MyFRS Financial Guidance Program

Keys to Retirement Planning and Investing

Table of Contents

GET ALL YOUR FINANCIAL QUESTIONS ANSWERED.

Use financial guidance from Financial Engines® at MyFRS.com or by calling a counselor at the toll-free MyFRS Financial Guidance Line — 1-866-44-MyFRS (1-866-446-9377; or TTY: 1-888-429-2160).

Retirement planning and investing for retirement are important — no matter which retirement plan you choose. Your FRS retirement plan by itself cannot provide enough for a comfortable retirement. Everyone needs to learn about saving and investing to help close the gap.

So, no matter which plan you choose, you owe it to yourself to learn all you can about how to plan and invest for your retirement.

The MyFRS Financial Guidance Program — Use It No Matter Which Plan You Choose

- **Phone:** MyFRS Financial Guidance Line: 1-866-44-MyFRS (1-866-446-9377; or TTY: 1-888-429-2160)
- **Online:** MyFRS.com
- **Employee Workshops:** Offered During Your Outreach Period

10 Keys to Retirement Planning and Investing

Keys to Retirement Planning — the Details

1 Find out how much you'll need for retirement.

If you're like most people, you'd like to retire early and enjoy the same lifestyle during retirement that you had while working.

Income Replacement

To keep your same lifestyle in retirement, you'll need to "replace" 70% to 90% of your annual income with income from other sources.

This figure assumes that some of your expenses should go down after retirement (work wardrobe, commuting costs, mortgage payments, etc.), while others may go up (medical, travel, etc.).

You'll need to replace 70% to 90% of your annual income after you retire.

EXAMPLE

If you have a yearly salary of $25,000 when you retire, you're likely to need about $17,500 to $22,500 of annual income during retirement. So what will your savings need to be if you spend $20,000 each year for 25 years of retirement?

- A lot will depend on your investment earnings and costs *during* retirement. But you'll probably need a nest egg of $250,000 to $300,000 at retirement.
- If you hope to retire early or to leave some money to your heirs, or you want to draw out more money each year to keep up with inflation — you'll need a larger nest egg.
- Unexpected medical conditions or family emergencies can change your needs and create large demands on your savings. Plan accordingly.

2 You will need three main retirement sources.

You should have the following **THREE** primary sources of income to pay for your retirement:

- ONE — **Social Security.** Social Security should replace 25% to 60% of your pre-retirement income. The higher your income, the less Social Security will replace. Also, the age at which you can receive unreduced benefits has been increasing.

Social Security, your FRS retirement plan and outside savings will be your primary sources of retirement income.

EXAMPLE

If you're in your early 40s, you won't be able to receive unreduced Social Security benefits until age 67.

- TWO — **Your Retirement Plan.** The amount of your FRS retirement benefit is determined mostly by which plan you belong to, your membership class, how long you remain with an FRS employer and how close to retirement you are when you leave the FRS.

EXAMPLES

So, here's how much of a retirement benefit you can expect to receive if:

- **you're an FRS participant retiring at age 62 with 30 years of service**

  Pension Plan – replaces 48% of the average of your highest 5 years of salary, which is the equivalent of 44% of your final year's salary

  Investment Plan – replaces 38% of your final year's salary (assumes you earn an investment return of 8% each year)

- **you have 20 years of service, leave the FRS at age 52 to work somewhere else and begin receiving your retirement benefit at age 62**

  Pension Plan – replaces 22% of your final year's salary

  Investment Plan – replaces 30% of your final year's salary (assumes you earn an investment return of 8% each year)

- THREE — **Outside Savings.** Any savings you've built up from other employers' retirement plans, profit sharing plans, deferred compensation plans, 403(b) plans, IRAs and personal savings are considered outside savings.

Social Security	+	FRS Retirement Benefit	+	Outside Savings	=	Retirement Income

The MyFRS Financial Guidance Line and MyFRS.com have tools to help you identify:

- How much income you will need to replace during retirement,
- Your sources of retirement income, and
- How likely it is that you will reach your "income replacement" goal (i.e., 70% – 90% of your current salary) if you continue doing what you're doing.

These resources will also help you develop a saving and investment plan to increase the odds of meeting your income replacement goal.

