

10+ Tips
to a
*Dream
Retirement*



Southport Capital

OPTIMIZING YOUR SOCIAL SECURITY BENEFITS

For many of your employees, Social Security benefits may represent one of their largest financial assets. Unfortunately, most Americans decide when to begin Social Security benefits without any advice. A majority of Americans have no idea how important selecting a Social Security strategy can be. A smart “claiming strategy” can often mean hundreds of thousands of dollars in added benefits over a retiree’s lifetime. In 2009, consistent with previous years, 74% of all Social Security claimants started benefits before Full Retirement Age.² We offer your employees a complimentary “Social Security Calculator Report,” which will show them how to maximize both their own and their spouse’s Social Security benefits.

WHY A 401(K) IS THE BEST PLACE TO SAVE

It should be clear that it will not be enough for working Americans to rely on Social Security and the government to create a secure retirement. So what do we need to do? How can employers help encourage their employees to save and invest more to be ready for retirement?

The best place to begin is with their employer-sponsored **401(k) plan**, because that’s where they can save money automatically, through payroll deduction, very easily throughout their working years.

We wrote this book as a handbook for employers who want to impact employee behavior and encourage their employees to create a successful retirement experience for themselves. We like to help employers help their employees create a Paycheck for Life®.

It used to be that employers established a retirement plan for their employees to give them an extra benefit or an incentive, or to stay competitive. Times have changed. Almost every company offers a 401(k) plan today—and that’s why we say they have become America’s retirement savings plan.

If you would like to receive a sample Social Security Calculator report, please email us at: johnwoods@mindspring.com or jim.woods@southportcapital.com and simply request a copy.

²“Annual Statistical Supplement to the Social Security Bulletin,” Social Security Administration, released February 2010.)



RETIREMENT RISK PLANNING

The same concepts apply, really, to 401(k)s. One of the biggest mistakes a plan sponsor can make is getting too wrapped up in costs and returns and not putting any emphasis on risk; after all, if he or she is the business owner, he or she has more money wrapped up in that plan than anyone else. Pushing up on the risk scale is a road to ruin. When you're looking at what we like to call **Sleep Well At Night** (SWAN) money, you're looking for a solid return over a long period of time; you don't want to be flitting from place to place on the basis of knee-jerk reactions. If you want to have that paycheck for life to fund your dream retirement, it helps to have more money. You certainly don't want that money to disappear.

So, what does that mean for the individuals who have their money wrapped up in a 401(k)? For a plan participant who is in his or her twenties with \$15,000 or \$20,000 in their 401(k), he or she can put everything in a target date fund and be just fine. The challenge is to keep contributing and not get scared off. We don't even worry about that person's risk tolerance.

When you're sixty or older, the market goes down, and you see your account balance drop, I want you to think about units, not dollars. When prices go down, you're buying more units—like getting goods on sale. Sooner or later, the value of those units will climb, so the question then becomes: how many units can you acquire before they rise and before you cash them in over your retirement years?

A lot of business owners just see the 401(k) as another problem they have to deal with. They may worry about the fiduciary issue, but they forget that when it comes right down to it, it's an account they have money tied up in. **That money needs to be managed prudently**, which means taking on appropriate levels of risk. If a business owner is not in tune with the amount of volatility built into his or her 401(k), there's a chance there could be a serious jolt when the market struggles—even dropping 15 percent, let alone the 30 or 40 percent of a major downturn, can make people bail out if their risk tolerance is too low and that volatility is reflected in their plan.

Success, again, means not making that decision not dropping out when things are at their lowest—particularly when it comes to funding your dream retirement. Selling low and buying high is loss, and hence failure, if your goal is to maximize that paycheck for life. Success turns out to be as much about the psychology of risk as it is about trying to maximize return on investment.

PART 3

THE FIVE AUTOMATIC FEATURES (AUTO⁵)

Courageous Plan Design is the first step an employer can take to make an enormous impact on their employees' savings and investment behavior.

There are five features of the Courageous Plan Design:

1. Automatic Enrollment
2. Automatic QDIA
3. Automatic Escalation
4. Automatic Re-enrollment
5. The Stretch Match

Employers should evaluate all five automatic features and then decide which ones they are comfortable implementing.





