How to Protect Yourself in Today's Scary Economic Environment

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RUTGERS
New Jersey Agricultural Experiment Station

We don’t just have a perfect storm…

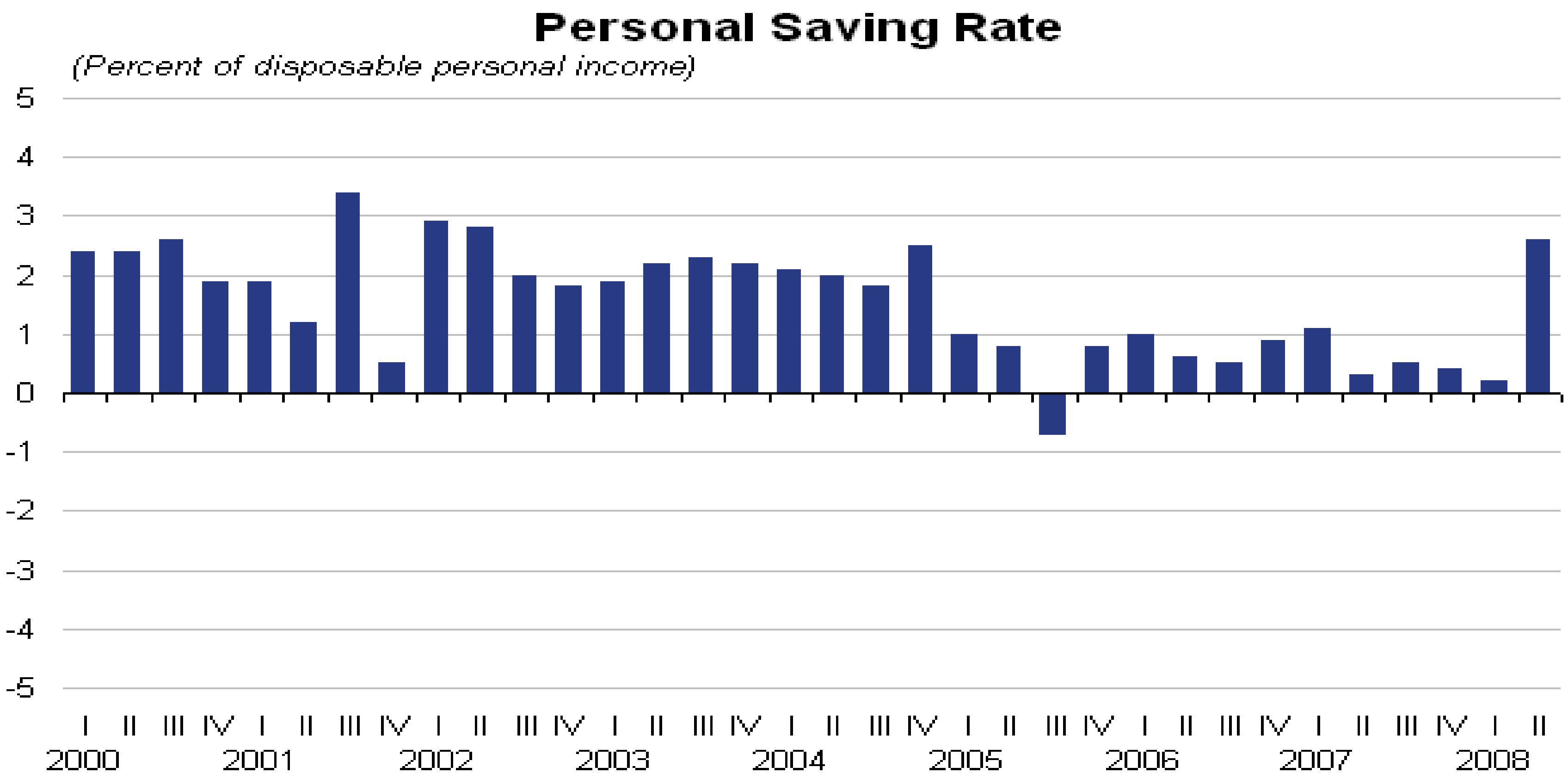
…We have a perfect **TORNADO!!!**

Recent Crises

- Recession fears
- Collapsed investment banks
- Bank failures and government takeovers

