

Financial Planning Discussion with Staff of New Trier High School

Staff Members Approaching Retirement
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Outline of Discussion

- **Elements of a Sound Financial Plan**

(the foundations of the holistic plan)

- Net Worth Page 3
- Cash Flow Page 3
- Portfolio Page 3
- Risk Management Page 3

- **Elements of a Sound Investment Strategy**

(the tools that assist in attaining retirement objectives)

- Determination of assets required on day one of retirement Page 4
- Principles of intelligent investing Page 5

- Equity structures Pages 6-7
- Fixed income structures Pages 8-9

- New Trier investment options Page 10, 12
- Importance of keeping expenses low Page 11, 13

- **Bringing it all Together**

(implementation of the retirement strategy)

- As you approach retirement Pages 14-15
- Once in retirement Pages 14-15
- On-going monitoring Pages 14-15

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- Appendix Page 18

Elements of a Sound Financial Plan

- **Current Net Worth**

- Assets
 - All personal assets
 - All investment accounts (the sum of which is used to determine your required retirement nest egg)
 - Your “starting point” for smart planning
 - Will this grow to a level sufficient to support and sustain you in retirement?
- Liabilities
 - All personal debt obligations

- **Cash Flow Patterns**

- Current sources of cash inflows and outflows
- Future years
 - Adjusting for the impact of inflation
 - What expenses will change in future years?
- Objectives, needs and wealth transfer
 - Your specific and unique goals
 - Education planning
 - Charitable intentions
- How these cash flows are expected to change over time
- Your cash flow patterns and future needs will determine “how much” will be required on day #1 of your planned retirement

- **Portfolio**

- Must be structured to support cash flow patterns
- Defined by investment options available through your retirement plan and access to other investment instruments
 - Think of TRS/IMRF as an “immediate annuity” that commences at retirement
- Return expectation must support attaining your nest egg target
- Must take both your “financial capital” & “human capital” into consideration

- **Risk Management**

- Insurance, as necessary

Elements of a Sound Investment Strategy

- **Develop an understanding of where you are now financially**

- A realistic and complete inventory of all financial resources and the related funding strategies
 - New Trier sponsored plans
 - Annuity contracts
 - IRAs, Roth IRAs
 - After-tax personal accounts
 - Be holistic and take ALL family assets into consideration

- **Where you need to be in the future**

- Determining how much you need to retire
 - The “Number”
 - The pre-tax total dollar amount of investments you should have accumulated, or ideally exceeded, by your specified retirement age to fund your golden years
 - Roughly equal to the present value of all possible expenses you will incur from the day you retire until death
 - Good software packages to estimate the “Number”
 - NSIC will assist you with this calculation

It is imperative that you have an estimate of this as you approach retirement

- Required savings patterns
 - How much additional savings may be necessary to arrive at your “Number”
 - Employer plans, other accounts
- Realistic expectations
 - Likely average annual portfolio returns (be conservative)
 - Downside risks
 - Possible inflation rate on expenses (be aggressive)

Principles of Intelligent Investing

- The following principles are very broad, and thus, applicable to all of your investment accounts, including:
 - Mutual funds held in variable annuities in your 403(b) plan
 - Direct mutual fund holdings in your 403(b) plan (e.g., Vanguard/American Funds)
 - Non-employer sponsored investments (traditional IRAs, Roth IRAs, after-tax accounts, other)
- **Markets work.** Capital markets do a good job of fairly pricing all available information and investor expectations about publicly traded securities.
- **Diversification is key.** Comprehensive, global asset allocation can neutralize the risks specific to individual securities.
- **Risk and return are related.** The compensation for taking on increased levels of risk is the potential to earn greater returns.
- **Portfolio structure explains performance.** The asset classes that comprise a portfolio and the risk levels of those asset classes are responsible for most of the variability of portfolio returns.

