I recently returned from a trip to France. While we certainly enjoyed ourselves, it was impossible not to have sticker shock wherever we went. If a dollar sign had preceded the numbers on menus, gas pumps, and price lists instead of the euro sign, the sticker shock might not have felt so painful. It now takes nearly $1.50 to buy one euro. With higher prices in Europe generally, coupled with the 50% premium due to the exchange rate, costs seemed to double. A cup of coffee was more than $5.00 in Paris, and it cost nearly $100 to fill up the small rental car. On my last trip to France about six years ago, the cost of a euro was closer to $1.20, which represents a decline in the value of the dollar during that time of about 25%. The dollar has declined against the euro even though the Euro-zone has experienced slower economic growth than the US.

The dollar started its current downward slide in 2002. The dollar gained in value during the recent recession and resumed its decline in early 2009. Pictured on the following page is a graph of the Dollar Spot Index from January 1, 2002 to present. This index tracks the spot price of the dollar versus a large basket of currencies.

There are a number of reasons behind the dollar’s steady drop in value. The Federal Reserve has maintained low interest rates in the U.S. compared with higher rates around the globe. In addition, the massive federal budget deficit has undermined confidence in the currency and was a basis for S&P to revise its outlook for the creditworthiness of our country to “negative” earlier in the quarter. In 2002, the federal deficit was about $6.2 trillion. Today, it stands in excess of $14 trillion. US creditors have been gradually exchanging their dollar denominated assets into assets valued in other currencies in order to protect themselves from further losses.

Following the end of World War II, global trade grew exponentially and the dollar emerged as the world’s reserve currency. As global wealth grew, the global demand for dollars expanded as well. But over the past decade or so, emerging markets have grown to the point where their economies have become more stable and the value of their home currencies more reliable. Central banks which traditionally held large dollar reserves have signaled their intention to reduce their holdings so that their dollar holdings are not out of line with their trade and financial exposures.

We are witnessing a huge unwinding of the dollar.
positions of countries around the world. As Mark Dow, a portfolio manager of the Pharo Management hedge fund has stated: “The stock adjustment will continue until a new equilibrium is found. The dollar is some 63% of global reserves, but the US is now only 20% of global output.” This great dollar unwinding helps to explain why the dollar has declined against both the euro and the yen even though the European Union is experiencing major fiscal problems within member countries and Japan has suffered through 20 years of anemic growth.

A weaker dollar hits domestic consumers in their wallets by raising the cost of imported products, particularly the price of oil. On the other hand, a weak dollar gives a boost to U.S. companies that export their products overseas, by making their products more competitively priced. A weak dollar has also been good for U.S. stocks, as foreign investors have found U.S. stock prices to be relatively cheap because of the strength of their currencies. While stock prices have increased, the value of the dollar has declined, and as U.S. stocks are priced in dollars, their real value relative to other global assets has not increased nearly as much as might be apparent.

The primary effect of a weak dollar has been to reduce the purchasing power of the currency, as I can personally attest based on my recent trip abroad. According to Walker Todd writing in the American Institute of Economic Research, “The rate of decline in the purchasing power of the dollar tended to level off in the 1980s, but a long, slow, cumulatively corrosive decline has continued to the present, with the consequence that a dollar today would buy one less than a nickel’s worth of goods and services in Woodrow Wilson’s time.” The Economic History Association operates a website that tracks the purchasing power of the dollar from 1774- present. To get a feel for the decline in purchasing power over the last 20 years, it now takes $1,670 to purchase $1,000 worth of comparable merchandise in 1990. See http://www.measuringworth.com/ppowerus

So as the dollar declines in value, what steps can investors take to protect their investments from being negatively impacted? We believe that multinational companies—those companies that sell products and services around the world—should be able to generate good earnings, as much of their sales will be conducted in other currencies. We also think that investors need to have a reasonable allocation to international and emerging markets where the economies are not as closely tied to the dollar. We recommend investing in both stocks and bonds in these foreign markets, primarily through diversified mutual funds. Prudent investing must take into account the risk of a further decline in the value of our currency.
One of the things I most enjoy about my profession is the opportunity to interact with peers to discuss the investment landscape and search for ways to add value to our firm’s investment process. Last month, my colleague Scott McGhie and I attended the Morningstar Investment Conference in Chicago. Morningstar is the largest mutual fund rating company in the world. It analyzes nearly 10,000 equity and fixed income mutual funds, from large cap to small cap, domestic to international, sovereign to corporate, and beyond.

