Investment Landscape:
Recovery from "The Brink of Despair"

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Topics covered today

- Key risks facing retirees
- Entities and individuals used to manage risks
- Market update with historic context
- Current state of major institutions in current environment
- Individuals' reaction to crisis
- Products and strategies with perceived value going forward

What are resources and plan?

- Three main groups of retirees
  - Poor
    - Social Security is main asset in retirement
    - Continue working and family support
  - Middle Class
    - Modest assets in addition to SS and house.
    - Broad marketing and some financial planning
  - Financially Secure
    - Focused marketing and specialized products

Key risks facing retirees

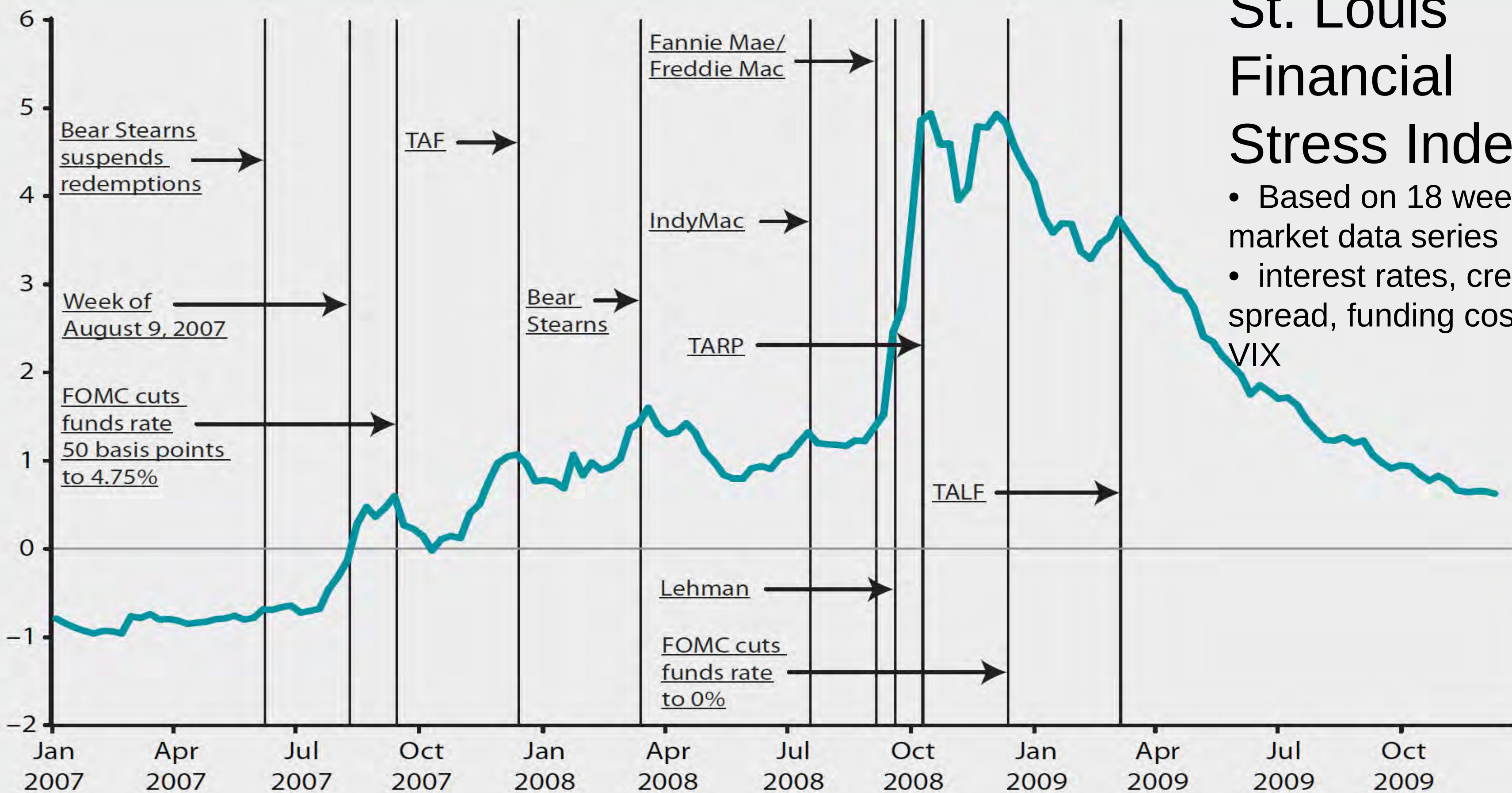
- Longevity Risk – will I outlive my assets?
  - Health status, life expectancy, omega?
- Inflation Risk – maintain purchasing power
- Market Risk – assets at loss when needed?
  - Equity, interest rate, credit, currency
- Medical Cost – Medicare, Supplement, LTC
- Tax Risk – Changing rates and estate plan
- Legal – divorce, disability, trusts, wills