Elements of a Sound Portfolio – Equity Allocations

- **Proper Equity Allocations**

- **Appropriate allocation to the stock market**

- Will be a function of expected TRS benefits and other assets
- At age 65, a conservative investor should have roughly 55% of total assets allocated to stock investments
- The “Rule of 120”
- Minimizes the risk of “superannuization” (e.g., running out of money)

- **Core / Satellite**

- **Passive Core**

- Up to 50% of stock allocation should be in index funds
- Large-cap focus

- **Active Satellites**

- Approximately half of stock allocation should be in active, or engineered, funds
- Intelligent, low-cost, low-turnover active manager inclusion helps contend with time periods when active management performs better than passive indexing
- Seek managers who have generated superior returns with “statistical significance”

- **Global**

- Half of the global stock market is now outside the U.S.
- Emerging markets taking on increasing importance
- Domestic investors allocate roughly 15% of assets outside U.S. (“home bias”)

- **Stock Allocation Tilts**

- **Value vs. Growth**

- Value stocks have generated superior returns when compared to growth stocks over time
- Holds true for domestic stocks, non-U.S. developed and emerging markets

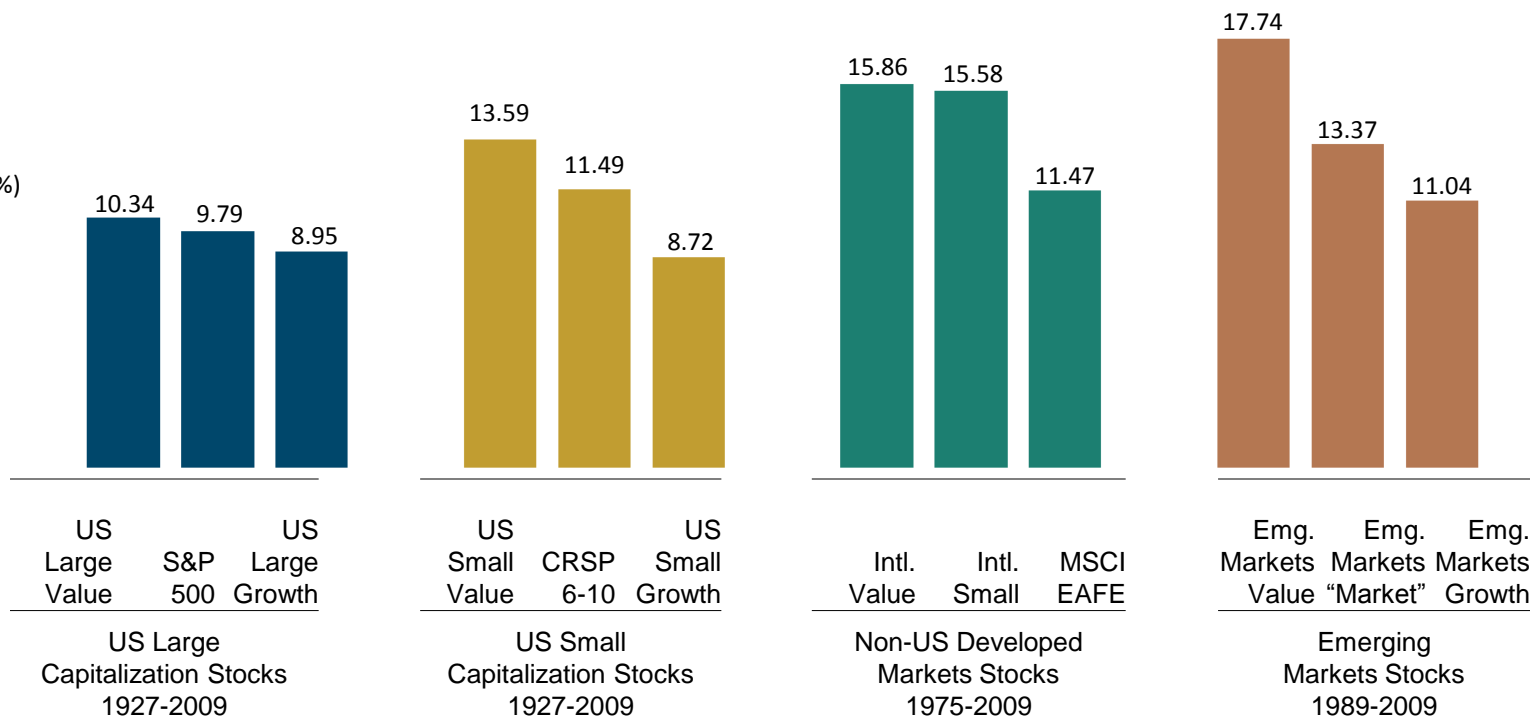
- **Small vs. Large**

- Small-cap stocks outperform large-cap stocks over time

See chart on next page

Size and Value Effects Are Strong around the World
Annual Index Data

Annualized
Compound Returns (%)



