Pettinga Insights and Outlook

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Quick Facts: Retirement

1. According to Aon Hewitt's "The Real Deal" 2012 study, an average full-career contributing employee needs 11.0 times pay at age 65, after Social Security, to expect to have sufficient assets to last through retirement. For example, if your salary is $80,000, you will need to have accumulated $880,000 by the time you're 65 and ready to retire.

2. In reality, the same employee is expected to have only 8.8 times pay in resources at retirement, which translates into a 2.2 times pay shortfall. To reuse the example above, this means you'd be $176,000 short.

3. The 2013 Transamerica Retirement Survey found that the percentage of participants who have taken a loan from their 401(k) plan has increased from 16% in 2008/2009 to 21% in 2012, then slightly decreased to 17% in 2013.

4. Wells Fargo conducted a survey of 1,000 middle-class Americans. The study shows that across middle class members of all generations, only 24% are confident in the stock market as a place to invest for retirement. The apprehension about the market is stronger for those age 25 to 29, with 56% expressing fear of losing their nest egg. When asked if given $5,000 for retirement where they would invest, 58% of those age 25 to 29 said they would invest in a savings account/CD.

5. Only 18% of workers are very confident they will have enough money to live comfortably in retirement (according to the EBRI 2014 Retirement Confidence Survey).

Sources: Aon Hewitt's "The Real Deal: 2012 Retirement Income Adequacy at Large Companies." "14th Annual Transamerica Retirement Survey of American Workers," Transamerica Center for Retirement Studies, July 2013. Wells Fargo news release, "Middle Class Americans Face a Retirement Shutdown," October 2013.

Monthly Market Commentary

So far, it's been a chilly spring for the economy. Growth in most U.S. metrics has been slow for three months or longer. Some of that stagnation is weather-related, but certainly not all. Factors such as the government shutdown and budget settlement, major inventory build-ups, and higher interest rates have all been negatives for recent economic activity.

Federal Reserve News: The Federal Reserve policy statement, economic forecast, and press conference on March 18-19 didn't really tell markets much that they didn't already know. Much emphasis was placed on Fed Chairwoman Janet Yellen's comment that rates could begin to be raised as soon as six months after the bond-buying program was completely wrapped up. Irrespective of when, one thing's for certain: rates are going higher and investors will have to learn to live with it. However, unless the economy picks up a little steam soon, the Fed may not feel nearly as aggressive a month or two from now.

Housing: Existing-home sales fell from an annualized 4.62 million units in January to 4.6 million units in February. That is after a giant swoon between July 2013, when existing-home sales peaked at 5.38 million units, and the most recent 4.6 million level. A drop of 14% in unit sales in the middle of a recovery is more than a little disconcerting. In terms of total dollar values transacted, the market is down 20% from its July peak. Similar to the existing-home data, monthly housing starts changed little from January to February after several months of decline, perhaps indicating that the bottom is in, which would be a welcome relief. Data for housing permits looked better, but most of the improvement came from multifamily homes, which tend to be less expensive and add less to GDP growth.

Inflation: The headline inflation number for consumers looked great on a top-line basis. Month-to-month prices were up just 0.1%, and an amazingly low 1.1% when comparing February of this year with February of last year. However, the categories that were up are truly important to consumers. Grocery prices were up 0.5%, airline fares 1.3%, and drugs 0.9% after showing almost no growth in 2013. Holding back price increases was gasoline (down 1.7%). That was a bit of a mirage, though, as bad weather delayed normal refinery shutdowns from February to March.

GDP: The estimate of GDP growth in the fourth quarter of 2013 was bumped up modestly from 2.4% to 2.6% at an annualized quarter-over-quarter basis. The more representative full-year growth rate for 2013 was unchanged at 1.9%. Interestingly, both the annualized sequential growth rate and the fourth-quarter-to-fourth-quarter growth rate are now equal, at 2.6%. So it would appear that the economy's true GDP growth rate lies somewhere between the bounds of 1.9% and 2.6%. A meaningful shrinkage in the government sector just about cancelled an unusually large (and not sustainable) increase in exports. Business spending picked up some but not a lot, and residential investment was a net detractor from GDP growth for the first time since 2010.

Quarter-End Insights: The U.S. economic data has shown signs of weakening for the past three months running, despite some real optimism that developed in the fourth quarter of 2013. That optimism was based on the end to the fiscal stalemate in Washington in October, a 4.1% GDP growth rate in the third quarter, and a 3.2% estimated growth rate in the fourth quarter (later revised down to only 2.4%). Sky-high retail sales data that was subsequently revised sharply downward also contributed to economists' bright mood at the end of 2013. However, poor weather seems to have interrupted the upward trajectory. The effects of abnormally cold and snowy weather seem real, but the weather is not the only cause for the recent weakness. Parts of the economy, including the housing sector, were already showing some slowing even before the cold weather arrived.

Find the Right IRA in Three Easy Steps

Even if you're already convinced that saving in an IRA is a sensible thing to do, there's still a little bit of research to conduct. There are two main types of IRA accounts, and selecting the one that's best for you can be a daunting process. You can figure this out in relatively short order by following these three steps.