Entities used to manage risks

- Government and employers
  - Social Security statements, 401(k)
- Mutual Funds and Financial Institutions
  - Professional asset management and investment products, costs vary
- Insurance Companies
  - More guarantees, complexity, higher commissions, "sold not bought"
- Financial Advisors for higher net worth
  - Independent or affiliated with product?

Dramatic events of 2007 – 2010

- Markets had a chance to settle down after historic crisis



St. Louis Financial Stress Index

- Based on 18 weekly market data series
- interest rates, credit spread, funding costs, VIX

NOTE: FOMC, Federal Open Market Committee; TAF, Term Auction Facility; TALF, Term Asset-Backed Securities Loan Facility; TARP, Troubled Asset Relief Program.

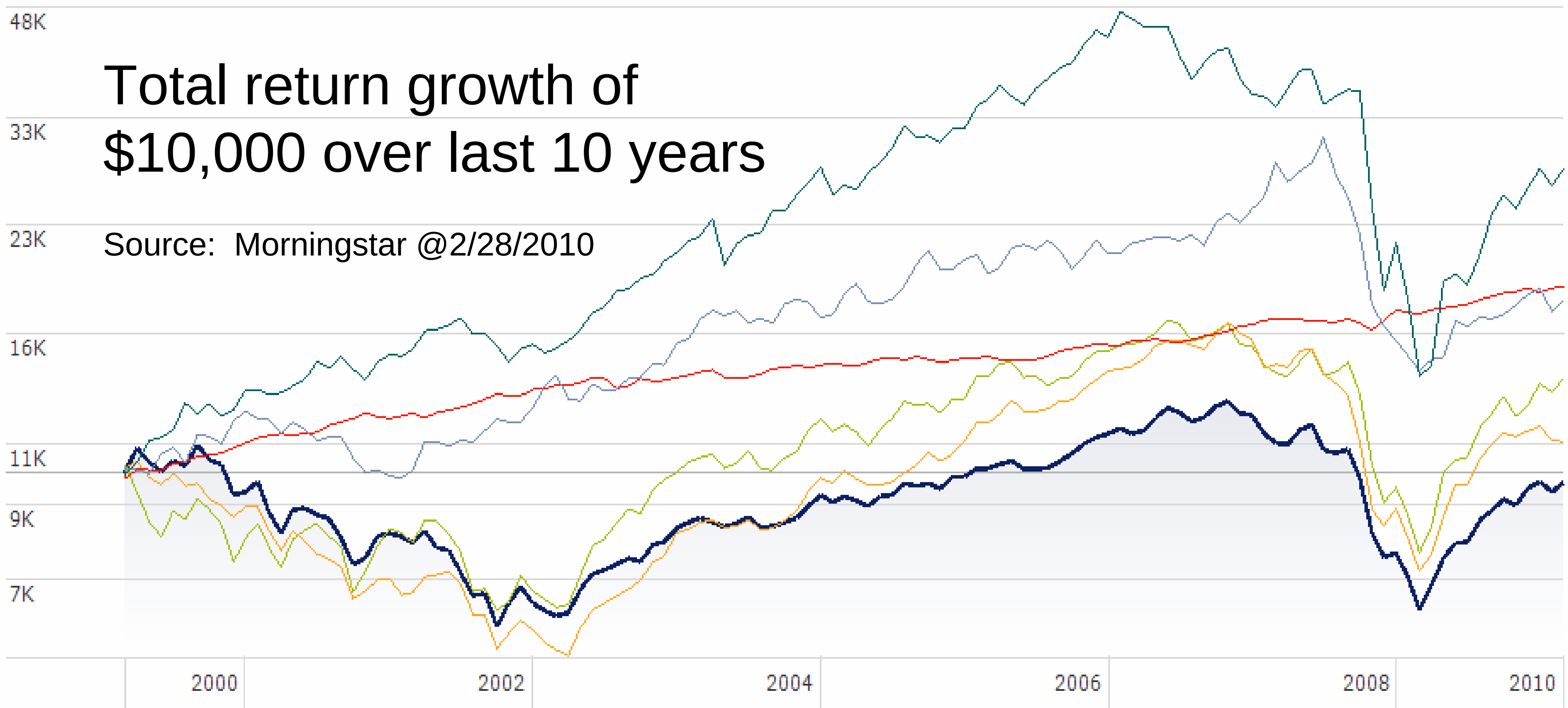
Source: Economic Synopses, 2010 #2 – St. Louis Fed

Market Risk – Asset Class Returns

- Not a “lost decade” for all asset classes - DIVERSIFY!

