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I. Retirement "Aces in the Hole"

Here, as quoted from the recent *Fortune 2005 Retirement Guide*, are two ideas for stretching your investments in retirement. Consider these if your investments (or the investments of someone you know) come up shorter than needed for financing retirement.

A. "How to Get Dough While Staying Put"

"Moving to a cheaper place when you retire may make financial sense. But what if you want to stay in your current house? A product called a reverse mortgage can help. It taps the value of your home to give your retirement income a boost—especially useful if you're house-rich and cash-poor.

"Reverse mortgages are mirror images of the regular kind. A bank lends you money against the value of your house; you can take a lump sum, a line of credit, or regular monthly checks. But you make no payments. All charges and interest (typically around 5.5%) are added to the amount of the loan. You, not the bank, own the house, and you can keep living there until the day you die or leave for good (to go to a nursing home, for example). Then the loan is repaid from the proceeds from the sale of the house, probably by your estate. If the house sells for more than the loan amount, you or your heirs pocket the difference. If the house doesn't sell for enough to fully repay the loan, that's the FHA's problem—the FHA insures most such mortgages.

"Reverse mortgages are offered by a handful of big banks and mortgage lenders. The older you are and the more your house is worth, the more you can borrow (see aarp.org/money/revmort/). On a $250,000 house, for example, a 70-year-old can get a check for $802 a month (the amount adjusts every year based on interest rates) for as long as he or she lives. An 80-year-old can get $1,192. So rather than scheming to cash out of this fantastic housing frenzy, consider staying put, collecting checks, and letting the FHA take the risk."

Smartt comment: if you leave the house for longer than one year, generally, the mortgage comes due. Because of the front end fees involved, this is not a step to be taken lightly. I'd be glad to discuss with you the possibilities. Note that this "ace in the hole" and the one which follows both may allow an investor saving for retirement to take more investment risk (with the prospect, but not the guarantee) of higher investment returns, using one of these approaches if stock and/or bonds don't do as well in the coming decades as they have in the past.

B. "How an Annuity Can Protect You"

"When it comes to retirement planning, few investment vehicles generate the confusion annuities do. The most basic annuity, known as an *immediate fixed lifetime annuity*, works like this: You pay an insurer a lump sum—usually upon retiring—in exchange for regular payments until you die. (These aren't to be confused with variable annuities, which give you payouts that depend on market returns, or deferred annuities, savings vehicles that begin paying out years after an initial deposit.) Here's an example: In

exchange for a $500,000 lump-sum deposit into Vanguard's 'lifetime income annuity', a 65-year-old man would collect $3,221 a month for life. (The monthly payment for a 65-year-old woman would be slightly lower; if you choose an annuity that continues for your surviving spouse, the payments are lower still.)

"Many annuities offer a dizzying array of options, from inflation-adjusted payouts to complicated withdrawal provisions. As baby boomers near retirement, brokerage houses…and mutual funds are marketing products with confusing new bells, whistles and names so clever…that you'd think you were buying the guarantee of happy sunset years rather than a simple stream of income. Indeed, many financial pros have long been wary because they're so complicated it can be almost impossible to figure out whether they're a good deal. What's more, with an annuity you typically lock yourself into a prescribed return, you forgo easy access to your money, and your heirs often receive nothing when you die.

"And yet, with the disappearance of traditional pensions and questions about Social Security, annuities' guarantee of lifetime income is looking more appealing, even to the pros. If you decide an annuity is the way to go, invest just a portion of your retirement savings—say 25% to 50%; keep the rest in standard vehicles like…mutual funds."

Smartt comment: Although mentioned above as a complication, I believe that accepting a smaller initial benefit payment which is indexed to (increases with) inflation is superior protection to a flat benefit payment. Lot's to think about here too. I'd be pleased to assist you, your family, or your acquaintances to consider either of these above "aces in the hole."

Using an annuity for part of your income in retirement largely frees you from worry about the future course of stock and bond prices for that part of your retirement income. This virtual guarantee may well allow you to take more investment risk with the rest of your retirement investments (and feel more confident in doing so). Call or email me for further discussion.

Note well, I do not recommend using annuities as tax-deferred investments because of their very high costs, inflexibility, and negative estate tax consequences. Better, lower cost alternatives are available.

II. What Are OUR and THEIR Asset Allocations?

Each of us has a different ability to live with uncertainty (risk) and so our investments will be different:

As of June 30, 2005	Clients	The Smartts
Money Market Funds	1.3%	0.0%
Bond Funds	35.1%	4.1%
Stock Funds	63.6%	95.9%
Totals	100.0%	100.0%

I continue to believe that for long periods of time, a decade or more, the risk of stock-based mutual funds within an investment portfolio is smaller than investors generally believe, and the risk of bond-based mutual funds is larger.

For bonds, the issue is the rekindling of inflation. We haven't seen much inflation in the last decade or so, but historically, inflation has averaged almost 3.5% per year, within the USA, throughout our 200+ years of economic history. At this average rate, the value of each dollar is halved in 20 years and halved again in the next 20; a real issue with retirement and the longer lifetimes we are living.