US Large Value	S&P 500	US Large Growth	US Small Value	CRSP 6-10	US Small Growth	Intl. Value	Intl. Small	MSCI EAFE	Emg. Markets Value	Emg. Markets "Market"	Emg. Markets Growth
US Large Capitalization Stocks 1927-2009			US Small Capitalization Stocks 1927-2009			Non-US Developed Markets Stocks 1975-2009			Emerging Markets Stocks 1989-2009		

Average Return (%)	13.96	11.85	11.27	18.98	15.82	13.74	18.63	19.12	13.82	24.72	19.45	17.00
Standard Deviation (%)	27.17	20.63	22.06	35.30	31.09	34.20	24.90	28.54	22.60	42.22	37.49	36.21

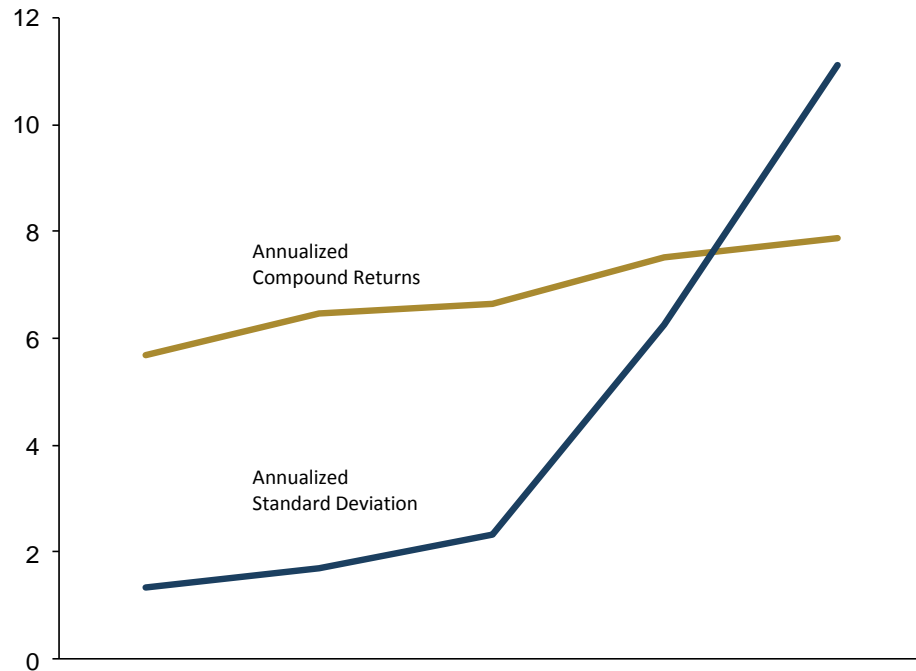
Elements of a Sound Portfolio – Fixed Income Allocations

- **Fixed income holdings should be short-term in nature**
 - Less than 5-years average bond maturity
 - Beyond 5-years, bond risk begins to exceed expected return
 - Focus on investment-grade quality domestic funds
 - Bond portfolios with an average credit quality of AA or greater
 - Non-U.S. bond holdings must be hedged for currency exposure
 - A short-term bond index fund is appropriate for most investors
 - Vanguard Short-term Bond Index mutual fund is ideal
 - Well diversified
 - Low fee structure
 - High quality
- **Do not think of fixed income investments as a primary source of portfolio return generation**
 - The main reason to include fixed income in portfolio asset allocation is to reduce overall portfolio volatility
 - “Helps you sleep better at night”
 - Sizeable client portfolios (roughly \$1.0 million or more) may have limited allocations to high yield bonds, Treasury Inflation-Protected Securities (“TIPS”) and other niche bond categories
- Remember, once in retirement, TRS/IMRF pension payments will mimic immediate fixed income annuity return patterns
- **At age 65, should have roughly 45% in fixed income**
 - Including the present value of your TRS/IMRF pension benefits

Evaluating the Maturity Risk/Return Tradeoff for Bonds

Quarterly: 1964-2008

- Historically, longer-maturity instruments have higher standard deviations (levels of risk) than shorter-maturity instruments.



