Pettinga Insights and Outlook

June 2012 | Vol. No. 1 | Investment Updates

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.

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Monthly Market Commentary

The EU Overhang

- The markets sufferred a pullback in May, triggered by investor fears over the EU financial crisis.
- The stock markets will be restrained in their ability to rise as long as members of the EU run the risk of a default on their debt. Concerns over Spain in May and Greece in June forced investors to pull more money from equities.
- At Pettinga, we believe a properly diversified portfolio based on your ability to weather the most challenging economic times will protect you against negative economic events. The overhang of the EU is likely to last for the forseeable future.

Fear grew in May as bad news out of Europe and China continued to dominate the markets. Greece remained the epicenter of European problems as Greek election results have made it difficult to form a new government. Bank runs in Greece and rumors of an exit from the eurozone have plastered headlines as people speculate the possibility and implications of such an event. On a lighter note, investors breathed a slight sigh of relief for the eurozone, which managed to eke out a very slight GDP growth in the first quarter of 2012 after contracting in the fourth quarter of 2011, avoiding the technical indication of a recession (back-to-back quarters of negative GDP growth).

As China's growth rate continued to soften because of manufacturing and export demand weakness in tandem with Europe's slowdown, China cut interest rates for the first time since 2008 with the hopes of spurring more growth. Barring a complete financial collapse, there should be minimal impact on the U.S. economy because the U.S. exports next to nothing to Europe (and even less to China), while Chinese exports to Europe represent a significant portion of China's GDP.

Employment: Markets tanked as a result of a disappointing employment report, with only a meager 69,000 jobs added in May. Worse, the previous two months of unemployment data were revised downward by a total of 49,000 jobs. Despite these setbacks, Morningstar economists still expect monthly employment growth to average about 195,000 jobs per month, with better housing employment and continued 2% or so GDP growth to drive that employment. The unemployment rate rose slightly to 8.2%.

Manufacturing: Despite a tepid manufacturing sector outside of the U.S., domestic manufacturing data mostly came in above expectations in April. Almost every category showed strength, led by utilities, which rebounded nicely as weather returned to more normal-conditions. While autos have been a huge help in the past couple of months, April showed a broadening of the improvement in manufacturing across all categories. Investors should be aware that while the month-to-month numbers looked positive, the year-over-year growth rate remained flat, indicating just steady, forward progress as opposed to a boom-or-bust scenario.

Housing: Seasonally adjusted home prices increased 1.1% from the fourth quarter 2011 to the first quarter 2012, the largest increase since the third quarter 2009. Year-over-year, prices fell by 1.9%, which was much better than the 4.6% year-over-year decline in the first quarter of 2011. As home prices stabilize, this will likely help the difficult appraisal process that had prevented thousands of homes from closing. April's pending home sales fell from March but was still up 14.4% year-over year, marking the 12th straight month of positive growth. Morningstar economists believe that the U.S. housing market has far more room for upside than downside at this point in the business cycle.

Consumers: Consumer spending continued to increase on both a month-to-month and year-over-year basis despite the apparent volatility in the employment market. Some of the reasons include greater availability of credit, falling gasoline prices, and a substantially lower inflation rate. However, in the face of weakening employment as businesses hit the pause button on hiring, there is little chance that consumption growth will accelerate.

Market: The U.S. stock market suffered its worst day of the year on June 1, 2012; the Standard & Poor's index fell by 2.5% after the release of a surprisingly weak employment report. Fears of the impact on the U.S. because of the slowing global economy saw a flight to safety away from stocks and into Treasury bonds.

Takeaways for Retirees from the Recent Market Drop

Retirement May Have To Wait

- Analysts project lower rates of return for both equity and fixed income markets for the forseeable future.
- Lower portfolio returns will force Americans to delay retirement to give themselves a chance to accumulate the resources reuired for retirement.
- The 2000s concept of pacing oneself for a longer career is replacing the 1990s concept of early retirement.

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.

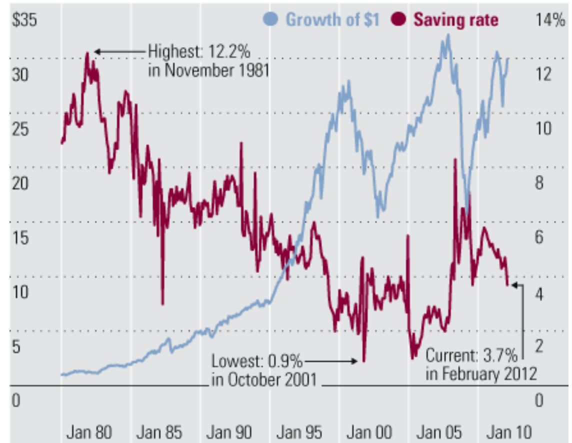
Dollar-Cost-Average Into Inflation Protection: If gloom over the strength of the global economy continues to worsen, inflation-conscious investors might be able to add inflation protection to their portfolios at more advantageous prices than when inflation was grabbing all the headlines. Dollar-cost 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.

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).

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