AUTOMATIC ESCALATION

We believe that automatic escalation is probably the most important auto feature—and here's why. Remember, we stated that Americans need to save at least 10 percent of their pay throughout their working career, if they're ever going to hope to get to their retirement date with an adequate amount of money saved?

If the company only automatically enrolls an employee at 3 percent, or our example of up to the matching 6 percent, we're still a long way off from that required 10 percent savings rate. In addition, if you tell employees they need to save 10 percent right out of the gate, we can tell you from working with thousands of employees in 401(k) plans that they will say, *"What, are you crazy? Ten percent?"* Not going to happen. I have credit card bills to pay. I have my kid's tuition. I'm buying that boat."

A better solution for employees is for them to incrementally increase their savings rate.

We have this mantra. It's called "10-1-NOW."

The "10" stands for that 10 percent savings rate, which we tell employees is what they need to save. When an employee says, *"I can't do that much,"* we say, *"Okay, how much can you save?"* If they say 5 percent, we say, *"Great. Start with that amount and then increase it by just 1 percent a year until you get to 10 percent."* Most employees say, *"Okay, I can do that; one percent, no problem."*

And then they don't do it. It's human nature. They forget. They don't remember to increase it a year later. That's why, as an employer, you need to automate the decision process for them, NOW! The *"now"* stands for *"do it now."* Automate that additional 1 percent savings rate a year. The employee just needs to tell the employer, *"I want you to increase my percentage every year by 1 percent or even 2 percent, until I get to 10 percent."* The problem is most employees won't even remember to tell the employer.



Automatic escalation solves that problem. Each year, the employer automatically sends out a notice to every employee that their contribution will be automatically increased by 1 percent. That way, they don't forget to do it.

To drive home the power of this, take a look at the following chart

10-1-NOW									
Base Salary: \$40,000			Average Rate of Return: 6.00%			Average Salary Increase: 0.00%			
Year	10% per year Susan			5% Now + 1%/yr until 10% George			5% forever Morgan		
	Annual Savings	Earnings	Balance	Annual Savings	Earnings	Balance	Annual Savings	Earnings	Balance
1	\$4,000	\$0	\$4,000	\$2,000	\$0	\$2,000	\$2,000	\$0	\$2,000
5	\$4,000	\$1,050	\$22,548	\$3,600	\$675	\$15,521	\$2,000	\$525	\$11,274
10	\$4,000	\$2,758	\$52,723	\$4,000	\$2,226	\$43,320	\$2,000	\$1,379	\$26,362
15	\$4,000	\$5,044	\$93,104	\$4,000	\$4,331	\$80,520	\$2,000	\$2,522	\$46,552
20	\$4,000	\$8,102	\$147,142	\$4,000	\$7,149	\$130,302	\$2,000	\$4,051	\$73,571
25	\$4,000	\$12,196	\$219,458	\$4,000	\$10,920	\$196,922	\$2,000	\$6,098	\$109,729
30	\$4,000	\$17,674	\$316,233	\$4,000	\$15,966	\$286,074	\$2,000	\$8,837	\$158,116
35	\$4,000	\$25,004	\$445,739	\$4,000	\$22,720	\$405,380	\$2,000	\$12,502	\$222,870
40	\$4,000	\$34,814	\$619,048	\$4,000	\$31,757	\$565,039	\$2,000	\$17,407	\$309,524
45	\$4,000	\$47,942	\$850,974	\$4,000	\$43,851	\$778,697	\$2,000	\$23,971	\$425,487
50	\$4,000	\$65,510	\$1,161,344	\$4,000	\$60,035	\$1,064,621	\$2,000	\$32,755	\$580,672

We call it the 10-1-NOW Mantra chart.

This is a hypothetical example and not representative of any specific product.

It's an example of three employees, Susan, George, and Morgan. They all make the same amount of money, \$40,000 a year. They are all 30 years old, and we are going to assume they can all make an average of 6 percent on the savings each and every year. Susan says, "No problem. I can save 10 percent of my pay every year." She saves the 10 percent religiously every year and by the time she's 65, assuming her money grows at 6 percent, she has \$445,739. Pretty good.

