

# 401(k) TODAY

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The Latest News on Saving and Investing

Third Quarter - 2006



By Stephen J. Butler

My analytical golfing buddy, Howard Fuchs, was prompted to wonder what might be a reasonably sized nest egg for a comfortable retirement. The same question has become the obsession of the popular press, and the answer has now entered the lexicon as "The Number." After careful study and tedious calculations, Howard concluded that "The Number" is whatever your wife has decided it needs to be.

Meanwhile, a new book titled "The Number," by Lee Eisenberg, is one of the best books I have read on the subject. It digs far deeper than the simple arithmetic and demographic probabilities. It shatters many myths that most of us harbor with regard to how we will live the last third (hopefully) of our lives and pay for that retirement experience. Most important, it demands that we answer some questions that help us shape the quality of life in retirement.

Beyond its information and advice, the book is humorous, with a narrative style that makes it a riot to read, which, considering the subject matter, comes as a pleasant surprise.

A focus of the book is three questions we can ask ourselves and actually write out the answers:

- First, if we had an unlimited amount

## A "number" of ways to save for retirement

of money, what would our ideal retirement look like?

- Next, if we were told we would live for exactly five more years in good health and then die a precipitous death, how would we spend the next five years?

- Finally, if we had 24 hours to live, what would we write down that we thought we had missed? What did we not get to be or do?

The first two questions are answered with pretty similar answers and focus on material wants. Answers to the third question are always qualitative. It's not a trick question. It's a trick set of questions.

When prompted to think about what is really important, planning for retirement for many people takes on a different meaning. Much of the quality of life is not necessarily tied to financial resources. In the book, this message is reinforced over and over.

Another important point from "The Number" is the extent to which a large portion of the public is clueless. This is referred to as "The Lost Years Club." The mind-set of this group is stuck in the question: "How come it's always the jerks who have all the money?"

The "Lost Years" people have made no effort to understand how to achieve financial success. I attribute this to the fact that people in this category have never experienced the sense of satisfaction that can come from having fi-

nancial affairs in order as part of a successful march toward post-job self-sufficiency. The journey is the destination. Many people can't seem to visualize the smug sense of immediate gratification that comes from knowing that they are on the right track right now.

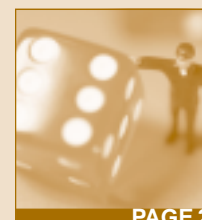
Thank goodness, the average 401(k) participant has had a force-fed course in investment basics -- and with real money to play with. It's the financial industry's equivalent of feeding geese with a funnel for foie gras pate.

But it still takes some amount of personal effort to achieve financial stability. In a roundtable discussion recently, we speculated as to how many people actually keep track of their spending by allocating all of their expenditures into various categories.

Generating this habit is the first step toward responsible financial management, but for some it can be extremely difficult. Years ago, I remember read-

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# Be smart about gloomy forecast

By Stephen J. Butler

The Bible says, "The lamb will lie down with the lion." "But," Woody Allen would add, "the lamb won't get much sleep."

A computerized Monte Carlo simulation spells out the different rates of return to expect from a portfolio of investments after we apply all probable combinations of good and bad influences. These days, after reading ex-Treasury Secretary Paul O'Neil's account of his experience as a member of the administration, I'm convinced that we are all lying down with the lion.

Why would I stock up on "No-Doz?" Apart from O'Neil's account of the administration's obtuse, hopelessly politicized approach to economic policy, I had the opportunity to spend an afternoon with a walking, talking personification of Monte Carlo simulation. This opportunity came in the form of Alan Beaulieu, an engaging economist and partner at the Institute for Trend Research.

Beaulieu points out that we are approaching what could be a perfect storm's economic downdraft, characterized by excessive debt, high interest rates, an aging population, inflation, high inventories, problems in China, midterm elections, much higher oil prices, and a collapse of home prices.

I can't possibly deal with all these in just one column, but let's say that a third of them come to fruition and the rest fall victim to the domino theory. The Institute for Trend Research is predicting that the economy will unravel in 2008 and that the major impact of the coming recession will hit in 2009. This time around, even housing prices will be impacted because part of the perfect storm will be higher interest rates.