3 Put time on your side.

When it comes to saving and investing, put time on your side — get started now so compound growth can increase your retirement income. Compound growth happens when your investment's dividends or interest earnings are reinvested to earn more dividends or earnings. *"Getting earnings on your earnings"* helps turn a little into a lot over time.

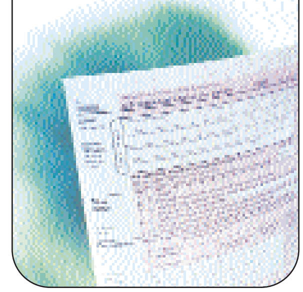
With compound growth, the earlier you start saving, the less you'll have to put away to end up with the same amount. In other words, once you've worked for your money, your money starts working for you.

The earlier you start to save and invest, the more you'll have when you retire.

EXAMPLE

The benefit of starting early.

Meet Tony. He's a 25-year old parole officer. Let's say Tony has an investment that pays 8% interest each year. If he put $3,000 in that investment each year, he would have about $367,000 after 30 years. If instead he started putting money aside 15 years later, he would have to save over $11,000 each year to end up with $367,000.



4 Put off paying taxes on your savings.

Save with pre-tax payroll deductions whenever you can and allow your savings to grow protected from taxes. As a public-sector employee, you probably have the opportunity to make pre-tax payroll contributions to a 457 deferred compensation or a similar program. On your own, you can open an individual retirement account (IRA), where your savings can grow without your paying taxes. Many of these programs do not allow you to get at your savings before retirement, unless you pay tax penalties. Even so, every penny you can protect from taxes now will be worth a lot more when you finally retire.

You can't completely avoid taxes on your retirement savings — but you'll be better off if they can be postponed until later!

Using pre-tax dollars increases your ability to save by lowering your taxes.

EXAMPLE

Meet Michelle. She is 32 and has to pay 25 cents of every $1 of her paycheck in taxes to Uncle Sam. Because of a raise, she can save an extra $75 per month out of her take-home pay.

- If she puts $75 in a regular taxable account paying 8% interest per year, she would pay taxes on her interest earnings each year. After 30 years of contributions, Michelle will have **$75,339** as a nest egg.
- If Michelle can afford to save $75 out of her take-home pay, she can afford to have $100 of her monthly paycheck put directly into a tax-deferred 457 program account. The $25 difference is just the tax she would have paid on the $100 if she'd saved after-tax instead of pre-tax. She would not pay taxes until she withdrew money from the 457 program. If she contributed $100, after retiring in 30 years, Michelle could withdraw her money and have **$111,777** as a nest egg, after paying taxes.

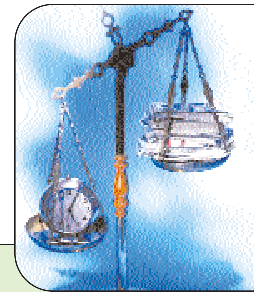
5 Make sure you don't outlast your money.

The good news: People are living longer. Americans who were born at the end of the 20th century are likely to live at least 30 years longer than those born at the beginning. Most 62-year-olds will live at least another 20 years. Many will live another 30 years.

The bad news: You might outlive your retirement savings if you don't plan carefully. After you retire, you'll need to take money out of your savings to live on, so you'll need a payment plan.

Unless you have a medical condition, after you reach retirement age you might consider using an *annuity* to help manage your retirement income. *An annuity is an insurance contract that guarantees regular payments for life or over some set period of time.* The FRS Pension Plan also pays benefits as an annuity.

However, because a financial or medical crisis in your family could cause you to need some money right away, it's a good idea to build flexibility into your payment plan. In retirement, keep some savings in short-term investments, like a money market fund, that have little risk of going down in value. Financial planners often suggest keeping an amount equal to six months of normal expenses in these investments.



Annuities help guarantee that you won't outlast your money. They keep paying you a benefit until you die — no matter how old you are or how long you live.

Keys to Investing for Retirement — the Details

6 No pain, no gain.

Short-term pain, long-term gain

To be a successful long-term retirement investor, you need to understand and accept that the value of your retirement savings will go up and down over the short term. It might hurt to see your savings go down in value, but if you want to see gains over the long run, you're going to have to accept some short-term risk.

