



## Retirement Income Sources

Concerns about shortfalls in traditional retirement income sources like Social Security and pension plans have caused people to expect to rely more heavily on personal savings to fund their retirement. The graph illustrates that while only 50% of current retirees utilize their personal savings for retirement income, 65% of current workers anticipate personal savings to play a role during retirement. Further, 73% of workers expect to receive retirement income from an employer-sponsored retirement savings plan, while only 51% of those already retired actually receive income from such a source.

It may be a good idea to plan for a diminished reliance on Social Security or a pension plan. Whatever extra funds you save by taking this more conservative view will make retirement all the more enjoyable.

Times are Changing:  
Sources of Retirement Income are Shifting



Source: Employee Benefit Research Institute, 2011 Retirement Confidence Survey.



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# Takeaways for Retirees from the Recent Market Drop

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A bear market might be good news for young investors looking to buy stocks on the cheap, but budget-priced stocks are thin gruel for retirees and pre-retirees who are relying on their portfolios to fund living expenses. A deep and protracted down market, such as the one we encountered in 2008 through early 2009, carries some takeaways for retired investors or those looking to retire within the next few years.

**Get Used to Low Yields (as if you weren't already):** True, some market watchers had been warning about the potential for higher interest rates at some point in the not-too-distant future. But that eventuality became even more distant when the Federal Reserve announced that it will hold interest rates near zero through the middle of 2013. That's good news for borrowers and owners of riskier assets, such as stocks, but it's bad news for yield-starved savers.

As a retiree, you probably don't want to hold more cash than you need to fund one to two years' worth of living expenses, as the opportunity cost of holding too much cash is extreme. Also, don't put up with nonexistent yields from your local bank; shop around and be willing to be flexible. For example, you can create a two-part short-term fund consisting of true cash combined with a high-quality short-term bond fund.

**Don't Be Too Quick to Cast Out Treasuries:** In recent months there's been a lot of trash talking going on in the Treasury market. Some investors have been avoiding the bonds or even shorting them, saying the bonds' yields are too low and the U.S. deficit is too high. There is also fear that Treasuries will get creamed in a rising-rate environment. And, in the latest bit of ignominy for Treasuries, Standard & Poor's said they can no longer be considered a "risk-free asset."

But the market's recent swoon telegraphed something loud and clear: In a true flight to safety, very few assets will hold up better than U.S. Treasury debt, downgrade or not. That's not to say Treasuries are a screaming buy at this point, and yields are more anemic than ever. But it does argue for not getting too heroic about purging them from your portfolio

altogether. If your goal is to find an investment that will zig when your stocks are zagging, it's hard to argue that Treasuries don't deliver.

**A Well-Thought-Out Asset Allocation Is Your Best Friend:** If you're retired or getting close, by far the best way to ride out periods of market weakness is to pay due attention to your asset allocation and cash reserves. The bucket approach to staging retirement portfolios, whereby you stash enough to cover your near-term expenses in ultra safe securities and hold the rest in long-term securities like bonds and stocks, is an intuitive way to back into the right appropriate asset allocation.

**Dollar-Cost-Average Into Inflation Protection:** If gloom over the strength of the global economy continues to worsen, inflation-conscious investors might be able to add inflation protection to their portfolios at more advantageous prices than when inflation was grabbing all the headlines. Dollar-cost averaging into investments such as TIPS or commodities will help reduce the odds of buying into inflation fighters when their prices are lofty.

There is no guarantee that diversification, asset allocation and dollar-cost averaging will protect against market risk. These investment strategies do not ensure a profit or protect against loss in a declining market. In addition, since investing by dollar-cost averaging involves continuous investment in securities regardless of fluctuating prices, investors should consider their financial ability to continue purchases through periods of both low and high price levels.

## Income Gap

The recent low interest rate environment has resulted in lower income from short-term fixed income investments. Relying on yields alone may not generate the cash flow needed to meet your income requirements in retirement. If you are looking to generate more income, consider adding dividend-paying stocks to your retirement portfolio.