Maturity	One-Month US Treasury Bills	Six-Month US Treasury Bills	One-Year US Treasury Notes	Five-Year US Treasury Notes	Twenty-Year US Govt. Bonds
Annualized Compound Return (%)	5.69	6.46	6.66	7.50	7.87
Annualized Standard Deviation (%)	1.34	1.71	2.32	6.24	11.10

Source: One-Month US Treasury Bills, Five-Year US Treasury Notes, and Twenty-Year (Long-Term) US Government Bonds provided by Ibbotson Associates. Six-Month US Treasury Bills provided by CRSP (1964-1977) and Merrill Lynch (1978-present). One-Year US Treasury Notes provided by CRSP (1964-May 1991) and Merrill Lynch (June 1991-present). Ibbotson data © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld). CRSP data provided by the Center for Research in Security Prices, University of Chicago. The Merrill Lynch Indices are used with permission; copyright 2009 Merrill Lynch, Pierce, Fenner & Smith Incorporated; all rights reserved.

Common 403(b) Retirement Plan Instruments

- Insurance Company Products (Annuities)

- AIG(VALIC), Hartford, Pacific Life, Horace Mann, Lincoln, ING, Fidelity, Fiserv, AXA Equitable, GCG/American Skandia

- The Upsides

- Predictable income stream in retirement
- Consistent with risk averse investor profiles, but at a price
- Possible collateral benefits
 - Be careful here: a “death benefit” guarantee that is capped at your total contributions has an economic benefit only if (1) you die prior to annuitizing and (2) the value of the annuity is less than your total contributions. Term insurance may be more appropriate

- The Downsides

- Limited investment flexibility; often poor choices
- Fees are very high by industry standards (> 2.0% is common)
- When held in a 403(b), there are no additional tax-advantages
- Possible surrender charges
 - Upwards to 10 year surrender charge periods / fees as high as 10% initially

- Convert an Annuity 403(b) to an IRA at Retirement?

- In two words: “most likely”
- In many cases, conversion from an annuity to an IRA upon retirement may be appropriate if:
 - TRS income is expected to be adequate, or near able, to support lifestyle in retirement; **OR**
 - You are interested in improved flexibility and possible return enhancement; **OR**
 - The “math works”
 - » Surrender fees are zero or minimal
 - » You can save money by converting to an IRA

- The basic equation to check if conversion makes sense:

[Savings by Converting to IRA + Expected Performance Improvement] > Surrender Charges

“Savings by Converting to IRA” is roughly 1.5% per annum

“Expected Performance Improvement” can be estimated at about 1.5% per year

- The average passive portfolio with basic a 40% domestic stock, 15% non-U.S. stock and 45% bond allocation has outperformed the average variable annuity subaccount portfolio by 1.5% for the 10-year period ended 2009 (source: Morningstar Principia ®)
- Pronounced in non-U.S. stocks and fixed income
- Improvement may be even greater with proper core/satellite structuring

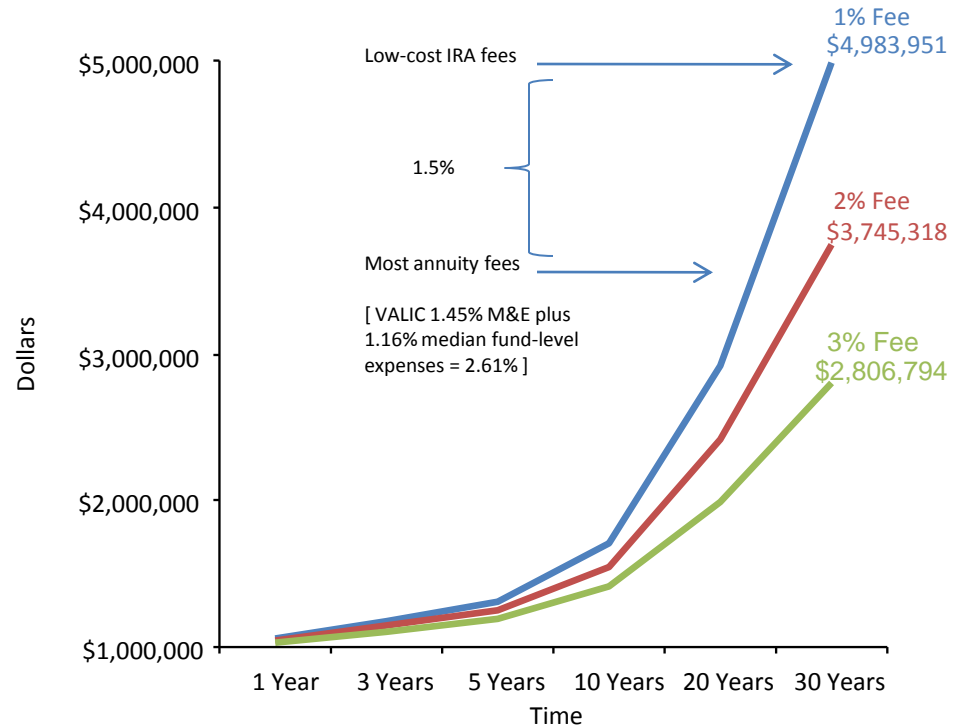
Bottom-line: think in terms of an annuity with no surrender charges or surrender charges of less than 3.0% as a solid candidate for conversion