George, however, says he can't save 10 percent. "I've got too many expenses," he says. "I can only save 5 percent." George agrees to increase his contribution by 1 percent each year until he gets to 10 percent. He does it automatically. In 35 years, he has \$405,380. He's only about \$40,000 dollars less than Susan's total. Not bad.

Meanwhile, Morgan also promises to start at 5 percent and increase by 1 percent each year. Then guess what she doesn't do? She doesn't increase it by 1 percent per year. And when she's at retirement in 35 years, she only has \$222,870.





It's amazing, isn't it? By NOT increasing her contribution by just that 1 percent a year, she has \$200,000 dollars LESS than Susan.

We call that *"the \$200,000 mistake!"*

That's why we want employers to institute automatic escalation, because they're really doing the employees a disservice when they don't. When employees see the 10-1-Now chart, its impact is remarkable. Employees see this \$200,000 mistake and say, "I don't want to be like Morgan. Sign me up for automatic escalation right now!" It is not uncommon for us to see employees even increase their savings rate by 3-4 percent overall.

Again, employees can opt out of that automatic increase. With every one of these automatic features, an employee just has to notify the employer and say, "Don't automatically enroll me in the plan. Don't automatically put me in that Qualified Default Investment Account. Don't automatically increase my contribution every year." An employee is always in control

⁷ Using Re-enrollment to Improve Participant Investing and Provide Fiduciary Protections, a white paper by Fred Reish & Bruce Ashton, Drinkle Biddle & Reath LLP, March 2014



PART 4

SMART WAYS FOR EMPLOYEES TO DIVERSIFY

Once your employees contribute money to a 401(k), the question is where should they invest it.

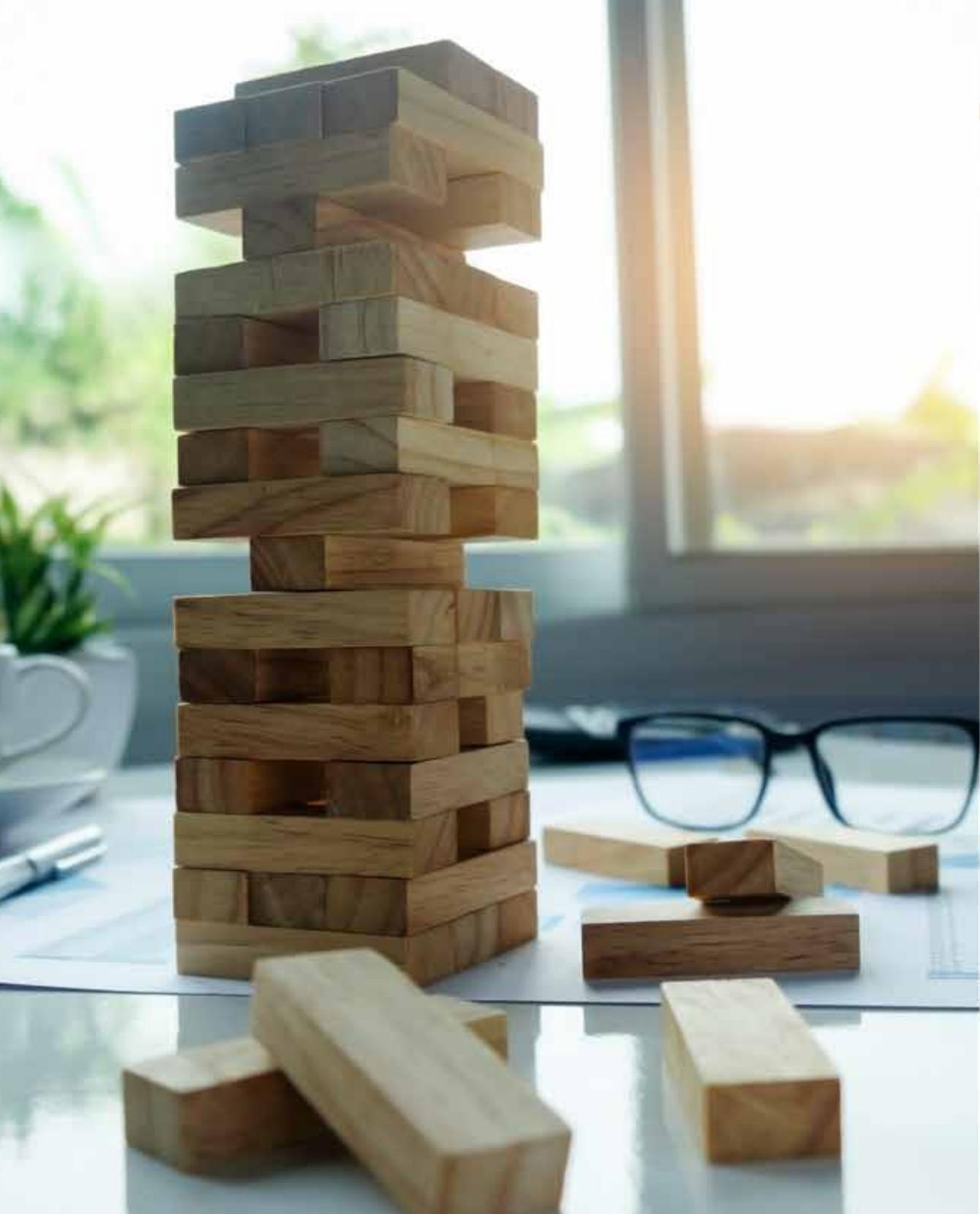
The first rule of successful investing is to diversify among a broad range of asset classes that behave differently and are in different markets.