Dividend stocks may provide income through dividend payments as well as the potential to benefit from stock price appreciation. Further, these dividend payments may soften losses during turbulent markets, particularly when investors incur negative returns. This means that when dividends are paid out, they act as a cushion and are positive whether stock returns are positive or negative.

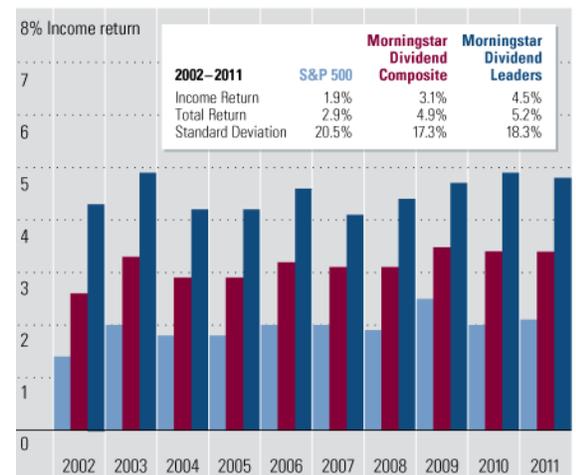
The image compares the annual income return for the S&P 500, Dividend Composite and Dividend Leaders index over the past 10 years. As seen in the image, dividend-paying stocks produced higher income returns relative to the S&P 500 over this time period. The 10-year average income return for the S&P 500 was 1.9%, compared with the Dividend Composite and Dividend Leaders indexes, which returned 3.1% and 4.5%, respectively.

Stocks that pay dividends may serve as an income source while also providing investors with exposure to the growth potential of the stock market. Consult your financial advisor to learn more about adding dividend-paying investments to your portfolio.

Past performance is no guarantee of future results. Dividends are not guaranteed. Diversification does not eliminate the risk of experiencing investment losses. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than the other asset classes. Income return and total return are represented by the compound annual return over the time period analyzed.

The Morningstar Dividend Composite Index captures the performance of all stocks in the U.S. Market Index that have a consistent record of dividend payment and have the ability to sustain their dividend payment. Stocks in the index are weighted in proportion to the total pool of dividends available to investors. The Morningstar Dividend Leaders Index captures the performance of the 100 highest yielding stocks that have a consistent record of dividend payment and have the ability to sustain their dividend payments. Stocks in the index are weighted in proportion to the total pool of dividends available to investors.

### Income Returns 2002–2011

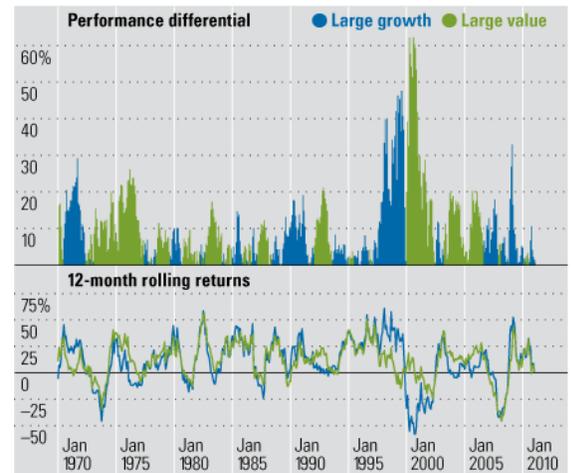


S&P 500 is represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the U.S. stock market in general. Morningstar Dividend Composite is represented by the Morningstar Dividend Composite Index, and Morningstar Dividend Leaders by the Morningstar Dividend Leaders Index.