The stock market jumps around every day, sometimes a lot. Money market investments, on the other hand, are very stable from day to day and hardly ever go down. Yet, respected financial planners nearly always recommend investing some of your long-term retirement savings in stocks. Why is that?

It's all about inflation

Having enough at retirement will depend on how much your retirement savings stays ahead of increases in the cost of living.

If you're a long-term investor, investing in stocks may help you keep ahead of inflation by providing a higher rate of return than other investments.

EXAMPLE

At 3.5% annual inflation, your $1.00 candy bar today will cost $2.81 in 30 years. Looking at it another way, 30 years from now, $1.00 will only buy you what 36 cents buys today.

To get a true picture of how you're doing financially, you'll need to know your "real" *rate of return. Real rate of return is how much your investments earn after you figure in the effect of inflation.* If your investments earn 6% and the inflation rate that year is 3.5%, then your real rate of return is the difference: 2.5%.

Higher "real" rate of return = more buying power in the future.

Stocks have provided the best inflation protection over the long term

Information recorded on U.S. investments over the past 198 years shows that stocks have provided the highest *average* real rates of return, followed by bonds and then money market funds (cash). Of course, past investment results don't guarantee future results, and no one actually lives for 198 years. Over shorter periods of time, the real rate of return is less dependable — it can be high or low. But over longer periods, the real returns of stocks have provided better protection against inflation than have bonds or cash.

EXAMPLE

If you invested $100 in cash, bonds or stocks, how much would you be able to buy after 1 year and after 20 years?

For people investing over different periods of time, 90% of the time they would have been able to buy this much…

	After 1 Year	After 20 Years
Cash	$93 to $107	$57 to $165
Bonds	$92 to $115	$73 to $265
Stocks	$77 to $144	$136 to $1,064

All figures are based on today's dollars and supplied by Ennis, Knupp and Associates using monthly investment data since 1926 from the following source: Stocks, Bonds, Bills and Inflation® 2001 Yearbook©, 2001 Ibbotson Associates, Inc. Based on copyrighted works by Ibbotson and Sinquefield. All rights reserved. Used with permission.

Because they are relatively new, U.S. Treasury inflation-protected securities were left out of the example. However, they were specifically designed by the U.S. government to protect you against inflation, and they are available to most investors (including participants in the FRS Investment Plan).

In addition, the MyFRS.com Web site has a number of tools that let you check out inflation and investing.

7 Plan your meal before you shop.

Consider the task of planning a meal for a get-together of family and friends. First, you want the food and drinks for the meal to be well balanced and fit together, so the experience as a whole is enjoyable and nutritious. Second, you can't put together a shopping list before deciding what your entire meal is going to be. Similarly, asking what investment funds you should invest in makes no sense if you haven't figured out your retirement goals and strategies.

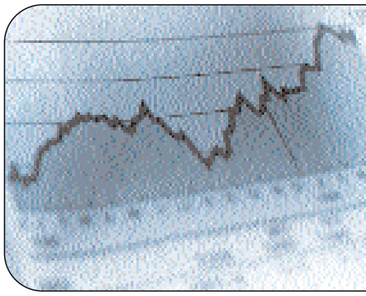
Protect your investment assets by making sure you own a balanced mix of investments (e.g., stocks, bonds, cash).

Get the right balance in your retirement savings

Trying to pick the "best" investment funds or best fund companies without a strategy for how they should fit together is a loser's game. Experts say that **90% of your investment success** will be based on getting the right balance, or asset allocation, in your savings. Why does balance matter? Most investments go up and down in value over time, but not necessarily at the same time. This is known as *diversification*, or *not putting all of your eggs in one basket.*

- Diversification means getting the right mix of different asset classes: stocks, bonds, cash and U.S. Treasury inflation-indexed bonds. A good mix of different asset classes helps spread investment risk and allows you to set how much risk you want in your savings.
- Diversification ***does not mean*** investing in a lot of investment funds. If you invest in funds that are too similar, you may not get any protection against market declines — and you may end up paying higher costs.

Avoiding the loser's game is easy!