We are all pleased with investment "risk" when stocks are going up and become rather easily scared when stocks go down. One of the functions of an investment advisor is to provide both long term perspective and reassurance during the rough patches. If I can assist you further to quiet your fears as you deal with the *inevitable* rough patches in bearing investment risk, please let me know. (As we've seen in the last several years, there are even rough patches to owning CDs; e.g. even beyond inflation, what to do with your $$s when the CD matures and the rates then being offered seem unreasonably low).

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III. Vanguard Rates of Return (through June 30, 2005):

Performance percentages are per ***Morningstar.*** Amounts in parentheses are percentile rankings (1= best and 100= worst) within category.

Periods ended June 30, 2005	Yr. to date		5 Years		10 Years	
500 Index	**-0.9%**	(56)	**-2.5%**	(52)	**9.9%**	(21)
Tax-Managed Growth & Income	**-0.8%**	(53)	**-2.4%**	(50)	**10.0%**	(18)
Total Stock Market Index	**-0.3%**	(37)	**-1.4%**	(34)	**9.8%**	(32)
Tax-Managed Capital Appreciation	**0.5%**	(16)	**-3.5%**	(17)	**9.8%**	(16)
Extended Market Index	**2.0%**	(45)	**1.7%**	(85)	**10.6%**	(63)
Tax-Managed Small Capitalization	**1.9%**	(26)	**10.5%**	(46)		
Small Capitalization Index	**0.9%**	(43)	**6.4%**	(73)	**10.5%**	(76)
REIT Index	**6.2%**	(37)	**19.6%**	(43)		
Tax-Managed International	**-1.5%**	(48)	**-0.7%**	(27)		
Balanced Index	**0.9%**	(30)	**2.6%**	(36)	**8.7%**	(36)
Total Bond Market Index	**2.5%**	(17)	**6.9%**	(38)	**6.6%**	(24)
High–Yield Corporate Bond	**0.8%**	(28)	**5.8%**	(53)	**6.6%**	(27)

For comparison, here are several stock and bond benchmarks:

Periods ended June 30, 2005	Yr. to date	5 Years	10 Years
S & P 500 (large stocks)	**-0.8%**	**-2.4%**	**9.9%**
Russell 2000 (small stocks)	**-1.3 %**	**5.7%**	**9.9%**
Lehman Brothers Aggregate Bond Index	**2.5%**	**7.4%**	**6.8%**
CS First Boston High-Yield Index	**0.8%**	**8.5%**	**7.6%**

IV. Past Performance and Our "Pre-Wired" Brains

Without a bit of guidance, many of us select our investments based on past performance. But consider, as quoted in the May 2005 issue of *Financial Planning Magazine*, "evidence from Wilshire Associates. The Santa Monica, Calif., firm identified the small-cap value [mutual fund] managers who performed in the top quartile (top 25%) of their category during the five years ended 1997 and tracked their performances over the following five years. The results show that our pre-wired brains just get it wrong. Past performance is, in fact, an extremely poor predictor of future results. Of the mangers who delivered top-quartile returns during the first five-year period, just 21% managed to do the same during the second five-year period. Amazingly, a full 50% of these fund mangers posted bottom-quartile (bottom 25%) returns."

We ought to take away three lessons from these findings, the article continues,

A. "Although we say we're long-term investors (and we truly believe it), we are constantly tempted to react to short-term influences.

B. "We want to invest in asset classes that are currently performing well, and

B. "We want to avoid or even sell any asset classes that are currently not performing well."

Smartt comment: After stocks as a whole have gone down in price, they are a better buy than when the prices of stocks are very high. But this is the exact point when financial news is largely negative and when our fears come to the forefront. What to do? Find an asset allocation which suits you and an independent advisor to assist you on your path. I'd be pleased to assist others you know who are in a quandary regarding their long-term financial future.

I am proud of my clients. Together, we stand against the tide of short-term news, worries. Together, we build our investments toward a future which meets our financial objectives. (Or we continue, in retirement/semi-retirement, to take measured investment risks without angst, without significant financial worry.)

Here's another bit of evidence: Over the four years from 1998 to 2001 the average stock-based mutual fund generated a 5.7% annual rate of investment return. According to a 2002 *Money Magazine* article, in every category except two (equity income mutual funds and utilities funds) "investors earned less than their fund did. While the period…was unusually volatile, researchers have documented these trends in calmer times as well. 'It's terrible how much money was destroyed,' laments Lawrence Siegel of the Ford Foundation. 'If investors earned the rates of return that the funds report, we'd all be rich. And why aren't we all rich? Because people keep shooting themselves in the foot by chasing hot funds that just can't sustain their performance.'"

Smartt comment: John Bogle, founder of The Vanguard Group of mutual funds, uses a concept called "regression to the mean" to assist in explaining that mutual fund investment managers who appear to being a super job during one period may just be lucky, that their mutual funds have a higher than average chance of lagging the performance of like fund in future time periods.

Further, one of the foundations of my practice is that the only portions of past performance which are worth studying are the costs of that performance. Costs to watch for include: commissions and brokerage fees, 401(k) plan costs being charged to your account, mutual fund annual expense levels and the costs of portfolio turnover within mutual funds. Finally, income taxes on dividends, interest income, and on capital gains distributions can significantly slow the accumulation of investment values. High past costs tend to predict high future costs—stay away. Low past costs tend to predict better future performance.

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