gets more negative as the implicit value of the options become a greater portion of your overall portfolio.

Given these trade-offs, we developed an option exercise guideline that is a function of the time remaining until expiration, % in the money, % of portfolio, underlying stock volatility, and the investor's risk tolerance / goals which would determine the target risk of the rest of the portfolio. Due to the complexity of this decision, contact your advisor for specific recommendations on your options.

4) In general, when it is the right time to exercise an employer stock options, we recommend using a cashless exercise to obtain the value difference between the current share price and the option strike price rather than purchasing the shares

5) Participale in ESPP's only if the purchase price is at least a 10% discount from market with a holding requirement of one year or less, or if there is any discount from the market price and there is no holding requirement.

Whatever the form, history has shown us the dangers of unmanaged equity compensation. Formalizing a strategy that limits your exposure to it is essential to avoiding a potentially catastrophic financial event that could simultaneously destroy your income production and savings. ■

Hot Topics: Target Date Funds in Your 401k

Given the massive declines in the stock market over the past two years, 401k's and other employer sponsored plans have come under scrutiny for their ability to prepare America's workforce for its retirement years. One of the most controversial parts of 401k thus far has been so-called Target Date Retirement Funds. PWA doesn't use these types of funds in managing your investments, but we thought it would be helpful to explain why we don't and why they're getting such criticism. Now part of over 75% of 401k plans, Target Date Funds are a type mutual fund that allows investors to align their retirement date to the target retirement date of the fund. For example, if you are currently 40 years old and plan to retire around age 60, you might choose to put your 401k balance into your fund provider's 2030 Retirement Fund. This is essentially a fund of other mutual funds that starts with a fairly aggressive allocation and moves to a more conservative one as you get closer to retirement in 2030. In theory, this should leave you with the nest egg you need to live comfortably in retirement via a "set it and forget it" investment that does not require further monitoring or thought on your behalf.

> *"A recent survey showed that 38% of investors believe Target Date Funds pay a guaranteed return that will enable their retirement..."*

PWA fully supports the concept of getting more conservative as you get closer to retirement, but the level of aggressiveness should not be based solely upon the individual's age. It should also be based upon their asset level and their plans for retirement. For example, take Al, a hypothetical 53-year old investor who, at the end of 2007, worked with his financial planner and determined that he'll need approximately $1.5M to retire comfortably at his goal, age 60. Al had accumulated $1.4M in his 401k over a long-career of consistent saving, almost the entire amount needed to retire. He decided to invest his 401k balance in Vanguard's Target Retirement 2015 Fund, an already diversified fund which targets his retirement year. With a well-respected fund provider like Vanguard, in a tax-advantaged 401k, almost the amount needed to retire, and a fund made almost especially for investors his age, this appears to be a simple and effective solution - a no-brainer to Al. What Al doesn't realize is that this fund contains more than 60% stocks and is not engineered to protect his wealth with conservative investments.

Price of Vanguard Target Retirement 2015 Fund (Jan '08 - Mar '09)

From Jan 2008 to March 2009, Al's fund decreased in value by 32%!!! By the time Al looks at his March 2009 401k statement, he sees that his 401k has fallen to $950K with only 5 years to retirement and what should have been an easy target to hit two years ago, has been made much, much harder. What's more, he now panics and moves to a more conservative fund so that he doesn't lose and more money just as the market hits bottom and starts to turn around. Clearly, the seemingly no-brainer choice of a Target Retirement Date Fund left something to be desired.

While Target Date Funds probably do have their place in 401k plans, and they are far better than a whimsical selection of investments based on past 1, 3, and 5-year performance, they tend to mislead inexperienced or poorly advised investors into believing that simply matching the date of desired retirement to the target date of the fund will ensure success. A recent survey showed that 38% of investors believe Target Date Funds pay a guaranteed return that will enable their retirement. But as Al discovered, there are no guarantees and there is no shortcut to managing your retirement funds. ■

Small Business, Big Needs

All this talk of the advantages of employee benefits doesn't do a whole lot for the self-employed, business owner, or contractor, since they don't have employee benefits. If you're already in this camp, as a PWA client, your plan reflects the points in this article already. But, if you are currently an employee (or unemployed) and thinking about breaking out on your own, here are the things you should consider:

- The self-employed have to pay both the employee and employer's share of social security and medicare taxes. That's an extra 7.65% of salary.
- Self-employed individuals can still have an employer sponsored retirement plan like a solo-401k, SEP, or SIMPLE. Which one is best depends on your goals, business structure, number of employees, and earnings potential.
- You won't qualify for a group health plan until you have at least two employees, but there are high-deductible, relatively low-premium individual plans available (assuming you're insurable). And, premiums are tax-deductible for the self-employed. Alternatively, you may be able to rely on a spouse's coverage or COBRA coverage from a previous employer for up to 18 months.
- Group long-term disability plans and group term life insurance are available through many professional associations and offer discounted rates similar to those available to you through an employer.
- You probably won't be able to set up a dependent care flexible spending plan unless you have a few employees, but if you have a high-deductible health insurance plan, you can still use the concept of a healthcare flexible spending account through a Health Savings Account (HSA).

You'll need to make 10-20% more in business for yourself to have the same post-tax, post-benefit earnings as an employee. PWA has helped clients come up with a more precise calculation, so if you're making a decision, contact your advisor for assistance. If you're just doing some high-level thinking, 15% is a good number to use. ■

I've Fallen And I Lost My House - Long-Term Disability

Having short-term disability coverage, often provided by your employer or your state, is not enough. Most people need long-term disability coverage that will replace a portion of their salary after a specified waiting period until their normal retirement date. While this can be expensive, many employee benefit plans include employer subsidized group rates that can lower the bill. If you were given the choice between 1) 100% of your salary while you're able to work and no salary if you're unable to work, or 2) 98-99% of your salary while you're able to work and 60% of your salary for the rest of your work life if you're unable to work, which would you choose?

In most cases, PWA believes the 1-2% cost of insurance in option 2 is worth the protection against permanently losing your income. Consider that one 1 of every 3 Americans can expect to have a sickness or disability lasting at least 90 days at some time during their career (Source: Society of Actuaries) and that prior to the latest recession, 46% of all foreclosures were brought about by a disability (Source: US Dept. of Housing and Urban Development).

> *"...prior to the latest recession, 46% of foreclosures were brought about by a disability."*

Every case is different, so discuss yours with your advisor, but by default, if you are more than 5 years from retirement, your employer offers group long-term disability coverage of at least 50% replacement of your income, you are not "independently wealthy" and just working for fun, and the annual premium is less than 1.5% of your annual salary, you should probably accept coverage. ■

Markets: Less Bad Is Good… For Now

Markets At A Glance

Segment*	2008	Last 3 Months	YTD 2009	
US Large Cap Stocks	-36.8%	11.3%	14.9%	thru 8/31
US Small Cap Stocks	-36.1%	15.5%	23.1%	thru 8/31
Foreign Developed Stocks	-41.4%	13.7%	20.2%	thru 8/31
Foreign Emerging Market Stocks	-50.0%	7.0%	42.5%	thru 8/31
US Treasury Bills	1.8%	0.0%	0.3%	thru 8/31
US Med Term Treasuries	18.0%	1.1%	-5.1%	thru 8/31
US Long Term Treasuries	33.8%	3.6%	-17.3%	thru 8/31
US Aggregate Bond Index	5.2%	3.1%	2.5%	thru 8/31
US Corporate Bonds	0.3%	9.1%	7.4%	thru 8/31
US High Yield Bonds	-23.9%	8.8%	16.1%	thru 8/31
US REITs	-37.0%	22.3%	11.6%	thru 8/31
Gold	3.0%	-3.5%	8.0%	thru 8/31
Oil**	-54.7%	5.0%	63.3%	thru 8/31
Aggregate Commodities	-36.7%	-0.2%	7.5%	thru 8/31
US Home Prices	-18.6%	1.3%	-5.8%	thru 6/30
GDP Growth	-6.2%	0.0%	-1.4%	thru 6/30
Unemployment Rate***	7.2%	9.4%	9.7%	thru 8/31
Inflation (CPI) Y/Y	0.1%	0.9%	0.3%	thru 8/31