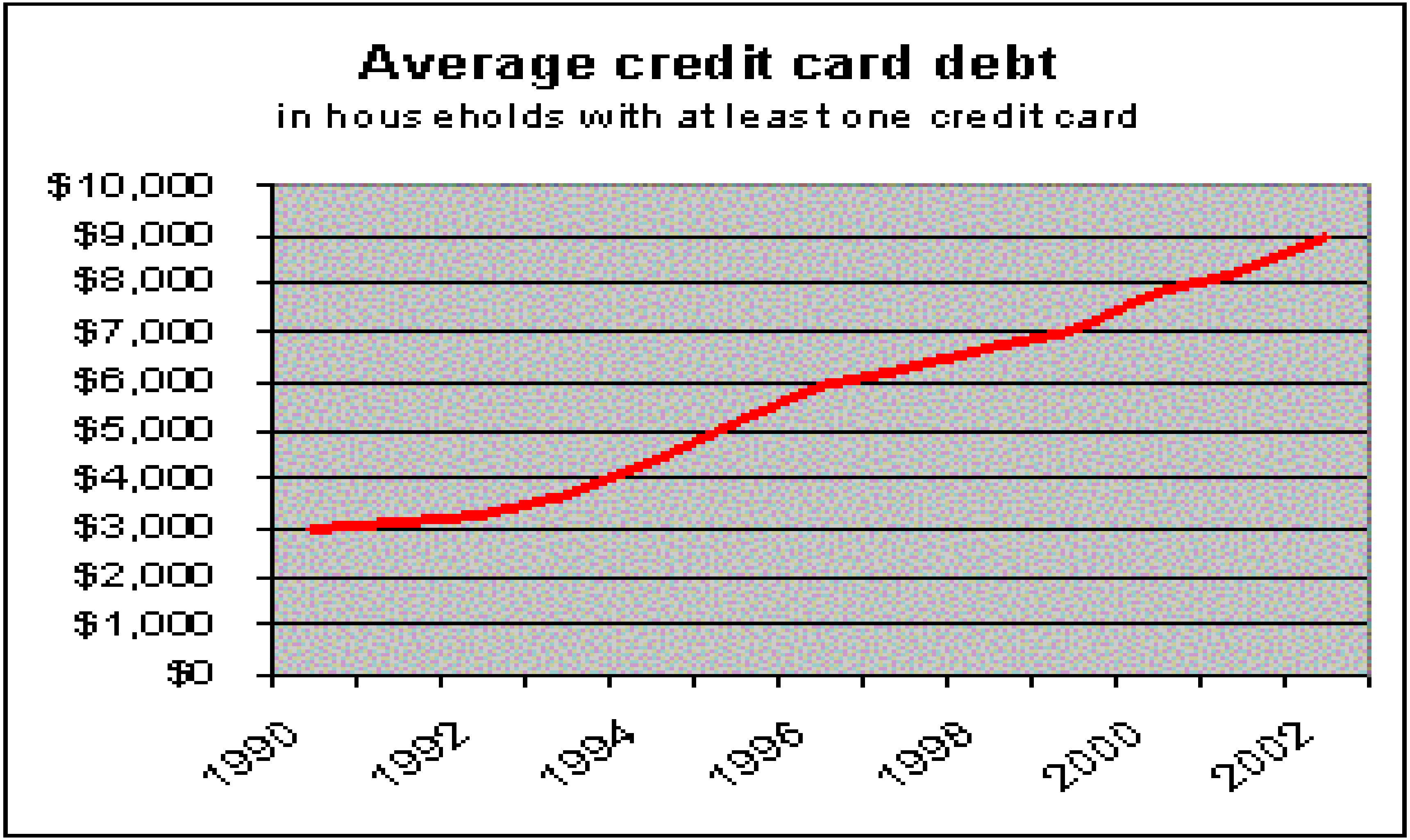
- Mortgage defaults and foreclosures
- Declining stock prices and home values
- Increased costs for food, home heating, and gas
- Rising unemployment rates
- Credit crunch