## Head to Head Competition: Large Growth versus Large Value

The battle between large-cap growth and value investing has been going on for years, with each style trying to seize the spotlight. Although there is an annual frontrunner, history shows that leadership shifts with market conditions. In the bull market of the late 90s, growth stocks offered superior returns. But, since that bubble burst in 2000, value went on quite an impressive run. Growth seems to have captured the spotlight more recently between 2007 and 2010; however, 2011 was a mixed bag. Many wonder if the tables have turned yet again. Determining your allocation between growth and value can be difficult. Which style is more stable, or which will provide higher returns? Unfortunately, there is no definite answer. Focus on finding the option that offers the most upside for your situation: perhaps it's growth, maybe value, or possibly a blend of both.

### One-Year Growth and Value Cycles: 1970–2011



Performance differential measures the outperformance of one asset class over the other using 12-month rolling returns. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Past performance is no guarantee of future results. Returns and principal invested in stocks are not guaranteed.

Source: Large growth and value stocks in this example are represented by the Ibbotson Associates Growth and Value Indexes for 1970–1997 and the Morningstar Style Indexes thereafter. Ibbotson Associates Growth and Value Indexes are calculated based on data from CRSP US Stock Database and CRSP US Indices Database, Center for Research in Security Prices (CRSP®), The University of Chicago Booth School of Business. Used with permission.

## The Personal Saving Rate

Saving is an important part of any sound financial plan. In order to measure consumer spending and saving, the Bureau of Economic Analysis publishes personal income, expenditure and saving statistics, including the personal saving rate. This saving rate is calculated by taking disposable income (income after taxes), subtracting personal consumption expenditures, and dividing the result by personal disposable income. The saving rate has been generally trending downward for the past few decades. Recently, the saving rate was 3.7% in February 2012, extremely low when compared with previous levels. As the image illustrates, it would seem that when the market is in trouble, consumers get scared, spending less and saving more; the opposite happens when the market is doing well. However, even if the economy is now on the way to recovery, it's probably not a good idea to stop saving.

### Personal Saving Rates and the Market January 1980–February 2012



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Source: The market is represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the U.S. stock market in general. Saving rate data from the U.S. Department of Commerce, Bureau of Economic Analysis, through the Federal Reserve Bank of St. Louis (FRED® database).

## The Cost of Taking a Cash Distribution

Deciding what to do with your 401(k) balance when you leave a job does not have to be difficult. It is something that almost everyone will have to do at some point. The best approach is to look at the various options, understand the differences, and figure out how your decision will impact your ability to save for retirement. In general, here are the options available: 1. Keep your savings in your previous employer's 401(k) plan (typically allowed if you have a balance of \$5,000 or more), 2. Transfer your savings to your new employer's 401(k) plan, 3. Transfer your savings to a Rollover IRA, or 4. Take a cash distribution.

Let's look at a hypothetical example of an individual with \$20,000 in a 401(k) who has left his or her job. This person now has to choose between the options above. Let's assume a hypothetical 8% annual return over a 20-year period. If the money was kept in a 401(k) plan or rolled into an IRA, it would have grown to \$93,219 over 20 years. Alternatively, you

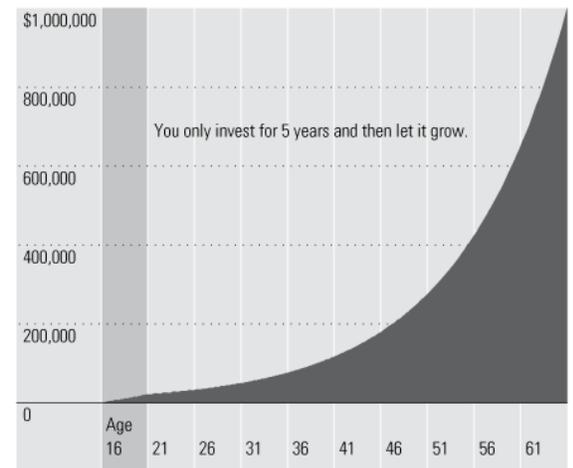
could spend the \$20,000 or put it into a taxable account, but these options do not provide the benefits of tax deferral. Furthermore, the tax consequences and early withdrawal penalties involved with the cash distribution would greatly reduce the actual amount of cash received. While cashing out from your retirement plan when you leave a job may seem like an attractive option, even the smallest withdrawal may have more sizeable financial consequences than you realize.