*All asset returns shown are returns by representative ETF except oil
**Oil returns measured by front month futures contract
*** Indicates ending value rather than change

What do you get when the economy loses 250k jobs per month instead of 600k, when housing prices are only down 15% over the last year instead of 20%, and when GDP is shrinking at an annual rate of 1% instead of 6%? You get the continuation of the biggest stock rally since the end of the Great Depression. Virtually all asset classes (with the exception of long-term government bonds) have had a fantastic run since March of this year. But, just as we reminded clients that the end of the financial world was unlikely when the worst was upon us, we also must not get too optimistic when markets are soaring and recovery seems imminent. We have seen some dramatic improvements of late, but we believe that cautious optimism is currently the best stance from which to view the market and the economy. Caution tends to trump greed as an emotion and to the direct contradiction of "Wall Street"'sGordon Gecko, for investors, greed is bad.

So what is there to be cautious about? First, while it is clear that getting "less bad" is a necessary condition for economic recovery, it is not a sufficient one. We will soon have to see more than just a slowing of the deterioration in order for the market to thrive. We will need to see expansion in manufacturing & services, hiring in the private sector, and overall growth in GDP. We have seen a massive jump in productivity measures lately, which will help to make growth a reality going forward, but it hasn't happened yet.

Next, for the past several quarters, we've seen corporate profits holding up better than expected, but only through dramatic cost-cutting. Businesses in aggregate have stayed ahead of their declines in revenue by downsizing their headcount, marketing, administration, and research & development. Cost-cutting though can only go so far and when everyone's doing it, can tend to hurt the overall economy through higher unemployment. At some point, revenue growth has to return and propel profits instead.

Another reason for caution is that while the banking sector may have stopped the bleeding for the time being, banks are still holding mortgages and other debt that continues to deteriorate as the number of foreclosures, defaults, and principal modifications add up. To paraphrase a recent quote (the author of which I cannot determine), the problem with bank balance sheets is that there's nothing left on the left (i.e. few assets), and there's nothing right on the right (i.e. liabilities that are not valued appropriately due to their complexity and the fear of insolvency if they are valued appropriately). Banks provide the oil that the economic engine needs to run effectively and until they heal, it will be difficult to move full-speed ahead.

Finally (and probably most importantly), there is the government intervention aimed at avoiding financial collapse. It has succeeded in its mission to date, but the difficult part will come in reining back that involvement. The Fed continues to buy mortgages and print money to keep interest rates near all-time

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Congratulations to our multiple clients who bought homes in the past few months, a major accomplishment in this economy!!

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lows and support the fiscal deficit. Congress and the Treasury continue to borrow money to fund the programs created by the stimulus plan. Government money has poured into banks and continues to payout on the guaranteed deposits of failed banks via the FDIC (which is seeking new funding of its own). Government jobs have been created to offset some of private sector losses. The first-time homebuyer tax credit has helped to stabilize the housing market though a subsidizing of the required downpayment to buy a home. Cash For Clunkers has temporarily helped the auto market. But, all of this spending, capital injecting, borrowing, and subsidizing will need to be reversed at some point. Whether the economy is ready to breathe on its own once the fiscal and monetary life support is turned off, whether the taxpayer can handle higher taxes, and whether foreign nations will continue to lend to the United States at incredibly low rates in the meantime all remains to be seen.

So, we're left with cautious optimism. Many have seen their accounts increase substantially over the past 6 months, undoing much of the damage of the previous 18. But now is not the time to get complacent or greedy. Just like we rebalanced your accounts back to their target allocations by buying stock on the way down, we're rebalancing by buying bonds (and selling stock in some cases) on the way up. That rebalancing provides a natural buy low / sell high algorithm for portfolios and increases the probability of achieving your goals. This, along with the solid foundation of a cash emergency fund, money for your short-term goals invested heavily in the safety of bonds, and your continued adherence to your plan will keep that probability high in good and bad markets. In the coming months, we'll be scheduling a formal check-up with you to review your plan, adjust where necessary, and set targets for 2010. Until then, have a great Fall season. ■

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