

THE RETIREMENT CHALLENGE

WILL YOU SINK OR SWIM?

A Complete,
Do-It-Yourself
Toolkit to Navigate
Your Financial Future

FRANK ARMSTRONG, III

BARRON'S TOP 100 INDEPENDENT FINANCIAL ADVISORS, 2007-2008

WITH JASON R. DOSS

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Introduction

Bill Gates and Warren Buffett are probably not stressing about their retirement income—but many Americans are. Study after study shows that they are not on track to support themselves in retirement and are behind their parents at the same age. Yet, most Americans spend more time researching which flat screen TV to buy than planning for retirement. Like Scarlett O'Hara in *Gone with the Wind*, they choose to “worry about that tomorrow.”

I can guess some reasons why you might put off dealing with your retirement: it's not fun, it takes a long time, it's complicated, it's difficult, it's confusing—it's all the above! I sympathize. Really I do. But I don't believe it's any of those things. Well, OK, perhaps your version of fun is a little different from mine. But planning your retirement isn't an ordeal. It can be done quickly, elegantly, simply, and economically. Hang in there with me. I'm going to prove it to you.

My first book, *The Informed Investor*, delivered the Cliff Notes of an MBA investment class. I reviewed investment theory and practice as it developed over the last 50 years. I'm not going to do that again in this book, but if you feel the need for more background, I recommend *The Informed Investor*.

This time, I'm going to stick to practical, actionable information and strategies for retirement planning. If *The Informed Investor* was 90% theory and 10% action items, *The Retirement Challenge: Will You Sink or Swim?*² is 90% specific information and action items. It gives you the tools to take control of your financial success without drowning in trivia or being overwhelmed by boring repetitive chores.

First, you meet your pension plan. You learn what it is, how to calculate benefits, how it works, what can go wrong, what to do if something goes wrong, and whether it's even attractive enough for

you to participate. If it's not, you have viable alternatives and, under a 2008 U.S. Supreme Court Ruling, some recourse.

Next, wherever you are in your career, there are smart moves you want to pursue to maximize your retirement benefits. Whether you are right out of school, or already in retirement, you have lots of options to control your benefits.

How much will you need for retirement? Early in your career, it might be hard to estimate, but as you get closer, you can refine your guesstimate. You will learn how.

Finally, you learn how to invest your retirement assets economically and effectively while controlling risk to give yourself the highest probability of success in meeting your goals. Best of all, the system is easy to monitor and set up, and it works with all your investment accounts, whether inside a pension plan or your taxable accounts.



www.Sink-Swim.com

Do-It-Yourself

A companion Web site, www.Sink-Swim.com, provides you with a wealth of additional information and updates. Visit this Web site for the following:

- Hundreds of articles on investment theory, products, and best practices.
- Updates to pension law, regulation, and enforcement.
- Over 75 calculators that let you see how much you need to contribute for a prosperous retirement and whether you are on track to meet your goals.
- Sample asset allocation plans that can be adjusted for any stage of your career and portfolio size.
- Budget spreadsheets.
- Links to other useful sites.
- Discussion groups and a blog.
- A *Sink or Swim* newsletter.
- Exclusive Web bonus material: Estate planning issues with retirement accounts.

*The Retirement Challenge: Will You Sink or Swim?*² is a reference work you can consult so when you have a retirement planning concern, you can identify it, understand it, take corrective action, and get back out on the golf course of life. For instance, if you are faced with a career change or forced early retirement, the sections in this book on changing jobs and IRA rollovers will be invaluable.

You might not need or even want to read every chapter word for word, or you might want to come back to some sections later. For instance, if you don't have a defined benefit pension plan, it won't wreck your life not to read that chapter. And if your primary concern is required minimum distributions for folks over 70½, reading the sections on early retirement tactics might not benefit you much. Feel free to pick and choose as your situation warrants.

Given the limited time most of us have and the various demands made upon our time, a system that requires minimum intervention and attention, yet still carry you to your goal, is the one that is most likely to be employed, and most likely to succeed. What's needed is an autopilot-type approach that is reasonably simple to set up and, once set up, will tend itself.

As a former airline pilot, I have a great appreciation for autopilots. By doing the grunt work of keeping the airplane in level flight headed in the right direction, autopilots free up the pilot for higher-level tasks, making aviation safer and more reliable. However, even the best autopilot needs to know where it's supposed to go and needs some degree of monitoring. Flight planning and situational awareness are still an important part of mission success. So, you can't bail out entirely, but you can limit your involvement to high-level planning and supervision.