In the recent stock market crash, housing prices continued to climb because interest rates declined and stayed low. This time around, rising interest rates will be part of the problem, and housing prices will fall as a result. Think about what house payments (and values) will do if mortgage rates rise from 6.5 per-



cent to 9 percent. The greatest share of our economy is the consumer sector and this recent period's strength has depended upon people spending what has been the equity in their homes. When this resource dries up, the economy will lose a major portion of its underpinning.

Coincidentally, I'm noticing a shift in emphasis from the asset-allocating gurus like Bob Brinker. Brinker's latest letter suggests that while the markets are still strong, any additional money invested at this point should be allocated over time to benefit from dollar-cost-averaging. This is code implying that the market could "tank" or at least "whipsaw."

His conservative portfolio recommends a 30 percent concentration of short-term bond funds and inflation-protected securities. Dan Wiener of the Independent Advisor for Vanguard Investors is suggesting that about 40 percent of the income-oriented portfolio be invested in a short-term bond fund and a GNMA fund.

All is not doom and gloom. By 2012, according to the ITR charts, we'll be rockin' and rollin' again. That's only six years from now. Reflect on how fast the last five years, with its downturn and subsequent rise, have come and gone. It always helps to maintain a long-term view. New money coming into the stock market over the next six years such as retirement plan contributions will have opportunities to buy stocks and mutual funds at low values. The key for people in business, or those managing their personal affairs, is to not be seduced by today's round of "irrational exuberance."

In case anyone hasn't noticed, the Bay Area is booming. Traffic is worse than it has been in five years, and in many vocations it is difficult to find good people to hire. In this heady atmosphere, it is easy to assume these happy days will continue indefinitely.

To make financial and personal decisions based upon this erroneous belief can lead to, let's just say, "a reversal of fortune."

We each have unique circumstances that call for different decisions than the next guy confronted with the same depressing concerns about tomorrow's economy. Those with a long investment time frame should ignore even the worst economic prognosis. Those close to, or enjoying, retirement should assume that their stocks and the equity in their homes might drop by a third for at least the short term and calculate what that will do to their retirement plans. This sobering thought reminded me of the question: "Other than that, Mr. Lincoln, how did you enjoy the play?"

A sense of humor can sustain us and improve our resolve through what could be tough times.

# Extra insurance can help

By Stephen J. Butler

So there I was, enjoying the colonoscopy I had been putting off for about seven years (until age 62). Any enjoyment, however, came from knowing that I was finally getting something accomplished that was foolish to postpone -- especially for a hypochondriac like me.

My concerns about the competence of my practitioners were assuaged when my foreign-born physician assured me that his associates were "the crop of the cream." I figured out what he meant, and he was right. They were excellent.

That was back in February. I am still trying to straighten out the bill, which is turning out to be an object lesson in the world of U.S. medicine today.

The actual cost of the procedure for anyone not having insurance was \$2,458. That was my initial bill. However, Blue Cross has negotiated a fee of \$514 for the procedure, so that's all the clinic will get.

Meanwhile, my company has a high-deductible health plan with a \$1,250 annual deductible. With all the money the company saves in health insurance premiums, we turn around and give each employee (including me) about \$2,000 of tax-free cafeteria plan money that more than offsets what we have to pay in deductibles.

Our company's total cost of health insurance (including these cafeteria plan deposits) has remained constant over the past five years, while elsewhere the costs just skyrocket.

Since the clinic saw that I had a high deductible, they made me pay \$1,200

up front and now I am waiting ... and waiting ... to get back everything that I have spent. The clinic was overpaid by \$686 thanks to my \$1,200 payment. It is now the end of July, and I'm still waiting for this to get straightened out.

When the dust settles, I will effectively pay \$514, but my company cafeteria



plan will reimburse me for this payment. I won't pay any taxes on the \$514, so it will be just like having an insurance company pay the bill.