Mutual funds are a great investment choice for employees, for a variety of reasons. First, a single investment, no matter how small, in one mutual fund allows them to gain control of many stocks or bonds quickly and efficiently. Second, unlike with individual stocks, mutual funds allow people to buy a fractional share (less than one share), which means your employees can always invest 100 percent of their money, regardless of the fund price.

Mutual funds can be divided into two camps: actively managed funds and passively managed index funds (exchange traded funds, or ETFs, are classified as passively managed index funds).

An actively managed fund is one in which the fund manager has discretion over the selection of investments (e.g., stocks, bonds, cash, etc.) and how long investments are held.





Passively managed index funds, or ETFs, typically mimic a specific stock or bond market index, which is why they're referred to as index funds. An index fund manager is constrained to holding the same stocks or bonds as the index that he or she is attempting to emulate. Passively managed index funds and ETFs tend to have lower expenses and turnover than do actively managed funds.

One useful function of a professional investment advisor is educating employees on an appropriate asset allocation consistent with each employees' specific investment needs, circumstances, and preferences in mind. An employee can choose to use actively managed funds, passively managed index funds, or a combination of the two, depending on which options you provide in the 401(k) plan.

REBALANCING

Rebalancing is the systematic process of reallocating the assets within a portfolio to keep each asset's share of the portfolio in line with predetermined percentages.

Employees may be thinking

"If stocks are doing better than bonds, what's the problem? Why would anyone want to sell the asset class that's going up and reinvest money in the one that's going down?"

They need to understand that winners often become losers. If an employee's winners now represent a higher percentage than he or she started with, then the risk exposure has increased. When that asset class turns negative, the employee may be poised for big losses and become unable to earn the desired rate of return, they need to achieve their income replacement ratio.



PART 5

PARTNER #1: UNCLE SAM'S MONEY (USM)

If your employees were to take a dollar out of their wallets and each tear away a fourth of it, they would see immediately and graphically what happens to them if they are in the 25 percent tax bracket. Uncle Sam lays claim to one-quarter of each dollar earned.

What does Uncle Sam do with that 25 cents?

He builds bridges and schools, manufactures airplanes and guns, provides agricultural programs, funds Medicaid, and so on—whatever he wants.

Does he ever plan on giving it back to you once he's taken it?

No. To the individual, that's 25 cents never to be seen again.

UNCLE SAM'S TAKE

WHAT YOU GET

For investors, the problem is that they have also lost the interest that they could have earned on that quarter.

To those who say that doesn't sound like a lot, let us ask this:

Suppose we were to give you one penny of that 25 cents, and you could double that penny every day for 30 days. How much money would you have at the end of that month? Ready for the answer?