Total return growth of
$10,000 over last 10 years

Source: Morningstar @2/28/2010



Investment Name	Value				
DJ US TSM Large Cap TR US...	9.67K	DJ US TSM Small Cap TR US...	13.73K	MSCI EAFE NR USD (Market ...	11.09K
BarCap US Agg Bond TR USD...	18.66K	DJ UBS Commodity TR USD (...	17.85K	DJ US Select REIT TR USD (M...	27.72K

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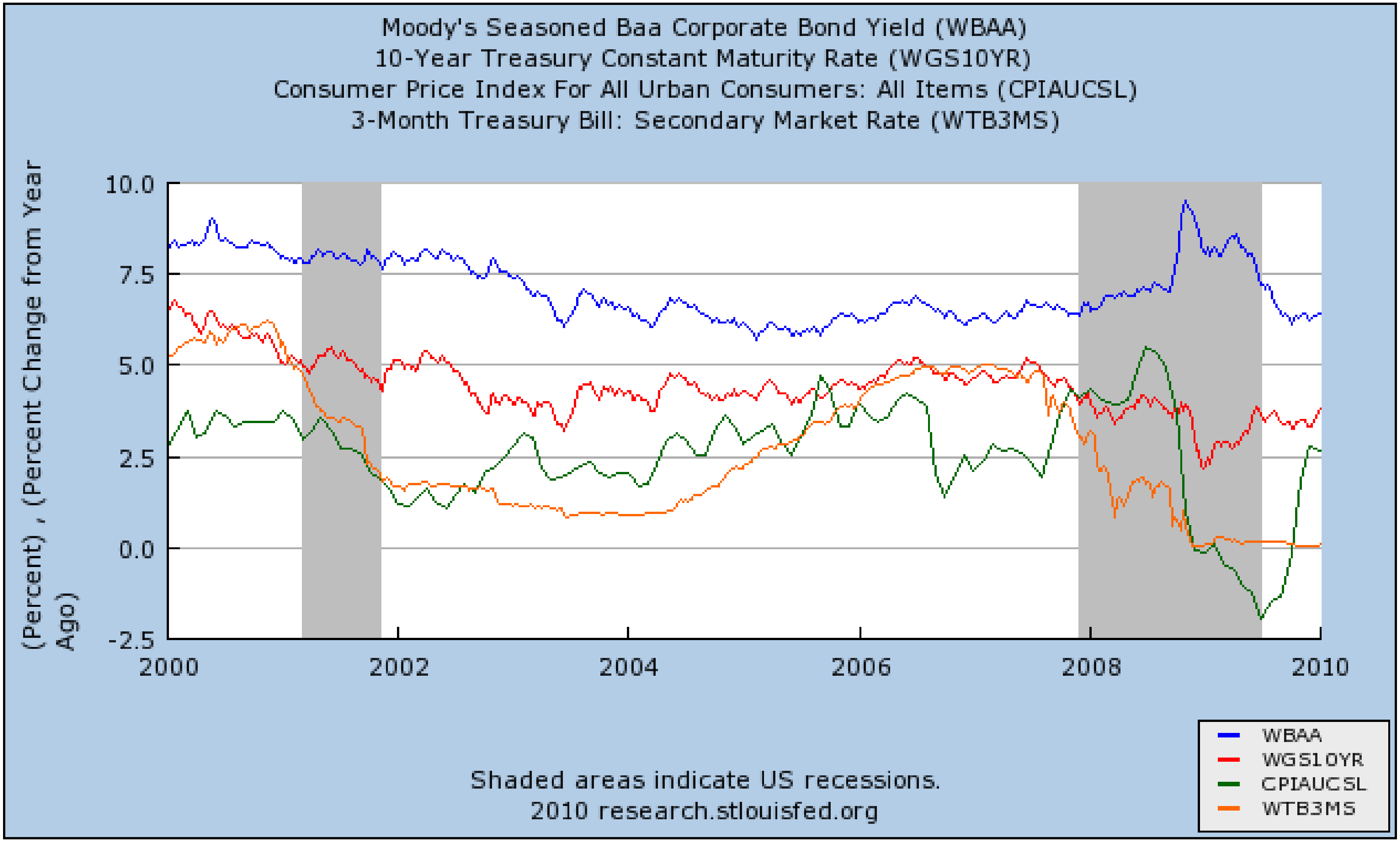
Market Risk – Interest Rates and Inflation