The main purpose of the conference is to bring together mutual fund managers, advisors, and industry experts to share perspectives. The highlight for me is not only listening to lectures, but also having one-on-one conversations with some of the world’s savviest investors. Included in the line-up were three recipients of Morningstar’s Fund Manager of the Decade award: Bruce Berkowitz, manager of the Fairholme Fund (Equity); David Herro, manager of the Oakmark International Fund (International-Stock); and Bill Gross, manager of the PIMCO Total Return Bond Fund (Fixed-Income). These headliners, along with over thirty other speakers addressed 1) the current macroeconomic environment; and 2) how they are positioning their portfolios in light of economic and business conditions. Question and answer was the primary format, so I have summarized the key takeaways in the form of Q&A.

Q: Comment on how the macroeconomic issues are impacting global markets.

A: Stock fund managers typically spend most of their time analyzing individual companies, rather than trying to predict the macroeconomic environment. And for good reason. It’s difficult. At his most recent news conference, Federal Reserve Chairman Ben Bernanke commented, after downgrading his growth forecasts: “We don’t have a precise read on why this slower pace of growth is persisting...we have an awful lot of uncertainty right now about how much of a slowdown is temporary, how much is permanent; so that would suggest, all else equal, that a little bit of time to see what is going to happen would be useful in making policy decisions.”

Many of the fund managers echoed Bernanke’s caution about the lack of visibility, but did reach consensus on two macro issues: 1) Global debt levels are too high, and must be addressed; and 2) monetary policy has been a significant contributor to the recovery, but this will not continue.

Debt as a percentage of gross domestic product (GDP) for many countries has been increasing over the last several years. We have begun to see its impact by watching Greece’s debt crisis unfold. The yield on 2-year Greek debt increased from 14% to 26% during the three months leading up to its austerity vote on June 29. While Greece is a small player in the global economy, market participants know that fiscal problems have the potential to ripple across markets. Many European banks hold Greek debt, while many U.S. based money market funds hold European bank debt. The interconnectivity of global markets means that a small dislocation can have a much greater than anticipated impact. We have already witnessed a similar story when problems in the U.S. subprime mortgage market morphed into the 2008 credit crisis.

The U.S. Treasury has benefited from the uncertainty in Europe, via lower borrowing costs, yet also ails from too much debt. Most recently, the 10 year note yielded less than 3%. Fund managers agreed that time is short for the government to present a plausible
Monetary policy in the U.S. has been a tailwind for the economy, yet it is starting to abate. While the Fed has more than tripled the size of its balance sheet since the start of 2008, from $800 billion to $2.7 trillion, its most recent program to purchase $600 billion of Treasury securities ended on June 30. Easy monetary policy has been good for asset prices, but fund managers acknowledged that stocks and other risk assets may face a difficult transition as the role of the Fed subsides.

**Q: IN LIGHT OF THE MACROECONOMIC ENVIRONMENT, WHERE ARE YOU FINDING VALUE?**

**A:** Bill Gross, who manages the largest bond fund in the world with over $200 billion in assets, was the keynote speaker and opened the conference with a pessimistic speech on the outlook for the bond market, especially Treasuries. And it’s easy to agree with him. Referencing a recent USA Today article, Gross opined that the U.S. government is not offering investors enough compensation, given its $62 trillion in unfunded obligations. With an average yield of about 1.5% across the Treasury yield curve (from 2 years to 30 years), creditors are not only receiving a low nominal yield, but also a **negative real return** after recognizing the effects of inflation.