Record Low Personal Savings Rates



U.S. Bureau of Economic Analysis

Record High Credit Card Debt

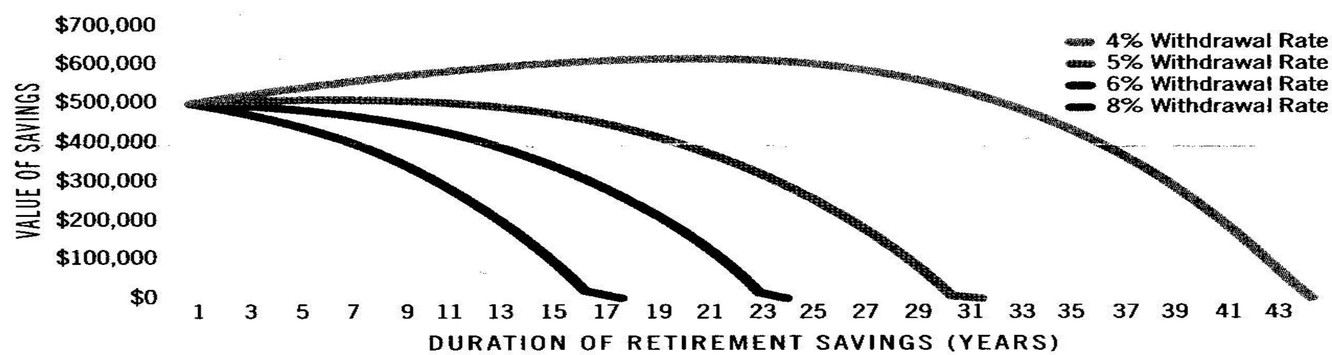


Americans Unprepared for Retirement: Asset Withdrawals

- Almost 7 in 10 (69%) surveyed adults said they could withdraw 7% of savings annually while preserving principal (MetLife Mature Market Institute Survey, 2008)
- Financial experts generally recommend a withdrawal rate of no more than 4% to 5% annually (less for conservative investors)