- T-Bills don't always beat inflation and credit spreads can widen drastically



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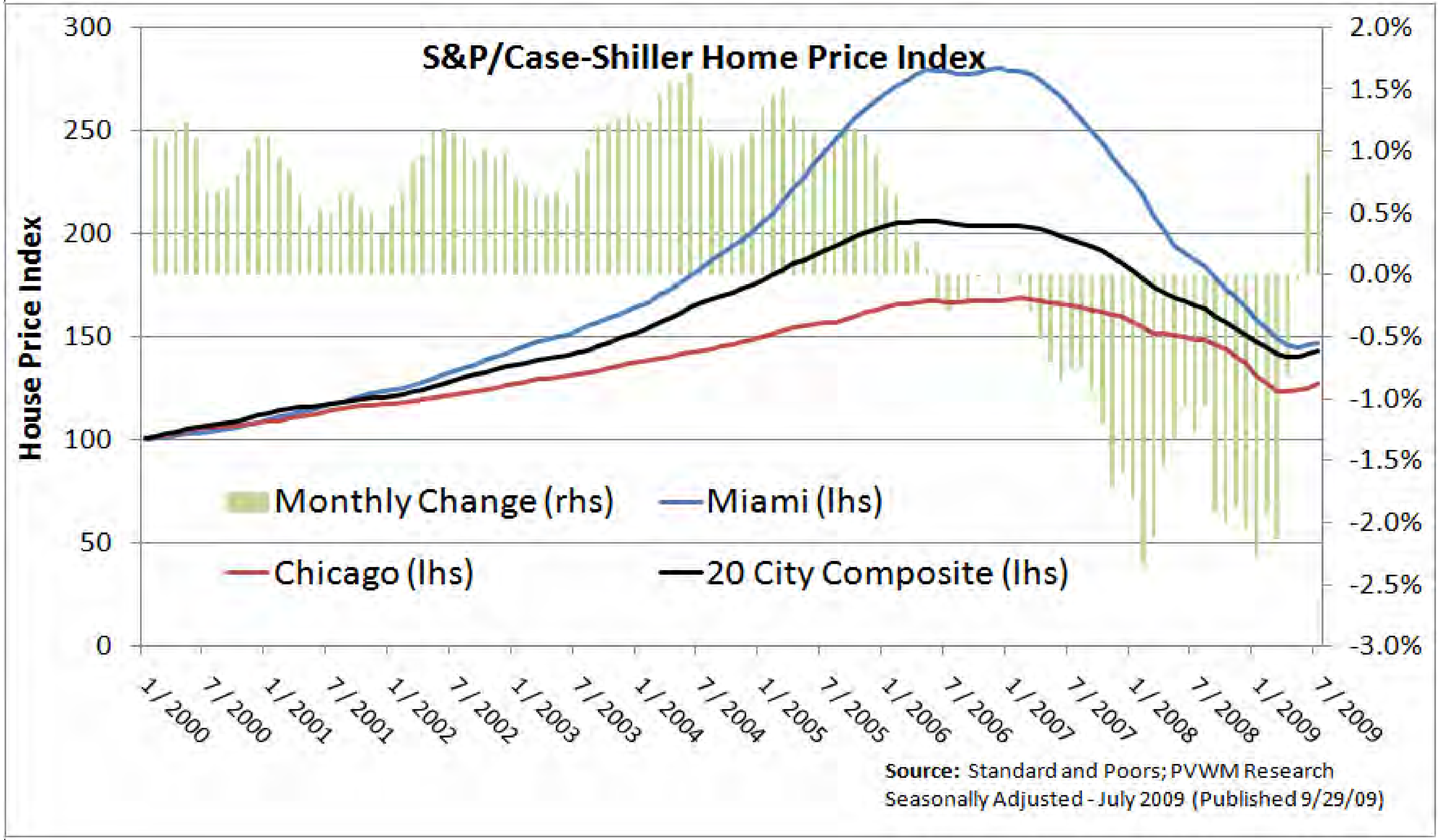
Market Risk – Housing Market