Gross’ recommendation was to look outside of the U.S. for sovereign credits with relatively better balance sheets that offer positive real rates of return (this is not a free lunch, as inflation risk is replaced by credit risk). The exclamation point on Gross’s negative bond view was his recommendation for investors (who do not want to go outside of the U.S.) to purchase “blue chip” stocks that pay dividends. Certainly, we don’t often hear bond managers touting stocks.

On the equity side, fund managers shared Gross’s bias on the relative attractiveness of stocks over bonds. Many thought there is a good possibility for a reallocation into equities after a 20 year bull market in fixed income.

The S&P 500 Index has doubled in the last 27 months, and as a result there are fewer opportunities to buy mispriced assets today. Yet, businesses are reasonably valued, and have available capital and good prospects for growth. The S&P 500 Index currently trades at a price to earnings multiple of about 13x 2011 expected earnings per share. If you invert this ratio, you arrive at an 8% earnings yield, which compares favorably to the 3% yield on the 10-year Treasury bond.

So if we look out five to ten years, a portfolio of companies that have pricing power, dividend paying capacity, share repurchase ability, and growth from the emerging markets, appears attractive relative to a fixed income instrument that cannot re-price itself...

Even as the case for stocks is more compelling than bonds, we will continue to build balanced portfolios, seeking capital appreciation and cash flow, while managing risk. Our goal is to understand the intrinsic value of what we buy and the likelihood of the investment reaching its intrinsic value. As always, we invest with the knowledge that the range of potential outcomes is wide, but that proper diversification, asset allocation, and due diligence help mitigate downside risk.
Evaluating a company and its management’s performance is both quantitative and qualitative. No two companies are created equal, as the returns on shareholders’ invested capital come from varying sources of value creation. Analyzing the drivers behind shareholder value creation is one step, while determining the sustainability of those drivers is another.

Companies are able to grow sustainably and create shareholder value for two primary reasons: 1) they have been able to build and sustain competitive advantages; and 2) management consistently allocates capital to projects which produce higher returns than the cost of invested capital. All capital sources have a cost, whether it is paying interest to bondholders, or delivering returns to stockholders. A key challenge in analyzing companies is to understand how all the factors discussed below interact with each other to produce the expected returns.

**COMPETITIVE ADVANTAGES**

Competitive advantages are sustainable, long-term advantages one company has over peers in its industry. A competitive advantage may appear in many forms including, but not limited to:

- **Branding** – a company’s brand can be a very valuable competitive advantage to the extent its customers and investors recognize that value. Consider the value and influence of the Coca-Cola brand, and the wide economic and competitive moat that the brand has built around the company’s business.

- **Economies of scale** – in certain industries, size matters because it allows companies to drive down supplier pricing due to high volume of orders. Wal-Mart is able to consistently be the low-cost retailer because its economies of scale enable the company to pay less for goods than virtually any competitor.

- **Distribution network** – a company cannot sell its products without a means to distribute them. DirecTV has the strongest distribution capability in the television entertainment delivery industry because it is not limited by the wiring constraints and municipal contracts that govern cable services.

- **Patents** – patents are how companies protect their intellectual property. Patent advantages are most prominent in Healthcare and Technology. Pharmaceutical companies, such as Pfizer, maintain competitive advantages through patent protection of their drug lines, which prevent generics from being formulated for many years.

- **High barriers to entry** – in some industries, barriers to entry for new competitors are so high that they protect the profitability of companies in that industry. For example, Boeing and EADS (parent of Airbus) are the predominant makers of airline jets in the world due to the high capital it would take for a new entrant to build the facilities, technology, and materials to compete.