My company actually administers these cafeteria plans for hundreds of Bay Area companies. The people trying to straighten out my bill are my own trained professionals who work with these problems every day. If we're having trouble battling the system, how on earth does the average person manage to extract what they are owed out of their health insurance carrier?

I have to guess that millions of reimbursements owed by a combination of the insurance industry and health care providers just never get paid. The sys-

tem is too complex, and people undoubtedly just resign themselves to accepting less than they are owed because they don't want to remain on hold for another 30 minutes.

I have heard a few anecdotal success stories told by people who successfully badgered a claims payment person over the phone until they just agreed to pay the claim. It's beginning to feel like the system might be run like the mirror image of a meter maid ticket quota. People working in health insurance claims probably get bonuses for the number of claims they manage to avoid paying.

Meanwhile, United Health reported last week that its quarterly profits are up 25 percent over the same quarter last year. This is the same company that paid its president \$1.6 billion last year. (Billion is not a misprint.) It's enough to make anyone just switch to Kaiser and hope for the best.

This dysfunctional system should be of great concern to people who have left the work force and who are too young to be covered by Medicare. This is the "donut hole" in the health insurance industry that really needs attention. When we read about the various states adopting, or at least considering, universal coverage for all residents, it is this group of formerly productive members of the work force that are my biggest concern.

True, there are 6 million uninsured people in California right now, but we all pay for their coverage to at least some extent if they are impoverished and go to county emergency rooms for treatment.

Actually, people with no health insurance, but who have assets to attach, are charged astronomical rates for services and effectively subsidize the cost of those with no insurance. Responsible residents who have worked forever and who are just trapped by the system for a few years deserve something better.

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## Number of ways... (from page 1)

ing that Tony Curtis was told by his manager to keep track of all his expenses or he would wind up like Mickey Rooney. At the end of the month, Tony's list read something like sandwich (\$1), gasoline (\$5), miscellaneous (\$3,456).

Investing money successfully is also very simple. All you need is a collection of inexpensive mutual funds that reflect a mix of stocks, bonds, cash and real estate. You can skip the real estate fund if you own a home.

From this mix, after retiring, you can expect to spend about 4 percent per year to use as income if you want to be certain of not running out of principal and not having the asset value eaten away by inflation.

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All too often, however, we think we are better investors than we really are. A few good market years (like the past three) are all it takes for us to confuse brains with a bull market. Eisenberg quotes Warren Buffett, who said that it isn't stupidity that screws up investors; "it's not having the temperament to control the urges that get people in trouble."

To this, I would add that the current baby boomers include many who realize that they will be falling short of "The Number." The stage is set for some bad decisions made in a desperate attempt to shore up retirement resources. If something sounds too good to be true, it probably is, but many will be tempted by what looks like a quick buck.

The recent rush to buy ultra-leveraged residential housing for rental properties comes to mind in this respect. If the planets are lining up in a way that indicates you will be having to work well beyond 65, the best advice is to stay the course as a conservative investor and not fall prey to the temptation of what appears to be easy riches. There are no easy riches.

Cheer up. While retirement for some can be a boring wasteland, Eisenberg

points out that today's music played in the common areas of most "active senior" housing developments covers the same tunes that most boomers smoked dope to in the '60s. Trust me. This new class of retirees will find something exciting to do regardless of their economic circumstances. I can hardly wait.

## Extra insurance... (from page 3)

If you see yourself with the potential for this to happen, and you are insurable thanks to good health, it can pay to buy an individual health policy with a high deductible even if you're still working and covered today. If you are covered as a dependent of an insured worker, check to see what you are charged for that coverage and consider spending the money on something independent of the job. That way, at least one of you is guaranteed future inexpensive coverage if the job ends. You can check out rates at [www.ehealthinsurance.com](http://www.ehealthinsurance.com).

Finally, don't hesitate to practice preventive medicine regardless of how inconvenient some of these experiences might be. After all the brain power we apply to managing our investments, it will be all for nothing if we fail to nip a serious health problem in the bud.