Use financial guidance from Financial Engines® at MyFRS.com or call a counselor at the toll-free **MyFRS Financial Guidance Line —** 1-866-44-MyFRS (1-866-446-9377), to help you determine:

- How much retirement income you will need to live comfortably,
- How likely you are to meet your retirement income goal,
- How you can improve your retirement income by saving more and investing tax-efficiently (postponing taxes),
- How you can best change your investments to improve your chances of reaching your retirement goals, and
- How much the value of your savings could fall over the short term because of your decisions.

Whatever your goals and comfort with risk, these resources will provide you with guidance on the specific investment funds to invest in.

8 Patience is a virtue.

How will you react to a 20% decline in the stock market? It may be painful to watch your account value decline from time to time, but if you stick with a disciplined long-term investment strategy, you may make that money back and more. So, unless your long-term strategy has changed, you should resist the urge to "time the market."

Don't try to move your investments every time the market changes … remember, you're in it for the long haul.

What's the matter with market timing?

- *Market timing* is trying to move out of riskier investments such as stocks when the markets start to go down, and jumping back in when the markets start to move back up.
- *Market timers have to be right twice.* They must know when to sell their investments *and* when to buy them back. Since they don't have a crystal ball, the task is nearly impossible.
- In the past, the stock market has gone up over time. This is good for investors who can stay invested in the stock market over the long haul. Keep in mind that you may live many years past retirement age — and you don't have to pull out all your money right away!

For one-stop shoppers: balanced funds

If you're nervous about deciding how to react to the ups and downs of the market, there are other options. Balanced funds provide a simple and inexpensive way for you to keep to a realistic and balanced long-term investment strategy. They diversify by investing in more than one asset class. They also keep the mix of these investments balanced over time, so you don't have to.

Do a realistic gut-check on your risk tolerance

You will need to take some risk to meet your long-term goals, remembering that markets will rise and fall over time. If you're a conservative investor, make sure you're able to handle these changes before you invest heavily in stocks and stock funds. If you're unable to tolerate an extended market loss, you might end up panicking and making bad market timing decisions by selling when stock values are temporarily low.

The MyFRS Financial Guidance Program has resources to help you design a realistic and balanced long-term investment strategy that you can stick with through thick and thin. The resources will also give you guidance on when you should change your strategy.

9 Those little investment fees add up.

What you don't know can cost you plenty over time and cut into your retirement nest egg. *Did you know that if you pay 1% each year in fees on an investment of $20,000, then you'll have about 25% less ($64,000 less) after 30 years then you would have if there were no fees?*

Smart investors look at their investment funds' performance *AND* their fees and expenses, with an eye toward keeping costs down. A fund with high expenses has to perform a lot better than a low-cost fund just to stay even. Really savvy investors also pay attention to hidden expenses, like turnover, surrender fees and restrictions on moving funds. Remember, costs are a drag on your savings every month, and they take away more and more of your savings over time.

The administrative fees that some IRAs and investment funds charge can also have a big impact on your retirement savings. They seem little but they can really add up.

Check it out

You can check out the fees for thousands of investment funds and each of the funds in the Investment Plan by logging on to MyFRS.com or calling a financial planner at the toll-free **MyFRS Financial Guidance Line** — 1-866-44-MyFRS (1-866-446-9377). You can also use a cost calculator at MyFRS.com to see the long-term effect of fees and expenses.

10 Keep your head out of the sand.

You're the customer, so take charge. Understand your rights, ask hard questions, and do what's in your best interest. Practice "buyer beware" whenever you're investing. You're also not getting any younger! The key to a financially secure retirement is to ***start early*** to learn about retirement planning and investing.

Be sure to review your statements from the FRS, Social Security and any savings plans you're participating in. They will help keep you on track and help you learn more about fees.

Don't know whether a savings plan is available through your employer? Check with your human resources representative or benefits coordinator to see what savings plans may be offered at your work location.

YOU OWE IT TO YOURSELF.
Become a smart investor by using the independent and objective education resources available to ***all*** members of the Florida Retirement System — free of charge — no matter which plan you choose.

GET ALL YOUR FINANCIAL QUESTIONS ANSWERED.
Use financial guidance from Financial Engines® at MyFRS.com or call an Ernst & Young financial planner at the toll-free MyFRS Financial Guidance Line — 1-866-44-MyFRS (1-866-446-9377).

MyFRS
Financial Guidance Program
Florida Retirement System