NSIC will assist you with this calculation

Fees Matter

- Over long time periods, high management fees and related expenses can be a significant drag on wealth creation.
- Passive and low-cost investments generally maintain lower fees than the average actively managed investment, and significantly less than variable annuity contracts (e.g., VALIC 2.61%)
- The average NSIC client IRA incurs fund-level fees of less than ½ of 1% per annum and about 1.1% total, net of advisory fees.
- Retirees at age 65 should still view their time horizons as long-term (must plan for 30-plus years in retirement)

Assumed 6.5% Annualized Return over 30 Years



Common 403(b) Retirement Plan Instruments (continued)

- Mutual Fund Family Products

- Vanguard, American Funds, Diversified Investment Advisor, Putnam
- The two mutual fund providers most recently added to your 403(b) program, Vanguard and The American Funds, provide New Trier employees with powerful tools to make sound investment decisions to plan for retirement

- The Vanguard Group

- Low cost leader
- Passive approach is outstanding
- Ideal for equity core and short-term bond allocations while still funding

- The American Funds

- R shares (the higher the # after the “R” , the better)
- Performance for this group is outstanding over time
- Good candidates for satellite equity holdings while still funding

- Convert a Mutual Fund 403(b) to an IRA at Retirement?

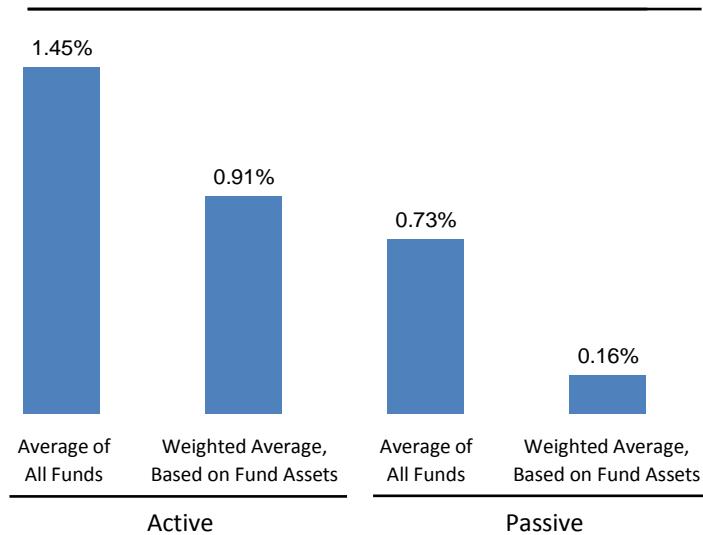
- In a word: “yes”
- With no annuity contract restrictions, conversion from a mutual fund 403(b) to an IRA rollover account is a prudent choice at retirement (see appendix on page 18)
 - » Avoid 20% mandatory withholding that would otherwise occur with the 403(b)
 - » “Open architecture”
 - Access to several fund families; best of breed
 - Ability to structure outstanding, low-cost portfolios
 - Individual stocks could be purchased

Mutual Fund Expenses

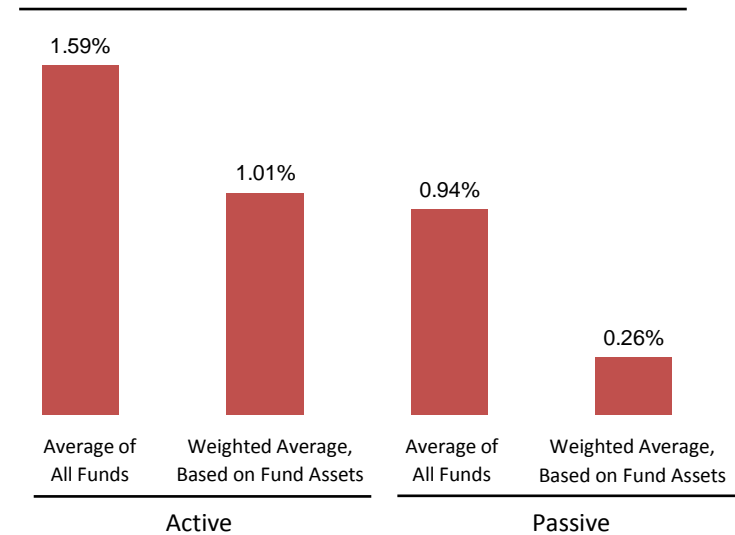
“After costs, the return on the *average* actively managed dollar will be less than the return on the average passively managed dollar for any time period.”