- Easy credit drove prices up quickly and also fell quickly



State of Major Institutions in Current Environment

- Banking System
  - Unprecedented Fed/Treasury intervention
  - FDIC continues closing banks
  - FDIC protection $250k to December 2013
  - Commercial real estate loan maturities/refinancing in 2010-2013 predicted to be problematic
  - Continued questions on bank balance sheets, compensation, and reform
- Life Insurers
  - Bond portfolio market values, liquidity have suffered
  - Variable annuity guarantees have increased capital/reserve requirements
  - Regulation spillover from banking industry, also opens debate between state and federal regulation
  - Questions on insurer rating agency reliability
- For both banks and insurers, a considerable focus on risk and transparency

Bank Failures Continue

Year	No. of Failed Banks	Total Assets of Failed Banks ($Millions)	Loss to FDIC's DIF
2007	3	$2,603	$113
2008	25	$373,589	$15,708
2009	140	$170,867	$36,433
2010	21	$15,168	$4,300
Total	189	$562,227	$56,553

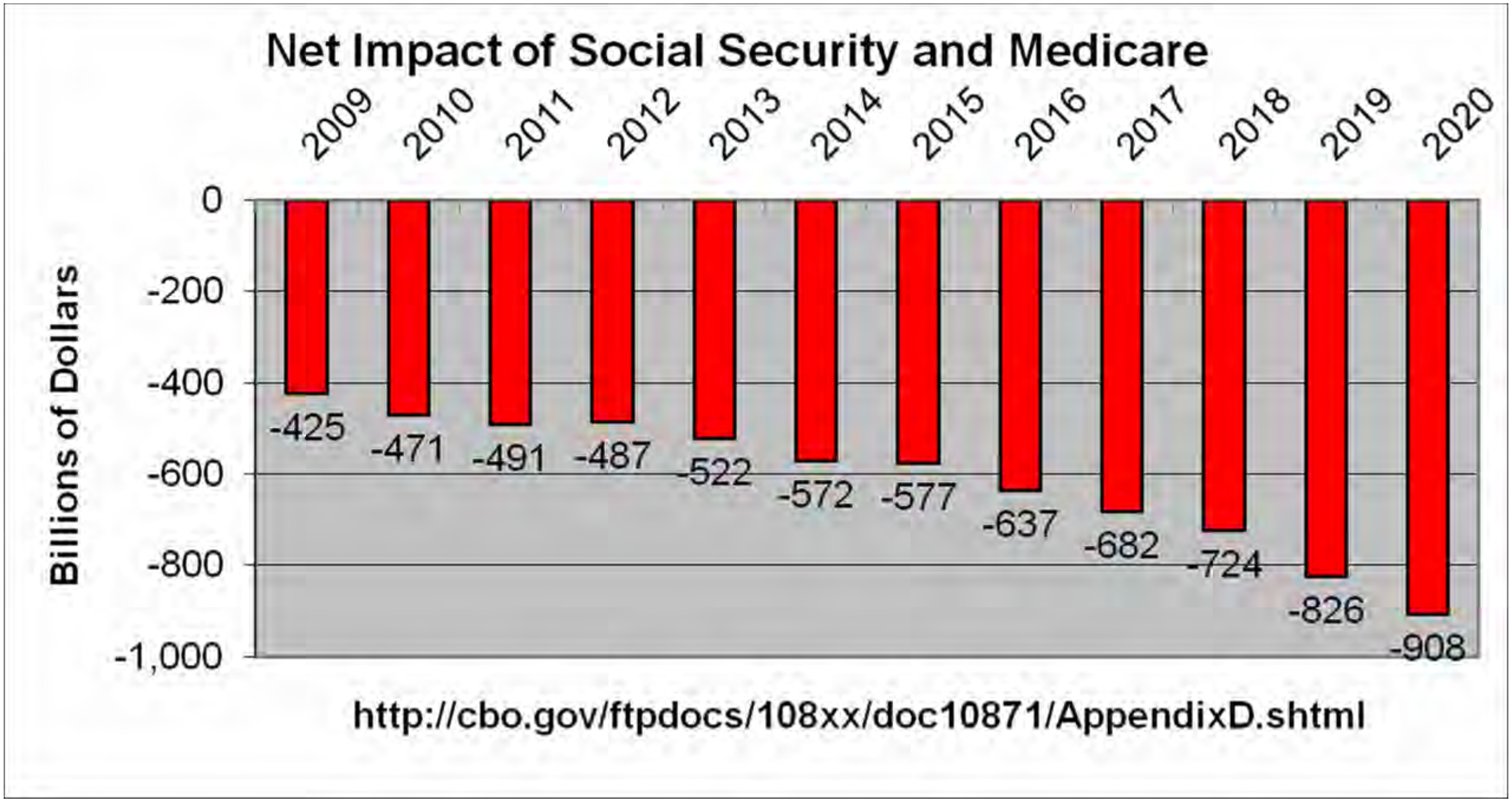
Through March 2, 2010
Source: FDIC, CalculatorsPlus.com

Idea, Government FDIC only 95% for depositors!?