Withdrawals from tax-deferred accounts will be taxed at then-current rates. Early withdrawals may be subject to surrender fees, and withdrawals made prior to age 59½ may be subject to a 10% IRS penalty tax. Past performance is no guarantee of future results. You should consult your tax advisor as to the tax consequences of a particular investment.

## Retirement: The Next Generation

If you had a dollar for every time you heard the phrase "Start investing early," you could retire with a million. If you actually acted on that phrase, you are probably retiring with more. Now is the time to encourage your children and grandchildren to start saving as soon as they get their first job. Let's assume that your teenage child or grandchild is employed for five years from age 16 to age 21. During this time, he or she saves \$276 per month (\$3,315 per year) and invests the money in a Roth IRA (paying taxes, of course, but at a low tax bracket). This may be a serious sacrifice for a teenager, so any contribution from you would be of great help. Assuming the money returns the historical equivalent of a diversified 60% stock/40% bond portfolio, your child can retire at 65 with \$1 million tax-free, without having to invest another dollar after age 21.

### Retiring With \$1 Million



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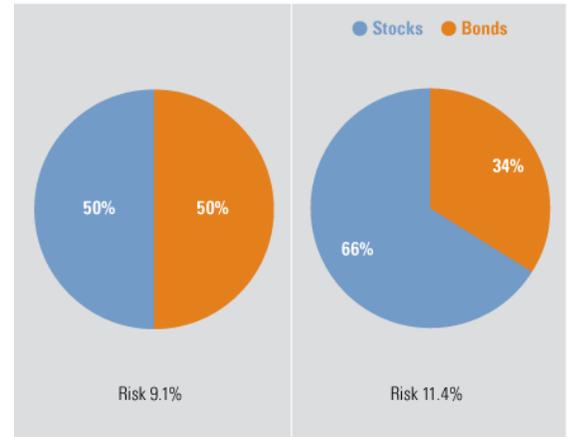
Source: Stocks in this example are represented by the Standard & Poor's 500®, which is an unmanaged group of securities and considered to be representative of the stock market in general. Bonds are represented by the 20-year U.S. government bond. An investment cannot be made directly in an index. The data assumes reinvestment of all income and does not account for taxes or transaction costs. The diversified portfolio was rebalanced every 12 months. The return used for calculations was the average of 50-year rolling returns for 1926–2010.

## The Importance of Rebalancing

Over time, your asset-allocation policy can veer off track because of market ups and downs. This is illustrated quite clearly in the attached image; a strong stock performance can cause a simple 50/50 portfolio mix to become unbalanced over time. After 30 years, what was once a 50% allocation to stocks now sits at 66%—quite a jump. Moreover, not only does the portfolio's allocation change, but the portfolio's risk also changes, rising sharply from 9.1% to 11.4%. If your needs and/or risk tolerance have not changed, your allocation shouldn't either.

But why would anyone want to sell investments that have done great in order to purchase laggards? While rebalancing might seem odd at first, it is all about risk control. If more and more of your total portfolio winds up in one investment, you risk losing a lot should that investment stumble.

Change of Portfolio Allocation:  
January 1982–December 2011



Keep in mind that an investment cannot be made directly in an index, and past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. The sale of an investment for the purposes of rebalancing may be subject to taxes. Risk is measured by standard deviation. Standard deviation is a statistical measure of the extent to which returns vary from the expected returns. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest. Stocks are not guaranteed and have been more volatile than bonds.

Source: Stocks—Standard & Poor's 500®, which is an unmanaged group of securities and is considered to be representative of the stock market in general; Bonds—five-year U.S. Government bond.

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