Political correctness is not my strong suit. Everybody who knows me knows exactly how I feel about almost everything. You won't find me beating around many bushes. In particular, I believe that both the pension laws and the securities industry need major reform. They

don't work as advertised to assist Americans to meet their legitimate financial goals. Advise your elected representatives that this is a critical issue that must be addressed. Let them know you are watching. In the meantime, you have to work with the current system and, if you understand it, you can pick and choose the parts that will work best for you—if you cherry-pick the system, you can make it work wonderfully.

In the spirit of full disclosure, my daytime job is providing investment advice. So, naturally I believe that competent, objective advisors add value. Not everyone shares that opinion, however. Some investors are determined to “go it alone.” If you fit into this category, following the principles I present will improve your investment results. If you want to delegate to a professional, I'll lay out how to choose one that is both competent and objective.

During my occasional appearances as an expert witness in securities arbitration and litigation, and during Jason Doss's career as a plaintiff's attorney securities litigator, we get to see more than a few investment crashes. The vast majority should never have happened. Crashes happen when the investor or advisor violates important investment principles. By looking at how other people screwed up, you can reduce the chance of being the next victim. Jason Doss is one of America's brightest securities litigators. He provides a lot of our crash analysis in this book, so you can learn from other people's mistakes.

There really are sharks in the financial waters. And there are lifeguards. Unfortunately, sharks and lifeguards might look somewhat alike to the casual observer. One of the biggest mistakes investors make is trusting the wrong advisors. Jason has a lot of experience with the sharks. Although Jonah might have gotten off lucky with the whale, Jason is the first to admit it's hard to retrieve a swimmer once he's been eaten by a shark. Better to avoid them in the first place.

With millions of boomers approaching retirement, and trillions of dollars changing hands from pensions to the boomers, retirees are a

target-rich environment for the financial industry. Sharks circle endlessly, looking for that juicy, easily picked-off meal. Sharks don't have morals; they just eat things that look tasty. Sharks have many distinguishing characteristics, however, and can rather easily be avoided if you know how to spot them.

If you do get bitten by a shark, all might not be lost. Although there are significant legal differences and performance expectations between fiduciary advisors and salespeople, all financial advisors are held to minimum standards of care and might be accountable for losses that occurred as a result of their lapses. Recovering losses is an uphill battle, however, so it's best to avoid the problem in the first place. As Ben Franklin so aptly put it: "An ounce of prevention is better than a pound of cure."

As a lawyer who represents investors, I see firsthand what happens when things go wrong. Even though the circumstances of each case and client are different, they all have one thing in common: All of my clients have lost money, trusting that their financial professional was acting in their best interest. I am faced with the difficult task of trying to get money back from brokerage firms, investment advisors, and insurance companies. If Frank Armstrong is the swim instructor in this analogy, then I am the paramedic. Most of the time, clients come to my office because they have nowhere else to turn. Unfortunately, though, most investors do not know that they can recover their losses from financial advisors who give bad advice. Let me take this opportunity to correct a common misconception:

Investing your money with a financial professional is not gambling!

If your trusted professional gives you bad advice, they (not you!) are responsible for the losses, and the laws allow you to recover your damages from the financial advisors and their firms. However, you do not want to rely on a paramedic to save your life. The best (and less painful) approach is not to drown in the first place!

Frank Armstrong's vast knowledge and experience with financial issues and his no-nonsense style of writing is the best way to learn about these daunting issues. If you wait to hear the topics in this book for the first time from a broker (that is, a salesperson), you will undoubtedly turn into someone who doesn't ask questions and blindly follows the advice of a stranger with a likeable personality. That is the best way to drown and lose your hard-earned nest egg.

News flash: Sharks always smile before they bite! One of the biggest mistakes that I see investors make is that they do not do their homework before picking a financial professional or before agreeing to an investment strategy recommended by a trusted professional. The question of who is investing your money is just as important as how your money is invested. All too often, investors choose their advisor based solely on personality. This is a big mistake because con-artists or simply incompetent salespeople always have a likeable personality. Before picking an advisor, you must dig deeper into their background and be able to articulate your investment goals prior to your first meeting. This book helps you separate the experts from the idiots.

My goal for this book is to keep you from becoming a victim of a terrible financial experience, and to provide you with the practical tools that help you to sleep better at night, knowing that you are in control of your own financial future. At various places along the way, I provide real-life examples of what can happen if you are not prepared to tackle the financial issues that face millions of investors every day. These examples are meant to reinforce the lessons explained by Frank Armstrong.