Not all competitive advantages are simple to identify, but suffice it to say that the largest companies across the world maintain sustainable competitive advantages which have enabled their long-term growth. Competitive advantages do not necessarily last forever, however. Dell Computer used to be the lowest cost provider of personal computers due to its direct-to-consumer model, but over time its competitors have been able to close the gap and eliminate its advantage. Our analysis focuses on identifying whether a company has competitive advantages, how strong they are, and how sustainable those advantages are.

**CAPITAL ALLOCATION DECISIONS**

Company management decisions regarding where and how to allocate capital is another determinant of future shareholder returns. Capital might come via
fundraising activities such as selling shares or issuing debt, or capital can be created through the company’s profitability each year. The management of a company has four basic choices:

- **Reinvest** – a company may attempt to grow organically by reinvesting in internal operations, capital expenditures, and research and development, or they may attempt to grow through acquisition.

- **Return Money to Shareholders** – a company may return cash to shareholders through paying or increasing their dividends, or repurchasing shares.

- **Deleverage** – a company may choose to change its capital structure by paying down debt with excess cash.

- **Hold cash** – some companies choose to hold substantial amounts of cash in profitable foreign entities due to the tax ramifications of utilizing it, or as a defensive move in uncertain economic times, or to be prepared strategically to take advantage of future opportunities.

Regardless of the company or the industry, our bias is towards companies that utilize capital generated to reinvest in their business in order to earn returns in excess of the cost of the capital, as this will lead to compounding growth for shareholders over time. Whether an investor prefers for management to pay dividends, repurchase shares, or de-lever the balance sheet will be based on company specific analysis.

**SHAREHOLDER RETURNS**

The strength of competitive advantages plus the efficiency and consistency of value creating capital allocation decisions should equate to shareholder returns over the long-term. One measure of shareholder returns—return on equity (ROE)—is often informative because it provides quantitative insight into the drivers of company profitability. These drivers, which are the three main components of ROE, are profit margin, asset turnover, and financial leverage. As analysts, we apply our subjective evaluation of what are acceptable, or preferred, levels of each metric, and having such quantitative metrics of the profit drivers allows us to compare companies and develop views of what drivers likely will increase or decrease profitability in the future.

**Profit margin** is the easiest to comprehend, as it represents how much profit is generated for each dollar of sales. A company’s cost of goods sold, interest expense, and tax burden all affect a company’s net profit margin. All else being equal, companies with higher operating leverage are preferred, as they can generate higher sales per unit cost.

**Asset turnover** represents the efficiency with which companies utilize their asset base to generate sales. This measure may be more meaningful in industries where inventory is important. For example, Wal-Mart and Amazon.com have similar asset turnovers, because inventory management is a key driver, despite the former being predominantly brick-and-mortar and the latter being online. In general, higher levels of asset turnover as between similar companies is viewed as an operating advantage.

**Financial leverage** is a term that is now very well known. This metric relates the amount of debt a company maintains in relation to its overall capital base, to its return on equity. Borrowing is an obvious risk, as over-reliance on debt capital may create liquidity concerns during recessions like the one we had in 2008, and it also can lead to volatile earnings and cash flow. Debt issuance is a common mechanism that certain companies and industries utilize to finance general operations, as well as growth. Management defines what it believes to be an optimal capital structure, and it is up to investors to determine what amount of financial leverage is acceptable to them for that company or industry.

**IT’S ALL OF THE ABOVE AND MORE**

The interaction of competitive advantages and capital allocation decisions leads to expectations about future returns. Insight into future success can be discerned from evaluating the drivers of a company’s profitability. The difficulty lies in determining the probability that competitive advantages will continue in the future, and how well the company will allocate capital to create future value for shareholders. Much of this rests on the decisions made by management. This is why strong management teams are so revered by investors. Evaluating a company’s management team and the manner in which a company grows are essential steps in making prudent investments. Many additional factors must be weighed, and data analyzed, before determining how much to then pay for an investment.
What Recovery?