—William F. Sharpe, 1990 Nobel Laureate

Domestic Mutual Fund Expense Ratios



International Mutual Fund Expense Ratios



Bringing it all Together

- **What is prudent to do as retirement approaches?**

- Work to determine your “Number”
- Adjust asset allocation if necessary
- Continue paying into TRS/IMRF
- Keep funding 403(b) and other plans
 - Increase contributions if necessary

- **What changes once you are in retirement?**

- Begin receiving TRS/IMRF benefits, mimicking an immediate fixed income annuity
 - Approximately 75% of average highest four-years of service earnings for TRS
- Tax-smart withdrawals
 - General rule: deplete non-tax advantaged accounts first, tax-advantaged accounts last
 - Required Minimum Distributions eventually
- Determine best action for your 403(b) plan
 - 403(b) mutual funds
 - Roll to an IRA (see appendix on page 18)
 - 403(b) insurance company annuities
 - Annuitize?
 - » If TRS/IMRF annuity income is not expected to be adequate to support lifestyle once in retirement, a partial or full annuity may make sense
 - » Must be evaluated on a case-by-case basis
 - Conversion to an IRA?
 - » In most cases where TRS/IMRF annuity income is adequate to support lifestyle once in retirement, or enhanced flexibility is desired or the “math works”, conversion to an IRA makes sense
 - » Must be assessed on a case-by-case basis for annuity contacts

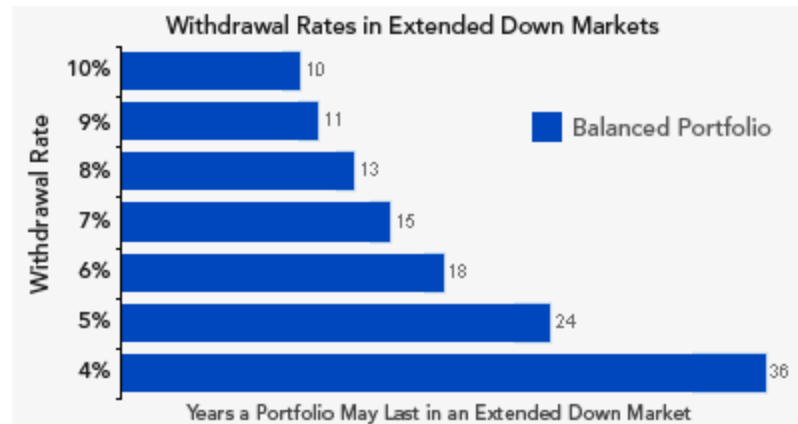
- **On-going monitoring**

- Work with a planner to assure that you remain on-track
 - Rebalancing
 - Fund monitoring, performance, “drift”
 - Recalibration as warranted

- Remember that the few years leading up to, and the first few years in, retirement are crucial

- Even good plans can require adjusting when markets dislocate (e.g., 2001, 2008)
- Once retired, withdrawal rates must be kept at 4% or less regardless of market conditions

Consider the effect of withdrawal rates on the life of your portfolio. As shown in the chart below, too high of a withdrawal rate can quickly deplete your savings, causing you to run out of money.



Source: Fidelity Investments. Hypothetical value of assets held in an untaxed balanced portfolio of 50% stocks, 40% bonds, and 10% short-term investments and inflation-adjusted withdrawal rates as specified

A lower withdrawal rate helps to ensure that your savings will last over a longer period of years. If your withdrawal rate is conservative enough, your portfolio may last well into your 90s and beyond. Keep in mind that your withdrawal rate can be adjusted up or down each year, based on market performance and as your longevity risk—the possibility that you'll outlive your assets - diminishes. But it requires discipline in both spending patterns and investment strategies to conserve your assets.