State of Major Institutions in Current Environment

- Federal and State Governments
  - Budgets are strained and will slow future growth
    - Federal debt projections show stunning picture
    - Many state budgets would have been tight even without recession
    - States projecting deficits through 2012
    - May result in additional taxation at various local levels as programs and funding are shifted
    - Questions on viability of additional local government debt
    - Questions on political will to address structural issues
  - Entitlements will require extra funding
    - Any changes will affect future beneficiaries and take years to work into the system
    - Most problems have been known for years but recession has pushed into crisis

Social Security and Medicare have Significant Impact



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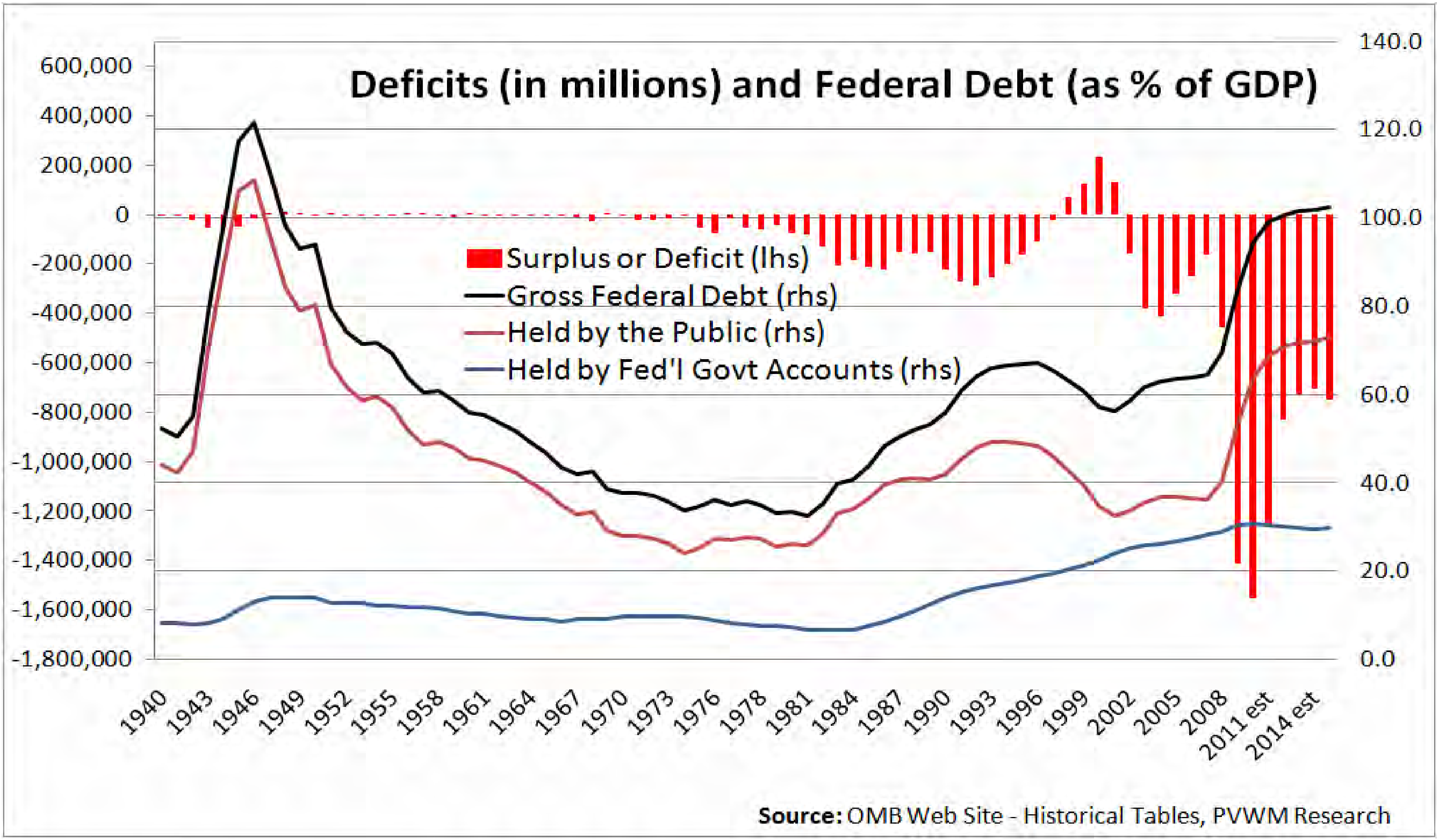
Federal Government's Finances