The U.S. has endured a rollercoaster ride over the last 3 years. During 2008 and the first half of 2009, the U.S. economy experienced one of the worst recessions in its history, with house prices and real wealth plummeting while unemployment skyrocketed. In the latter half of 2009 the recession officially ended, and it looked like the U.S. economy was on the right track, as unemployment began to stabilize and housing prices seemed to bottom out. The credit markets, which had virtually frozen during the recession, thawed and allowed businesses to borrow and grow again.

Headline GDP numbers of 1.8% in the most recent quarter point to a weak recovery. U-6 unemployment (a broader, more accurate picture of total unemployment) still hovers around 16%, and our Employment-Population ratio and participation rate are virtually unchanged versus 2 years ago. House prices are now at a post-recession low and look to trend downwards further in the near term. Corporate profits are hitting new highs, but as First Pacific Advisors recently pointed out, corporate profit margins as a percentage of national income are extremely high and most likely unsustainable.

The reality is that the odds of a (much desired) V-shaped recovery are low. The recovery feels slow, and as long as real estate and unemployment are suffering, this feeling is here to stay. The fact that headline inflation is drastically understated doesn’t help, either.

There is a Recovery

The feeling of stunted growth doesn’t apply to all economies, however. While the U.S. economy as a whole seems to be stalling, the digital recovery is in full swing. Growth and profits in this sector have been so explosive that it makes one wonder if the recession had an impact on the digital economy at all.

American e-commerce sales still only account for between 5-10% of total U.S. retail sales. However, e-commerce’s share of the pie is continuously growing, and during 2010 e-sales were up 15-20% versus 2009, while total retail sales were up less than 10%. Music and books seem to grab the headlines when it comes to sales on the Internet, but the reality is that virtually every type of product or service is for sale on the Internet.

No other company defines e-commerce like Amazon.com, and no other company demonstrates how well the digital economy has handled the recession. Amazon.com offers every product imaginable, and the company has morphed into the Internet’s version of Wal-Mart. Prices are extremely low, sales tax is nonexistent for most purchasers, and the company is constantly expanding into new markets and areas of service. Sales in 2007, the year before the recession, were $14 billion. In 2008, during the worst recession since the Great Depression, Amazon.com grew sales by 30% to almost $20 billion. In 2010, just 1-1/2 years after the recession had ended, sales were over $34 billion, roughly 80% higher than during the recession and almost 150% more than in 2007. Companies that can hold a candle to this sort of growth, during any period, are few and far between.

During the same period, many of the brick-and-mortar stores were either struggling or failing. Competitor Circuit City went bankrupt during the height of the 2008 recession and closed its doors in the beginning of 2009. In its final year of operations, Circuit City had about $12 billion in sales, yet its
razor-thin margins caused the company to collapse. Best Buy fared better, but even with its main brick-and-mortar competitor removed, the company has yet to improve upon its 2007 operating income or net earnings. Wal-Mart, the retail giant, most likely fared the best during the recession, yet has seen its earnings increase only 17% since fiscal year 2008. Wal-Mart’s revenue, however, stagnated in 2010.

And while Amazon.com cannot bear all the responsibility of the recent struggles of the brick-and-mortar giants, it certainly has had an impact. Electronics and general merchandise sales at Amazon.com have exploded over the past few years, as it has taken share from the giant retailers. At first glance one would assume that media would constitute the large majority of Amazon.com’s sales, but in 2010 media sales were less than electronics and other general merchandise. It almost seems strange that consumers would buy physical goods like TVs, tools, and gardening supplies from Amazon.com rather than being able to physically try them out at a brick-and-mortar retailer, but this is where the world seems to be headed.

E-commerce companies like Amazon.com haven’t rested on their laurels, either. They have continuously improved their services and changed the way we buy goods and services. Netflix, Hulu, Apple, and Amazon.com have changed the way we watch movies and TV and bankrupted Blockbuster and a host of other media rental companies. Subscriber/user growth for these services has continued to be strong, hurting the bottom lines of Time Warner and other established media companies. Netflix’s streaming of movies and TV shows has become so popular that it accounts for 20% of Internet traffic during certain periods. Profit growth has accelerated at these dominant e-commerce companies, with profits at Netflix and Apple more than tripling since their pre-recession highs.