1) Know the Basics: Understanding the difference between the two types of IRAs—Roth IRAs and traditional IRAs—is the key first step in determining which is suitable for you.

Both vehicles let you sock away money and enjoy a tax benefit. With a traditional IRA, you won't have to pay taxes on your IRA's investment earnings until you begin taking distributions from it during retirement; thus, your money enjoys the benefit of tax-deferred compounding. (That means you'll have to pay taxes on your earnings when you begin withdrawing money, but not as you go along.) The Roth, however, has a couple of huge advantages over a traditional IRA. Whereas traditional IRAs carry restrictions governing when you have to begin taking distributions, the Roth carries no such restrictions; you won't be forced to take distributions at any age. And perhaps even more significantly, qualified distributions from a Roth will be tax-free, not tax-deferred as is the case with a traditional IRA.

With that information, the choice might seem clear: Roth IRA all the way. But there are a few other issues to consider. For those who qualify (consult a tax professional or the IRS' site to determine if that's you), a traditional IRA provides up-front tax savings. All of your contribution to a traditional IRA plan could be tax-deductible. Contributions are not tax-deductible with a Roth IRA.

2) Determine Your Eligibility: Okay, you've now identified the account type that suits you, but there are eligibility hurdles you'll have to clear in order to use a traditional IRA or a Roth IRA.

Let's start with the most sweeping limits first. For 2014, according to IRS Publication 590, if you are covered by a retirement plan at work, your deduction for contributions to a traditional IRA is reduced (phased out) if your modified adjusted gross income (AGI) is: more than $96,000 but less than $116,000 for a married couple filing a joint return or a qualifying widow(er); more than $60,000 but less than $70,000 for a single individual or head of household; or less than $10,000 for a married individual filing a separate return.

For 2014, according to Publication 590, you cannot make a Roth IRA contribution if your modified AGI is $191,000 or more if your filing status is married filing jointly; $129,000 or more filing single, head of household, or married filing separately, and you did not live with your spouse at any time in 2014; or $10,000 or more if your filing status is married filing separately and you lived with your spouse at any time during the year.

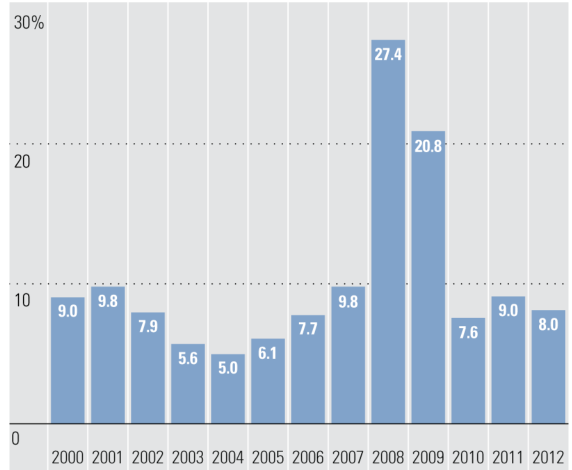
3) Weigh Your Options: You may find that certain IRA types are automatically off limits to you because of your income level. But what if you establish that you're eligible to make more than one type of IRA contribution—for example, you can contribute to a Roth and make a deductible contribution to a traditional IRA? You may decide to do both if you have the money to do so, but if you have a limited sum of money to invest, the decision becomes a bit tougher. For a situation like this, as well as to keep abreast of the latest rules and regulations pertaining to IRAs, it would be in your best interest to consult with your financial advisor/tax professional.

Funds in a traditional IRA grow tax-deferred and are taxed at ordinary income tax rates when withdrawn. Contributions to a Roth IRA are not tax-deductible, but funds grow tax-free, and can be withdrawn tax free if assets are held for five years. A 10% federal tax penalty may apply for withdrawals prior to age 59 1/2.

Dividend Income: Not So Fixed

Since interest rates are still relatively low right now, many investors looking for income and yield have begun to assess switching a portion of their investment allocation from bonds into dividend-paying stocks. However, it is important to remember that the interest payment of a bond is a contractual obligation of the company, whereas dividend payments are not. If a bond issuer does not pay either interest or principal on time, the company will be in default, and likely will be placed into bankruptcy. However, dividend payments are not a contractual obligation of a company and can be either cut or raised by its board of directors at will. When times are tough, companies may cut dividends to conserve cash, such as during the 2008 credit crisis. Conversely, when times are good, companies may increase their dividend payments, providing investors with additional upside.

Percentage of Companies That Cut Dividends



Source: Morningstar analysis. This is for illustrative purposes only and not indicative of any investment. Past performance is no guarantee of future results. Returns and principal invested in stocks are not guaranteed, and stocks have been more volatile than bonds. Dividends are not guaranteed and are paid solely at a company's discretion. Percentage of companies that cut dividends is calculated for listed companies on NYSE, NASDAQ, and NYSE AMEX.

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