\$5,368,709.12

That's right: One penny compounded every day for a month equals **\$5,368,709.12**.

What your employees need to understand is this:

Uncle Sam is giving them a choice. They can either invest 100 percent of their dollar in their 401(k), or else they can give him 25 cents and put just 75 cents in their pocket to spend.

GUARANTEED 33 PERCENT RETURN

Let's look at it another way. Let's assume that the employee earns \$100 and is in the 25 percent tax bracket. She could pay the taxes and take \$75 home to spend. On the other hand, if she decides to invest the \$100 in a 401(k), she is not taxed on that money—at least not yet. The tax comes when she eventually withdraws the funds. The point is that the **entire \$100 contribution to the plan will begin working today.**

By choosing to invest in a 401(k), the employee has an additional \$25 that would not have been available by taking the \$75 on an after-tax basis. **That extra \$25 would have been Uncle Sam's Money (USM) in the form of taxes.** Those additional dollars represent a guaranteed 33 percent return on the money you have available to invest ($\$25 / \75). That alone should get people's attention.



INTEREST-FREE LOAN

Another way to look at USM is that it really is an interest-free loan. Where else can anyone get a 33 percent return? From the local bank? Hardly. In 2014, interest rates were a miserly 0.50 percent to 1.50 percent.

Successful entrepreneurs are always looking for OPM to borrow at the lowest rate possible. Well, USM is interest free! Investors may wonder,

“What’s the catch? What’s my obligation for this interest-free USM?”

There are only two conditions.

1 **The money must remain working in the plan until the participant is 59.5 years old**, at which point she can begin to withdraw funds without a 10 percent early withdrawal penalty. While participants are not required to pay any interest on the use of this money until then, they will be required to pay taxes when they withdraw it to generate their Paychecks for Life. The taxes that they pay will be based on the prevailing tax rates during their desirement years.

2 **When they reach the age of 70.5 and retire from the company**, Uncle Sam requires that they begin withdrawing a minimum amount each year. Why? Because Uncle Sam wants to begin getting repaid for the money he has allowed the participant to use, interest-free, all those years. In essence, USM is a demand note or IOU that starts to become due at age 70.5 at the latest. A CPA or financial advisor can assist participants in making that calculation each year.





A WORD OF CAUTION:

Many people believe that when they reach their desirement years they'll be in a lower tax bracket because their income will be lower. Let us put this myth to rest. The truth is that no one knows what tax bracket they will be in when they stop working, including the government. In their desirement years, people could actually be in a higher tax bracket than they are now, if Congress votes to raise the income tax rates.

PARTNER #2: EMPLOYER'S MONEY (EM)

As part of your matching contribution, you the employer may also want to invest capital in your employees' 401(k) plan. The government also calls this investment a **profit-sharing contribution or safe harbor contribution**.

For the employee, the bottom line is this:

Such a contribution is another opportunity to invest using OPM.

Let's assume that you match the first 4 percent (under your Safe Harbor Design) of the income that the employee contributes. What this means is that **the employee earns a 100 percent return on that 4 percent** — instantly (depending on your company's vesting schedule). That's a remarkable return considering that the risk-free interest rate today is less than 1 percent per year and that the largest publicly traded corporations are proud to report a 20 percent return on assets at their annual shareholder meetings

The 401(k) participants need to understand that this contribution of Employer's Money (EM) **generates a consistent return of up to 100 percent** on some of their investment dollars, and it's risk free and interest free.



PART 6

FOUR PILLARS OF RETIREMENT READINESS

It will be valuable for employers to take the time to meet with their advisor and create an Educational Policy Statement that will focus on specific metrics of success they want to achieve in order to impact their employees' retirement readiness.

There are four pillars to retirement readiness we can track: portfolio allocation, savings rates, years to retirement, and the income replacement ratio. Those pillars can contribute to the participant's retirement goals and chances of achieving that "minimum adequate rate of success" for income replacement.

1. Portfolio Allocation:

Here we measure how employees are investing. We are looking at whether they are properly diversified for their age. We would be concerned to see employees who are either investing only in one or two funds or are overweighed in their asset allocation selections. We're going to measure portfolio allocation by specific age groups: 20–30, 30–40, 40–50, 50–60, and 60 through to retirement.