Elsewhere, companies like Priceline.com and Expedia have done their best to make physical, person-to-person travel agencies obsolete. Growth at these two companies has been tremendous, as they have allowed anyone with Internet access the ability to make travel booking a do-it-yourself activity. Priceline’s profits have increased more than 4-fold since 2007, and more than doubled during the recession in 2008. Google and AdMob have also experienced strong growth. Google’s profit has doubled versus its pre-recession high, and advertising dollars continue to flow from traditional media outlets to the Internet.

The reality is that no other economy has shrugged off the recession like the digital economy, and the strong growth of most of these companies will likely continue well into the future. While advanced countries in North America and Europe have large Internet adoption rates, less than one-third of the worldwide population uses the Internet. This presents tremendous opportunity for companies like Amazon.com and Netflix. The digital economy will be one to watch as the world continues to transition towards a more digitally-based norm.
HOW TO SUCCEED IN RETIREMENT

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Financial security during all of your retirement years is one of the cornerstones of a happy, healthy, rewarding life in retirement. Financial security requires adequate funding of your retirement account (and of course, good management of your assets and good control over your household spending during retirement).

There are three keys to success in funding your retirement adequately during your working years:

- **Save enough** during every year of your working life.
- **Invest prudently** to grow assets while managing risk.
- **Segregate retirement assets** and don’t touch them for other purposes.

This article deals with the first of the three keys to financial success in retirement: saving enough.

HOW MUCH IS ENOUGH?

How much you will need to have saved by the time you retire depends on how much you will need to withdraw from your consolidated retirement account each year to support your lifestyle. I use the word consolidated because you likely will have several investment accounts (401k’s, IRAs, ROTHs, taxable investment accounts) that you will manage on a consolidated basis to provide the retirement income you seek.

When you retire, your annual living expenses will probably be a function of the annual income you and your family are accustomed to earning by the time of retirement. A good rule of thumb is that you will need to replace 70% of the income you were earning at the time of your retirement in order to maintain your lifestyle.

If you have worked your entire career for a public or private entity that has funded a pension or profit-sharing plan that will pay out benefits to you in retirement to replace 70% of the salary you will be earning at that time, you are fortunate, and you are part of an ever-shrinking minority. In that case, your main concern will likely be the long-term financial health of the pension or profit-sharing plan on which you will rely. If you don’t have such an employer-funded pension or profit sharing plan, or if the benefits will replace something less than 70% of your salary at retirement, then you will need to have saved enough so that the income from your consolidated retirement account will replace 70% of the salary you were earning at the time of retirement.¹

This article focuses on the cake.

¹For purposes of this discussion, I am not including Social Security payments you may receive. Although you will have contributed to social security, given the precarious financial shape of the Social Security system (now that relatively far more beneficiaries will be depending on far fewer workers funding the system, and payouts to this larger number of retirees will be for longer-than-anticipated time horizons), coupled with the small amounts of the projected payments relative to the retirement income needs of high-income earners, it’s probably best to consider whatever you get from Social Security as “icing on the cake.” This article focuses on the cake.
ditional assistance you might need to ensure a healthy, low stress lifestyle. Also, most people who have been productive in their lifetimes would like to have money left over at the end in order to leave a legacy.

We’ve said this many times, and we’ll keep repeating it because it’s good advice. **You should limit your withdrawals from your retirement account to 4% per year.** This will ensure that your retirement account will last your lifetime, as it’s reasonable to assume that your account will produce at least that much in income and total returns while being managed reasonably conservatively. By protecting the principal in your account, you can ride out ups and downs in the market and also have reserves to call upon when and if emergencies arise. Living within one’s means—which is how you will have saved enough in the first place—is equally applicable in retirement, and that means limiting your withdrawals to 4% of your account value annually.