Questions

Please feel free to contact North Shore Investment Consulting to discuss any private concerns that require attention or to schedule an appointment:

Phone: (847) 445-4100

Email: jsmith@nsinv.com

These materials are not intended to be specific recommendations. An appropriate comprehensive planning program can only be identified and implemented after conducting sufficient diligence.

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Overview of North Shore Investment Consulting

- **Comprehensive Planning**

- Addresses all aspects of the financial planning equation
 - Cash flow from now thru life expectancy
 - Investment funding, structuring and tax-efficient distributions during retirement
 - Unique goals and objectives must be taken into consideration
- A holistic approach to investment planning
 - For NT employees, must include TRS/IMRF, 403(b) and all other personal assets
 - Spousal assets must be taken into consideration
- An institutional approach to portfolio management
 - Engineered investment solutions
 - Not simply “fund selection”

- **Investment Philosophies**

- Broad diversification is key
- Low fees are essential
- Minimizing portfolio “friction” is important
- Markets are mostly efficient
 - Trading and market timing are detractive from effectiveness
 - Occasional valuation discrepancies do occur
- Discipline to a predetermined, and appropriate, policy is imperative
- On-going monitoring is essential to assess efficacy of planning
- “Human Capital” and “Financial Capital” must be balanced

- **Curriculum Vitae**

- NSIC was founded in 2002 by Jeffrey Smith. Mr. Smith has in excess of 23 years of portfolio management experience; is a Chartered Financial Analyst (CFA), Certified Financial Planner (CFP®), Chartered Financial Consultant (ChFC); has earned a BA in economics, MBA in finance; has completed advanced studies in finance at Northwestern and the University of Chicago; has managed 401(k) plans and pension portfolios in the U.S., the U.K., the Netherlands, Hong Kong and Canada and is a member of the Investment Analysts Society of Chicago. NSIC is a member of the fee-only National Association of Personal Financial Planners (“NAPFA”) and the Kenilworth & Wilmette Chamber of Commerce.

Appendix

An Abstract from 403bwise

[Rolling a 403\(b\) into an IRA](#) by Vincent D. Tate

Leaving your job? If you're a typical American, chances are you'll have to roll over a retirement account at least once in your lifetime. Last year some 5.5 million Americans — with more than \$220 billion in retirement plan assets — retired or changed jobs.

Wondering what to do with your 403(b) when you leave your old job to take a new one may leave you babbling unintelligibly to yourself. Hopefully, this article will help. We'll explore some alternatives for managing your retirement assets upon leaving your employer, and provide some guidance on what may be one of the most important financial decisions you'll ever make concerning your retirement assets.

[Maintaining Tax Deferral](#)

If you'd like to continue to defer taxes on your plan investments when you leave your job, the most beneficial choice for many investors, it to roll over the money directly to an Individual Retirement Account (IRA).

[Roll over the money directly to an IRA](#)

An excellent way to keep your retirement plan assets growing tax-deferred when you change jobs is through a direct rollover of the assets to a traditional Individual Retirement Account (IRA). A direct IRA rollover allows you to avoid the mandatory 20% federal income tax withholding on withdrawals from tax-deferred retirement plans. You'll also be able to direct your assets to the financial institution of your choice. This will give you many more investment options because not only will you be able to invest in the mutual funds of your choice, but within an IRA you are permitted to invest in individual stocks. Remember, if you take cash from a qualified retirement plan account, you must roll over cash into an IRA, rather than some other asset of equal value.

There are certain advantages to rolling over your 403(b) into an IRA. Greater investment flexibility is chief among them. But there also may be a couple of distinct disadvantages. Administratively, it may cost you more to maintain an IRA. That's because in a 403(b) you often don't have to pay transaction costs. Also, money in an IRA is more vulnerable to claims made by creditors if you file for bankruptcy or are sued. That's because IRAs, unlike some 403(b)'s or other employer-sponsored pension plans, are not protected by the Employee Retirement Income Security Act (ERISA) which insures that money currently invested in a plan for the explicit purpose of your retirement is protected from people to whom you are indebted.

Here's something else to think about. To maintain your future flexibility, if you wish to eventually put the assets from your retirement into a new 403(b) plan, it's best to roll over assets to a new IRA, called a "Conduit IRA," to avoid "commingling." If the assets from your retirement plan are mingled with other assets in an existing IRA, you will be unable to roll over those assets into another employer-sponsored plan, should you wish to do so. With a Conduit IRA you have a temporary parking space for your money between 403(b) plans.