- Federal debt weighs on future growth with higher taxes and interest rates



State Pension Mess

"A train wreck waiting to happen. That's the only way to describe the mess that state pension systems are in right now, according to a report published today by the Pew Center on the States. According to Pew, there's a **$1 trillion gap** between the $3.35 trillion in pension, health care and other retirement benefits states promised their current and retired workers as of fiscal year 2008 and the $2.35 trillion they have on hand to pay them.

"What's worse, the gap may be even higher given that the study was conducted prior to the market collapsing in 2008 and given the way most states allow for smoothing of investment gains and losses over time."

Source: http://www.foxbusiness.com/story/states-pension-plans-face-steep-shortfalls/?utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+foxbusiness%2Flatest+(Text+-+Latest+News

Social Security and Medicare Considerations

- Not just retirement benefits
  - Medicare Part A, B and D
  - Survivor benefits – monthly benefits if early death or surviving spouse gets higher benefit
  - Disability benefits
- Benefits are significant portion of retirement security for large group
- Contribution to federal deficit
- Financing issues require combination of higher tax / lower benefits
  - 2009 Trustees Report states Social Security needs immediate 16% payroll tax increase or 13% benefit reduction for actuarial balance over the next 75 years
  - Not a complete loss of benefits but assume a portion of projected benefit for planning
- Health care uncertainty and impact on Medicare
  - To counter uncertainty, consider LTC or Health Savings Accounts

Individual’s Reaction to Crisis

- Shock, uncertainty, reduced goals, work longer
- Still standing, some re-entering
  - Recovering emotionally; “looking at statements again”
  - Fewer “should I get out now” calls; some reenter market
- Value guarantees and liquidity
  - Provided company can stand behind guarantee
  - Federal guarantee still perceived as strongest guarantee
  - Take little less return in money market for liquidity when need
- Realign consumption patterns
  - Budgeting, debt management, realistic realignment
- Revisiting existing relationships and use of independent advisors
  - Important to get it right !!!
  - Value independent advice without commission

Products with value going forward

- Fixed annuities
  - Deferred - Attractive to consumers looking for yields higher than CDs
  - Immediate – Attractive to retirees at certain income/asset levels who need guaranteed income
- Longevity annuities
  - "Long Life" insurance relatively cheap to add to portfolio
  - Similar liquidity concerns as immediate annuities
- Exchange Traded Funds (ETFs)
  - Provide lower cost, all-day trading, tax efficiency, transparent portfolio composition
  - Newer versions more complex and less understandable

Products with value going forward

- Target date funds
  - "Set it and Forget it" but know what you are setting
  - Higher stock and junk/int'l bond risk than many understood
  - More disclosure on risks, underlying strategy and investment

Target Date Fund	3 Yr Total Return	5 Yr Total Return	5 Yr Std Dev	% US Equity	% Non-US Equity	% US Bond	% Non-US Bond	% Cash / Other
T. Rowe Price Retirement 2010	-0.32	3.67	11.74	44.4	12.6	27.3	9.0	6.8
Principal LifeTime 2010 Instl	-3.62	1.42	12.25	39.5	13.7	27.0	4.0	15.7
Wells Fargo Advantage DJ Target 2010 I	2.38	3.98	7.17	16.5	8.3	46.1	19.1	9.9
T. Rowe Price Retirement 2030	-3.44	2.68	16.52	63.6	20.8	9.0	3.1	3.5
Principal LifeTime 2030 Instl	-4.85	1.59	15.41	55.0	20.5	15.1	2.2	7.3
Wells Fargo Advantage DJ Target 2030 I	-2.42	2.55	14.66	47.3	23.8	15.0	6.1	7.8