In order to replace 70% of your salary at retirement with income from your retirement account and not exceed the 4% rule, just follow the following formula:

\[
\text{Estimated Salary at Time of Retirement} \times 0.70 = \text{Required Annual Income from Retirement Account}
\]

\[
\text{Required Annual Income from Retirement Account} \times 25 = \text{Targeted Required Consolidated Account Value}
\]

Let’s take an example of a high-income earner:

Salary at Retirement = $250,000

70% of Salary at Retirement = $175,000 = Required Annual Income from Retirement Account

Targeted Required Value of Account at Retirement to Provide Required Income of $175,000 per year without exceeding the 4% rule = $4,375,000 (= $175,000 \times 25)

Thus, the worker who retires at a salary of $250,000 should have saved $4,375,000 in order to replace 70% of his salary and be assured that his retirement account will last his lifetime by limiting withdrawals to 4% per year.

**EARLY SAVER’S TABLE**

<table>
<thead>
<tr>
<th>Age</th>
<th>Savings Rate (percentage of annual income)</th>
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<tbody>
<tr>
<td>25-29</td>
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</tr>
<tr>
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<td>55-65</td>
<td>25%</td>
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Using the example of the high income earner above, with a starting salary of $50,000 at age 25 and an ending salary of $250,000 at age 65 (with incremental raises over the years), and assuming annualized returns of 7%, he/she would have accumulated $4,396,173 after 40 years by following the savings rate schedule above.

The Savings Table is applicable regardless of your level of income. A household that earns $30,000 at the start and retires at an annual salary of $85,000 will require a retirement account of $1,487,500 to replace 70% of annual income ($59,500 per year). If that household follows the Early Saver’s Table, and assuming 7% annualized returns, the household will have over $1.4 million at retirement.

Why does such an incremental savings rate schedule make sense? During the first 15 working years of your life, it’s likely you are raising children, buying a home, and meeting a lot of expenses. Start at 10% and work your way up to 15% during this time. By the time you are 45, you have likely saved enough to pay for college educations, your mortgage expense is pretty
well defined, and you can begin working your way up to the 20% target which you want to have reached by age 50. By the time you are 55, your kids are likely grown and their educations fully funded, and you should be able to increase your savings allocation to 25%, which is your “home stretch” funding during your peak earnings years.

WHAT IF I DIDN’T START SAVING FOR RETIREMENT EARLY ON?

What if you haven’t started saving early in life, for example, what if you haven’t saved during the first 15 years of your working life? You’ve hit 40, and you really don’t have substantial retirement savings. The facts are pretty straightforward, because the numbers don’t lie. Even if you immediately joined the savings program outlined above and started saving 15% of your salary at 40, increasing it 20% by 50, and to 25% by 55, you will fall short of your goal to reach your 70% income replacement factor in accordance with the 4% rule. In the example of the income earner above, who would be earning $160,000 at age 40 and would retire at 65 with a salary of $250,000, if he/she only started saving at age 40 and followed the schedule above, he/ she would retire with only $2,672,651 of assets (rather than $4,396,173 for the worker who saved according to the schedule since age 25). If the late saver were to live within the 4% rule, that would imply that the late saver would have to reduce his annual expenses to $106,906, less than 50% of what he/she was used to (4% of $2.6 million is $106,906).

What are your options if you have not started saving early enough?
- Play catch-up (save at much higher percentages for the later years);
- Work longer, so you save for more years;
- Reduce your expenses in retirement so that you are able to live off less than a 70% replacement income;
- Deplete your retirement account at a higher rate than 4% (which means risking deterioration of principal).