—*Contributed by Jason Doss*

Lesson 1 ---

You Are On Your Own

Americans traditionally expected defined benefit retirement plans, had networks of family support, looked forward to a rich Social Security benefit, and saved generously.

None of that is necessarily available to tomorrow's retirees. You must assume responsibility for your own retirement in the new era of cradle-to-grave insecurity. If you don't, nobody else is going to do it for you.

Surviving in an Era of Cradle-to-Grave Insecurity!

The days when all you needed to do was show up reasonably often and reasonably sober over the course of your career to earn a guaranteed income for life at retirement are over! In the good old days, the entire cost and responsibility for providing that retirement was assumed by the employer, as reflected in Table 1.1.

TABLE 1.1 Roles and Responsibilities: Defined Benefit Plans

Function	Employer	Employee
Determines benefit level	✓	
Calculates required contribution	✓	
Makes contributions	✓	
Makes investment decisions	✓	
Responsible for shortfall in capital	✓	
Pays plan administration cost	✓	
Converts account to lifetime income	✓	
Provides survivor benefit	✓	
Provides pre-retirement death benefit	✓	
Pays for investment advice	✓	
Provides education and advice	✓	

Under this type of plan, everything was done for you. You could be virtually brain dead and still expect a secure retirement.

Just 15 years ago, 70% of America’s workers were covered by a defined benefit plan; all workers and their families were covered by a generous Social Security system. In our parents’ time, the average employment was 25 years. Many employees had only one job their entire life; today, many people have a different job approximately every four years. Additionally, families were closer, and most expected to provide some intergenerational support. Even if this wasn’t exactly cradle-to-grave security, it did take a lot of the uncertainty out of life.

That world doesn’t exist anymore. Today, it’s the Ownership Society—a euphemism for “sink or swim on your own resources.” Depending on what type of organization you work for, the basic American retirement plan is now a 401(k), 403(b), or 457 plan. For-profit companies utilize 401(k) plans, whereas not-for-profit organizations have 401(k) or 403(b) plans, and state and municipal employees are covered by 457 plans or 401(k) plans. These plans are all very similar in that they require workers to decide on an adequate funding level, contribute all or most of that amount from their own pocket,

develop a rational asset allocation plan, choose from a bewildering menu of substandard investment options, and, finally, determine how to convert their nest egg into a lifetime income. The employee-funded, employee-directed retirement is a new and disconcerting development.

Table 1.2 shows how the majority of responsibility shifts to the employee in the employee-funded plan (401[k], 403[b], and 457).

TABLE 1.2 Roles and Responsibilities: 401(k) and 403(b) Plans

Function	Employer	Employee
Determines benefit level		✓
Calculates required contribution		✓
Makes contribution	Matching contribution	✓
Makes investment decisions		✓
Responsible for shortfall in capital		✓
Pays plan administration cost	Rarely	✓
Converts account to lifetime income		✓
Provides survivor benefit	Account balance	✓
Provides pre-retirement death benefit		✓
Pays for investment advice		✓
Provides education and advice	Some	✓

No matter what happens to the current Social Security debate, benefits going forward (in real terms) will be a fraction of what our parents enjoyed. The national savings rate hovers near zero; during some months, it’s negative. Average household savings for boomers is far too low to meet their retirement needs.

There’s plenty of evidence that most Americans aren’t up to the task of managing their retirement security. Workers are retiring earlier, often against their will. They are living longer and facing health costs that were unimaginable for their parents.

To put it kindly, the American pension system is one giant disaster area—a tsunami cresting over our heads. The time to take evasive action is now.

And help is not on the way! Investor literacy is almost nonexistent. You can graduate from high school without knowing how to balance your checkbook, graduate from college without ever taking an investment course, and get a PhD without ever hearing of asset allocation. Few accountants have ever studied portfolio construction, and most MBA programs and courses spend just one or two hours on the subject of portfolio construction.

The employee-funded retirement system—with some notable exceptions—is such a swamp that in many cases, the employee decides not to participate. Nationwide, it's an acknowledged failure. The system is plagued by high costs, poor investment choices, and insufficient education to enable employees to make informed decisions. As a result, it is little used. Many employees don't participate at all or fail to contribute enough to fund their retirement. Of those who do participate, many make consistently poor investment choices.