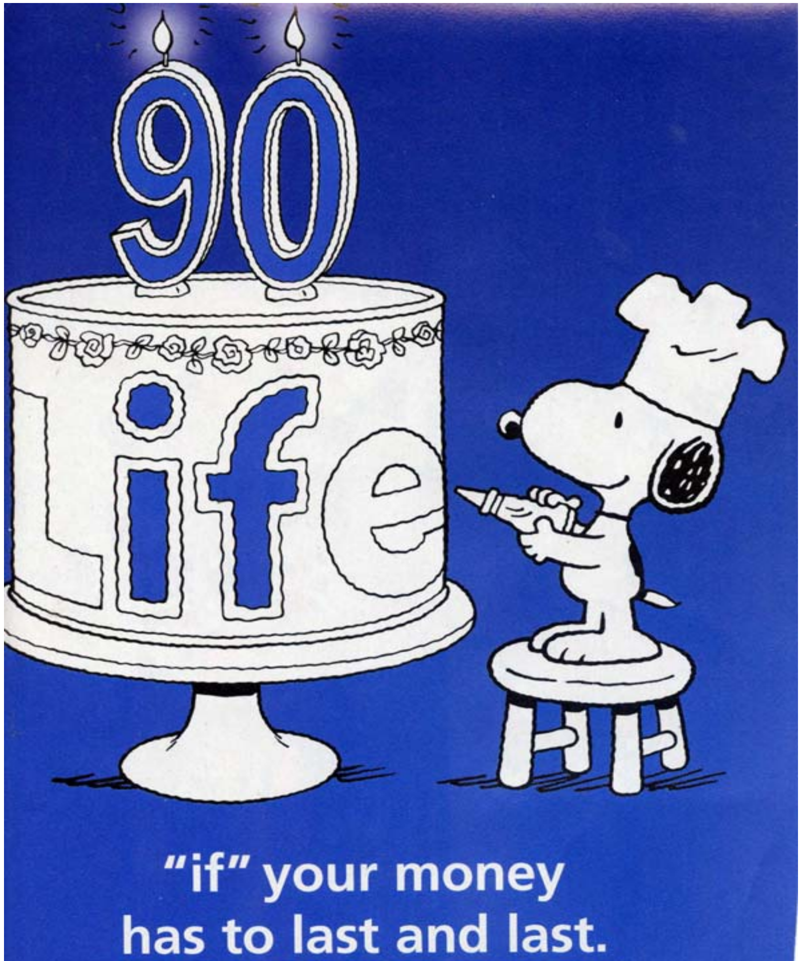
A Word About Withdrawals

Withdrawing too much on an annual basis may increase the chances of depleting your assets. The chart shows how long a portfolio worth $500,000 at retirement would be expected to last at various withdrawal rates. The example assumes a 3% annual inflation rate applied to annual withdrawals and a 6% annual rate of return.



Source: Standard & Poor's. The chart is hypothetical and for illustrative purposes only. It does not represent an actual investment.

Americans Unprepared for Retirement: Increasing Life Expectancy



= Homeland Financial Insecurity

How to Calm Yourself-Without Drugs

- Admit that you are nervous
  - Write down your biggest financial fears
  - Ask yourself how realistic they are
- Tune out market "noise": CNBC, CNN, etc.
- "Invest" in a personal bailout plan ASAP… debt reduction (see **www.powerpay.org**)
- Consider hiring a financial advisor