Reducing your living expenses and thus your lifestyle in retirement may not be desirable, and taking out more than 4% of your account as income per year may not be advisable. So for those who need to catch up and work longer, here’s a “Late Saver’s” guide to saving:

### LATE SAVER’S TABLE

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<thead>
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<th>Age</th>
<th>Savings Rate (percentage of annual income)</th>
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<tbody>
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<td>45-49</td>
<td>25%</td>
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<td>35%</td>
</tr>
<tr>
<td>60-70</td>
<td>40%</td>
</tr>
</tbody>
</table>

### TAKEAWAYS:

If you want to maintain your standard of living in retirement, you will need to replace 70% of your working income. To replace 70% of your income in retirement with income from your retirement account, you will need to save a portion of your income every year for your entire working life. Assuming a 7% annualized return rate, our roadmap shows you need to save at least 10% at the start of your work life (age 25) and increase that percentage over time (15% by age 35, 20% by age 50, and 25% by age 55).

There’s a big advantage to those who start saving early, due to the compounding effect on those early dollars saved. If you’ve started saving later in life, you will need to save a higher percentage of your salary, for a longer time (which means working longer). Savings rates for late savers start at 20% at age 40, increasing to 30% by age 50 and 40% by age 60, and will likely require you to work and save until you’re 70.

If you would like our help to create a retirement savings roadmap, and to make sure you’re on a solid road to financing your retirement, just give us a call. Our mission statement is: Conserve. Plan. Grow. And that’s just what we help our clients to do.
Like fire, debt is a good servant but a bad master. Just as fire to be useful must be contained in an appropriate place, so debt must be managed and kept within appropriate limits. In many cases, the right limit is zero.

The all-important question is not the interest rate charged or the payback period provisions. Rather, it is a simple question of what are the proceeds of the loan to be used for? How necessary is the intended purchase? Are there any available means to avoid making the purchase? If not, can it be postponed? Is there a harmful effect caused by delaying the purchase so as to reduce the intended size of the loan?

In the case of many loans for items of personal use, it does not become a matter of analyzing a proposed economic event but rather an exercise in self-gratification. If that is, in fact, true, then the question shifts to one of making sure that adequate funds will be available in a timely manner to discharge the debt as the contract provides. In the current economic situation, millions of our fellow citizens failed to cover the possibility of losing one’s major source of income, with painful consequences and even life-altering results.

There are few hard and fast rules of conduct when it comes to living our lives in freedom and peace. However, it rarely makes sense to enter retirement with outstanding debt. Reduced income and unforeseen expenses are normal circumstances in our declining years, thus militating against carrying debt into retirement.

Now for the good loans! Few people spend their time thinking about why or how England became the leading merchant and industrialized nation on the planet. The Dutch were equally resourceful in matters of trade between countries. However, England industrialized first so she had more goods to sell. Few enterprises succeeded without borrowed capital. Loans were obtained with legal protections to both the borrower and the lender. Other countries rarely had such laws and their local laws did not favor entrepreneurs.

A friend of mine tells me he knows many people who got rich using borrowed money. Of course, they did. Borrowing to produce income is the best kind of borrowing. Professional lenders are pretty good at determining the chances for repayment.

In my contributions to our last newsletter, I dealt with the matter of students borrowing to complete their education. The need to draw up a cost/benefit analysis to make sure that the loan never exceeds the expected benefits must be paramount. If a student chooses to plough ahead regardless of excessive borrowing at least he/she is aware of the deficit he/she must overcome.

WORDS FROM OUR CHAIRMAN EMERITUS:

THERE IS GOOD DEBT AND BAD DEBT

C. Lee Butler, LLB

NOTE FROM THE EDITOR:

We hope you have found this edition of The Fiduciary Group newsletter to be both interesting and relevant. We would like to hear your thoughts and suggestions. Please e-mail your feedback to julia@tfginvest.com. If you have family or friends who you think might benefit from receiving our newsletter, please e-mail us their name, address, and e-mail address. Thanks, and we look forward to enhancing our service to you with each edition.

-Julia L. Butler, Editor Chief Operating & Compliance Officer