2. Savings Rates:

We measure everybody's savings rates by age group. We may find that younger people are saving less than are older people, or vice versa. We may want to roll up our sleeves and do meetings for particular age groups to talk about the power of compound interest and why they'd want to save more while they're younger, as opposed to waiting until they're older.

3. Years to Retirement:

Here we focus on measuring how close people are to retirement and whether they have saved enough. We can then design education meetings to encourage those individuals who may need to "catch up" on savings. For example, anyone over age 50 can contribute an additional \$6,000 (in 2015), known as the catch-up provision.

4. The Income Replacement Ratio:

In the fourth pillar of success, we calculate each individual's income replacement ratio, as we have discussed. We then create education sessions that teach employees about specific income replacement ratios and how increasing their contributions by just 1 percent or 2 percent a year (automatic escalation) could easily get them back on track to saving enough money. **It's the 10-1-NOW Mantra!**





A good record keeper can provide every employer with the data needed to regularly measure each employee's income replacement ratio. The employer, with guidance from their advisor, can then target the percentage of employees who need to get on track to saving adequately each year with additional education.

By evaluating these four pillars of retirement success by age groups, we can then customize educational meetings and target the groups that need the greatest education.

A lot of times, people like to be among their peers. If we have people ages 20 to 30 in a group meeting, and we're talking about compound interest and why saving 1 percent more at age 20 could mean having hundreds of thousands of dollars more at retirement, they start talking to one another:

"Did you increase your contribution?" And if they didn't, "Why not?" You start to get that cultural influence of peer-to-peer groups encouraging success.



THE VALUE OF A QUALIFIED ADVISOR

Why doesn't every advisor out there offer these types of retirement readiness services and solutions? Managing a company's 401(k) plan has become a specialty business. It's no longer a field where a generalist financial advisor or just a friend of the family can provide prudent advice and expertise.

If you're a plan sponsor, then you need an advisor who has the experience, expertise, and capabilities to help you manage your fiduciary responsibilities and help your employees create retirement readiness. Your advisor should have retirement credentials, this can be the **AIF® (Accredited Investment Fiduciary)** designation and/or the **AIFA® (Accredited Investment Fiduciary Analyst)** designation, both from fi360 (www.fi360.com). Another strong credential is the **C(k)P®** designation from **TRAU, The Retirement Advisor University** (www.trauniversity.com). You can be sure these designees have gone through a rigorous curriculum and maintain annual continuing education requirements. Your advisor should also have at least five to ten years of experience managing retirement plans to help fiduciaries navigate the litigious nature of the 401(k) world that we live in today. They must bring a unique process and a success formula that will help a plan sponsor measure the plan's retirement readiness results.

In addition, employees today are overwhelmed and confused by the amount of information on the Internet and in print. When people are confused, they may end up feeling isolated and helpless, which may lead to **financial paralysis**.

That's why it is critical to hire a talented advisory firm, one that knows how to educate employees about their income replacement ratio so they have greater clarity about how much money they need to save and accumulate, with the least amount of risk during their working years.

The advisor needs to be willing to take the time to educate employees on how to manage that money to create those Paychecks for Life during their desirement years. Finally, the advisor needs to assist plan sponsors in meeting their fiduciary obligations and maximizing courageous plan optimization using Auto5.





Is your current portfolio in line with your risk appetite? Visit

www.SouthportCapital.com

for your **FREE** risk analysis.

If you have questions on:

**Portfolio Management
Planning for Retirement**

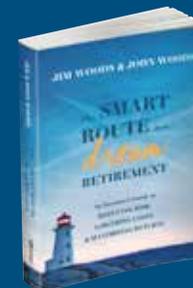
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The Smart Route to a Dream Retirement shows you—the employer and sponsor of the 401(k) retirement plan—how to educate, activate, and influence your employees to save enough money to build their own retirement income for life. Implement these valuable strategies at your company to instantly improve your 401(k) retirement plan and your employees' retirement saving experience:

- Five Automatic Features of Courageous Plan Design
- Desirement Planning® process
- Managing risk through diversification
- Paychecks for Life principles
- Fee and expense control
- Volatility management