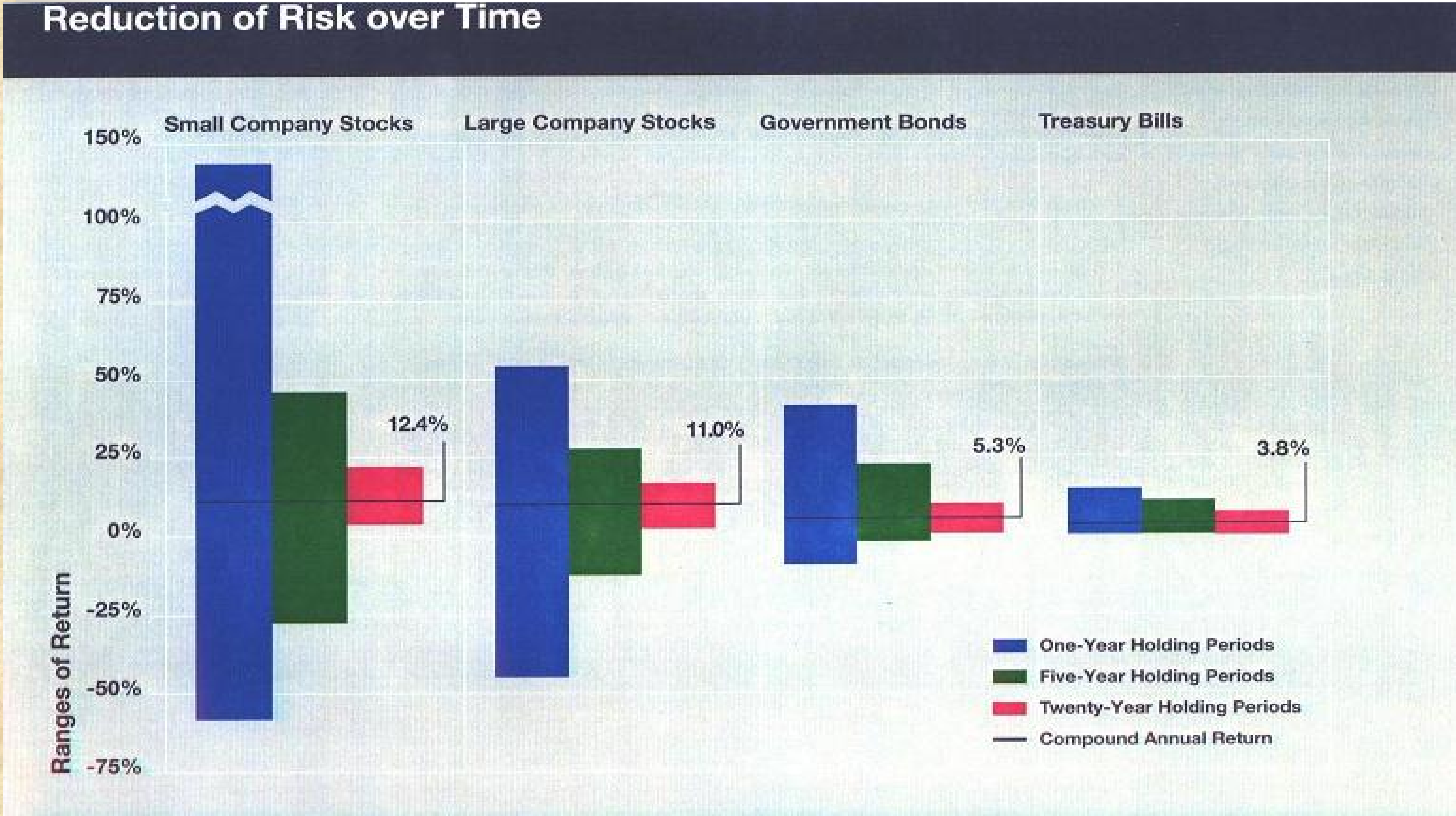
Key Behavioral Finance Concepts

- We feel losses 2 ½ times as much as equivalent gains
- We erroneously estimate our tolerance for investment risk and market volatility
- We extrapolate short-term events into the future
- When our sense of control is threatened, we tend to believe whatever information we have is complete and reliable

What We Know From Research

- People with financial plans feel more secure than those without financial plans (at all income levels)
- Market timing is futile: jumping in and out of investments and missing “up” days reduces overall returns
- Investment volatility is normal
- Over time, stocks have outperformed all other asset classes (e.g., bonds and cash equivalents)

Investment Risk Over Time



What to Do? Control What You Can (Your Response to Current Events)

- Spend less than you earn
- Be future minded
- Follow recommended financial practices
- Build human capital
- Make compound interest your friend
- Save and invest regularly
- Develop a personal asset allocation strategy
- HONESTLY assess your risk tolerance level
- Diversify your investments
- Buy low and sell high

Some Helpful Historical Numbers

Asset Mixes and Their Past Performance: 1926-2007

Portfolio Allocation: Stock%/Bond %, Average Annual Return (%), Worst One-Year Loss (%), Number of Years Out of 82 With Losses

100% bonds, 5.5%, -8.1% (1969), 13 of 82 years
20% stocks and 80% bonds, 6.8%, -10.3% (1974), 11 of 82 years
30% stocks and 70% bonds, 7.4%, -14.2 % (1931), 13 of 82 years
40% stocks and 60% bonds, 7.9%, -18.4% (1931), 15 of 82 years
50% stocks and 50% bonds, 8.4%, -22.5% (1931)16 of 82 years
60% stocks and 40% bonds, 8.9%, -26.6% (1931), 20 of 82 years
70% stocks and 30% bonds, 9.3%, -30.7% (1931), 21 of 82 years
80% stock and 20% bonds, 9.7%, -34.9% (1931), 22 of 82 years
100% stocks, 10.4%, -43.1% (1931), 24 of 82 years

Source: The Vanguard Group:
htpps://personal.vanguard.com/us/planningeducation/general/PEdGPCreateTheRightMixContent.jsp

Retiring in Bad Economic Times

- Get help
- Don’t bail on the stock market
- Consider putting off retirement
- Consider part-time work after retirement
- Start setting aside a 3-5 year cash cushion to fund uncovered expenses (above Social Security and pension income) to avoid selling stock
- Establish a home equity line of credit

Investment Tips

- Set target percentages for each asset class
  - % of portfolio in stocks, bonds, real estate, and cash
- “ Rebalance” periodically by selling what you are over weighted in and buy what’s low
- Sign up for automatic portfolio rebalancing services (e.g., TIAA-CFEF)
- Ideally, your risk tolerance level should be fairly stable over time

Protect Your Nest Egg

- Don't panic: you have time and options!
  - Your investment time horizon is your lifetime, not your retirement date!
- Don't get too conservative or your assets may NOT last your lifetime (Monte Carlo analysis calculators)
- Take a hard look at your asset allocation, cash flow, and spending
- The more asset classes you hold, the less volatile your portfolio will be

The Big Question: How Much $$$ in Stocks, Bonds, and Cash Assets?