If the 401(k) system is a swamp, the 403(b) system is a sewer. Again, with some notable exceptions, it's a complete disaster for participants. However, it's a great way for unions and local governments to repay political favors and distant relatives. The kindest possible interpretation of the 403(b) system is that many of the people who administer it are hopelessly inept.

The great investment houses that might be expected to provide assistance are instead bent on the plunder and pillage of their clients' accounts. Wall Street's commission-based sales system is so corrupt, it can't be fixed. Not everybody at every brokerage is a crook, but the incentives are all wrong. The commission-crazed sales system taints the entire advice model. You can't rely on getting either competent or objective advice there.

The cops (both state and federal regulators) allow toxic products to foul the retirement system. Conflicts of interest and undisclosed costs are universally acknowledged and little punished.

So, there it is. You are entering an era of cradle-to-grave insecurity. You and only you are going to be responsible for securing your financial future. You are left to your own devices to figure out this system. That's what the Ownership Society is all about. You are not moving toward a kinder, gentler society. The safety net and lifeline are disappearing. You will either sink or swim depending on your own skill.

You are on your own. You must educate yourself, take responsibility for your financial future, and design and execute a viable investment plan for yourself. If you don't, it's highly doubtful that anybody else is going to do it for you.

Given all that, if you would like to survive in the new society, it's time for some swimming lessons—or maybe it's time for you to start building your very own life raft.

If you can't swim and suddenly find yourself alone in deep water, the last thing you want to hear is a detailed lecture on fluid mechanics or how to calculate buoyancy. Someday you might get interested in those subjects, but the immediate need is to keep your head above water and get yourself moving toward safety. Likewise, *The Retirement Challenge: Will You Sink or Swim?*⁹ is not going to turn you into a financial economist, accountant, or analyst. However, you will be able to invest your retirement accounts and personal savings simply, quickly, economically, and effectively to meet your long-term goals.

*The Retirement Challenge: Will You Sink or Swim?*⁹ will teach you those essential survival skills needed to navigate serenely to a safe harbor through the nastiest financial storms likely to be encountered on your journey.

Let me be completely clear. The author of this book is the swim coach. You are the swimmer. Reading this book will not make you financially secure. Learning everything about pensions will not lead to a prosperous retirement. Only saving and investing effectively will do it—and only you can make that happen.

Let's suspend disbelief for a second and pretend that you meet with the world's best investment advisor. If you don't have any capital, and you don't have the ability to save, the advisor can't do anything for

you. Without serious commitment on your part, you and the advisor have a pleasant conversation and you go on to be a financial failure.

It is ridiculously hard for anybody in reasonable health to drown in calm, warm water. It's a very benign environment. Almost everyone should be able to float for days and swim for many hours. You don't have to be strong, smart, or brave. Simply roll on your back, put your head down, relax, and breathe normally. You will float serenely. Then just kick a little and sweep your arms around to swim for miles. Arrive on that distant shore relaxed and refreshed.

And yet people do drown. Why? You would have to do just about everything wrong. Panic and lack of knowledge sink them. Drowning swimmers are often their own worst enemy. Instead of conserving energy and floating comfortably, the swimmers flail around in total panic, quickly exhausting themselves and insuring early demise. A tiny bit of knowledge and discipline would save them.

In the same manner, most investment tragedies are self-inflicted wounds—totally predictable, but completely avoidable. The world's stock and bond markets are remarkably benign. With just a little planning and minimal effort, you can confidently expect to have a comfortable and secure retirement.

Wall Street sharks are the most vicious kind, world famous for their remorseless search for unwitting prey. Fortunately, you don't have to be dinner for them. *The Retirement Challenge: Will You Sink or Swim?*² provides you with tested repellent to fend off these dangerous critters.

The pace of modern life doesn't give you time to do all the things you "ought to" do. Unfortunately, most of us are swamped with competing obligations. The average American considers investment planning almost as much fun as doing taxes. But, taxes have an April 15th deadline and investment planning doesn't. So, it's far too easy to push the planning process to the back of the desk for another day. The danger is that it will linger there, gathering dust until you wake up one day to discover that time has passed you by, and you have neither a

plan, nor any investments. So, the first goal of *The Retirement Challenge: Will You Sink or Swim?* is to make this process quick and easy so you can get on to the fun things in life, while knowing that you will probably be in the top quartile of investors over your career.

So, can retirement planning and investment be easy, simple to understand, painless and quick to execute, effective, and economical? The author guarantees it. Read on. *The Retirement Challenge: Will You Sink or Swim?* is your life vest in turbulent financial waters.

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