Source: Morningstar Office; 2/28/10

- Tax deferral products may be more attractive as tax rates rise
  - Tax diversification among different products
  - Impact on products' value from future tax rates – income, capital gains

Newer Products Attempting to Address Problems

- Annuity in 401k
  - Purchase annuity credits as another fund choice
  - Must be sure an annuity is appropriate for needs and watch expenses
  - Unknown future credit quality of company for a long liability
  - Provides dollar-cost averaging of interest rates
  - Challenges with employee turnover and layoffs

- Liquidity products
  - Specialty products applicable to specific situations
  - Higher expenses typically involved
  - Reverse Mortgages and Life Policy Settlements are examples

Strategies with value going forward

- Recent crisis created some doubts on modern portfolio theory
  - "Equities were flat over 10 years" - true for US large caps
  - Notice different asset classes and the longer time period
    - NOTE: 1 Yr returns are from extreme crisis lows; not normal
  - Make sure to include dividends, not just price return

Asset Class	1 Yr Total Return	5 Yr Total Return	10 Yr Total Return	15 Yr Total Return	10 Yr Std Dev	10 Yr Sharpe Ratio
Equity-US Large Cap	53.36	0.89	-0.33	7.68	16.23	-0.11
Equity-US Small Cap	79.89	3.16	3.22	9.27	21.45	0.13
Equity-Int'l Developed	54.58	1.98	1.04	4.85	17.75	-0.01
Equity-Int'l Emerging*	91.63	12.32	14.59*		27.97*	0.46*
Bonds-US Inv Grade Credit	22.92	4.95	6.73	6.90	6.32	0.62
Bonds-US High Yield Credit	56.26	6.48	6.89	7.34	11.46	0.40
Commodity	26.45	-0.42	5.97	6.01	17.56	0.26
Real Estate-US	99.92	1.07	10.73	9.98	25.82	0.43
Cash	0.15	2.82	2.77	3.60	0.78	-0.03
Equity-US Large Cap Excluding Dividends		**-1.64**	**-3.59**	**5.08**		

* 10 Yr Return since 12/29/00; Std Dev and Sharpe for 5 Yrs

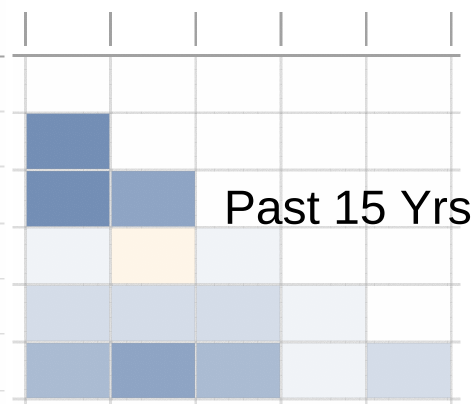
Source: Morningstar Office; 2/28/10

Strategies with value going forward

- Buy and Hold not dead, but need periodic rebalance
  - Large rebalancing movements not natural to most investors, involves buying into a declining stock market
- Diversification Benefits
  - Not the same as portfolio insurance
  - Downside protection can be added but require ongoing management
  - Correlation varies - “the only thing up in a down market is correlation”

Past 3 Yrs

		1	2	3	4	5
1	DJ US TSM Large Cap TR USD					
2	DJ US TSM Small Cap TR USD	0.95				
3	MSCI EAFE NR USD	0.92	0.88			
4	BarCap US Agg Bond TR USD	0.31	0.23	0.38		
5	DJ UBS Commodity TR USD	0.53	0.45	0.62	0.18	
6	DJ US Select REIT TR USD	0.82	0.89	0.75	0.28	0.34



Source: Morningstar @2/28/2010

Strategies with value going forward

- Recognize and respond to the need for individual responsibility for retirement living above subsistence level
  - Need savings plans that support goals
  - Don’t rely on full Social Security benefit
- Use of independent advisors to make sense of information
  - Bold media statement is NOT solid advice
  - One size rarely fits all
  - Consider motivation of the advisor

Strategies with value going forward

- Keep an eye on taxes and tax strategies
  - Roth conversion and other tax awareness strategies - 2010 opportunity
  - Not only tax implications current year but complex SS tax implications down the road
  - Overall tax rates and structures, including capital gains, estate and gift taxes, etc.
- Don't loan to deadbeats – Basic error of banks, government, many investors in CMOs, etc.

Conclusions

- Uncertainty continues
- Good Long Term plan should still be working
- Overly risky or No Financial Plan = distress
- If bad things are happening in the world, financial advisors can help but do not have magic wand

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