- Think in terms of THREE buckets
- Any money you KNOW you will need within 5 years -- **Cash**
- For money DEFINITELY NOT needed for 10 years -- **Stock Mutual Funds**
- For money you MIGHT need in less than 10 years -- **Bonds or Bond Mutual Funds**

In Times of Crisis and Uncertainty, Knowledge is Power!

- Visit Rutgers Cooperative Extension's *Money and Investing* Web site: **http://njaes.rutgers.edu/money2000/**
- Visit *Investing For Your Future* home study course: **www.investing.rutgers.edu**
- Use the Ask an Expert and FAQ features of eXtension's *Personal Finance* Web site: **www.extension.org/personal_finance**
- Attend seminars by, and meetings with, retirement plan providers

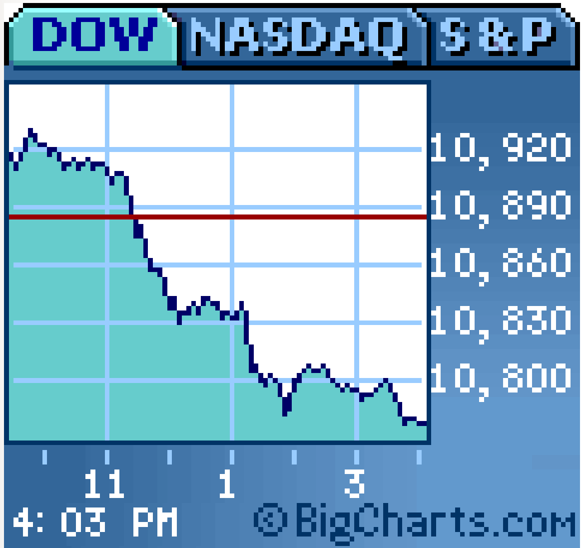
Closing Thoughts

- Take a long-term view of historical investment performance
- Time heals many wounds: stock markets will eventually rebound
- Keep saving and investing, consistent with your REAL risk tolerance level
- Get help, where needed

Don’t Try to Time the Market!

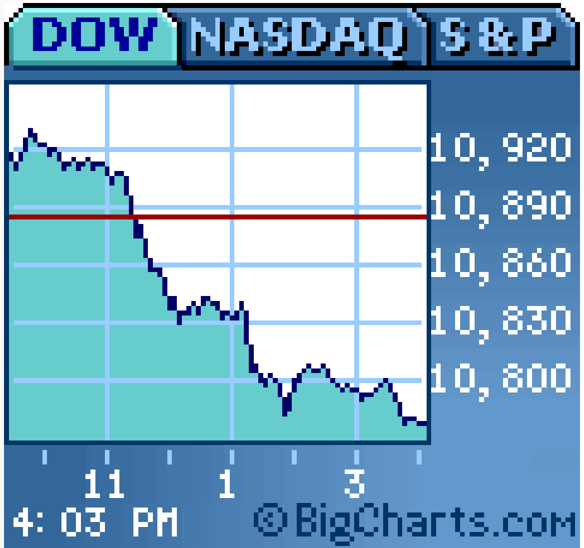
Closing Quote #1

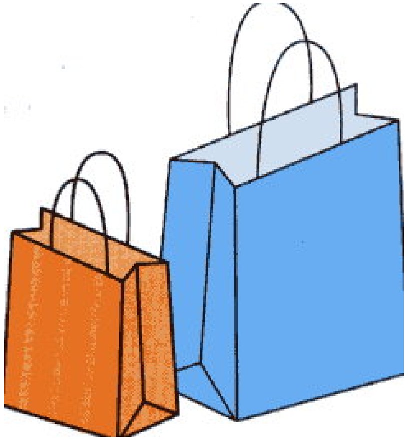
"The stock market is the vehicle for the orderly transfer of wealth from the impatient to the patient."



Closing Quote #2

"The stock market is the only market where, when they have a sale, people rush out of the store."





Questions and Comments?

What would you do in a real tornado? Protect yourself and take cover.

The same applies for this financial tornado. Eventually, it will pass!

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