

# Dialogues » WEALTH STRATEGIES FOR DISCUSSION



FIRST QUARTER  
2009

At Smith Barney, wealth management is defined by understanding you better—gaining deeper insight into your and your family's needs, goals and values. By looking at your whole financial picture, we can help you develop sound investment strategies. Let's continue working together to optimize your portfolio potential.

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## Rethinking Risk in Retirement

Today, experts agree that longevity is the name of the game in retirement planning and investing, as life spans in the U.S. hit highs unprecedented in human history. According to AARP, actuaries now say that if a married couple is healthy at age 65, there's a 50 – 50 chance one of them may live to age 92.

Conventional wisdom says that as you near retirement, you should dial down portfolio risk and shift into bonds, known traditionally for their safety and dependability. But there's a consequence to that action: Tilting too far toward conservative holdings around age 65 may actually increase the risk of outliving your assets.

We're being challenged to adopt a new attitude toward asset allocation. The effect of this overall mix could be greater than, say, market timing or which company's stocks you choose—research published in 2000 by Yale finance professor Roger Ibbotson found that asset allocation could be responsible for up to 90% of a portfolio's returns over the long term.

Despite recent market volatility, long-term trends suggest that a sufficient allocation to equities is the best way, over the decades, to outpace inflation and keep up with the rising costs of living longer. Depending on your life expectancy, tilting the balance toward conservative bonds and cash equivalents may need to begin closer to age 75 than age 50.

We can help you determine how the assets in your portfolio should be allocated to help meet your specific needs and goals. How you deploy your funds is one of the most important decisions in your financial life—and quite possibly, one of the key factors to having your money last as long as you need it to. ■

Diversification does not ensure against loss. Bonds are affected by a number of risks, including fluctuations in interest rates, credit risk and prepayment risk. In general, as prevailing interest rates rise, fixed income securities prices will fall. Bonds face credit risk if a decline in an issuer's credit rating, or creditworthiness, causes a bond's price to decline. High yield bonds are subject to additional risks such as increased risk of default and greater volatility because of the lower credit quality of the issues. Finally, bonds can be subject to prepayment risk. When interest rates fall, an issuer may choose to borrow money at a lower interest rate, while paying off its previously issued bonds. As a consequence, underlying bonds will lose the interest payments from the investment and will be forced to reinvest in a market where prevailing interest rates are lower than when the initial investment was made.  
By the Smith Barney Division of Citigroup Global Markets Inc.

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# Understanding Alternative Investments

» As you probably already know, today's investment landscape includes more than just stocks, bonds and mutual funds—it also includes investments such as private equity, real estate and hedge funds and managed futures, among others. These types of investments, known collectively as alternative investments, are not new, but they're growing in popularity as investors begin to better understand how they work and what potential benefits they may provide.

Like mutual funds, alternative investments pool capital from different investors into a commingled fund (meaning all investors share the same fund manager and asset allocation strategy) to make investments. Unlike mutual funds, however, these funds are generally structured as private, nonregistered investment funds and investors must meet certain net-worth or net-investment-asset requirements. Depending on their country of residence and tax status, investors contribute to onshore (U.S. based) or offshore (based outside the U.S.) versions of alternative funds. Alternative investments typically have high investment minimums and liquidity may be limited.

## HOW ALTERNATIVES WORK

Although they invest in the same markets as traditional funds, alternative funds use strategies that are vastly different. For instance, alternative managers may use short selling, leverage and derivatives to hedge risk and maximize return. What's more, alternative investments may provide diversification benefits because of their low-to-moderate correlation to traditional investments—and each other. (Correlation refers to the degree to which two investments are expected to move in the same direction at the same time.)

Alternative funds can also invest through other funds. So-called “funds of funds” distribute investments among other fund managers, who in turn invest the capital directly. Funds of funds often allow investors to invest in a broader array of funds than they would otherwise be able to because of impediments such as high minimums and limited access to single-manager funds. Investing in funds of funds also can help spread the risk of investing in a single-manager fund.

## MEASURING PERFORMANCE

While the performance of traditional funds depends primarily on market returns, the performance of alternative funds depends largely on manager skill. That's why alternatives are known as “absolute return” investments—managers aim to reach a target return, regardless of the direction of the market. (With traditional or “relative return” investments, managers aim to match or beat a relative benchmark such as the Standard & Poor's 500 Index.)

Some examples of alternative investments are listed below.

**Private equity:** Negotiated private investments in (most often) nonpublic companies at different stages of maturity. The objective is to resell at a higher price in the future.

**Hedge funds:** Private investment funds that invest primarily in the global equity and fixed income markets. Hedge funds typically use sophisticated trading strategies that involve leverage and derivative instruments.

**Real estate:** Negotiated private investments in real estate assets with the objective of generating current income and/or reselling at a higher value in the future.

**Structured/fixed income products:** Pools of fixed income securities purchased with equity from investors and leveraged with the objective of generating spread income (the difference between income and cost) for investors.

**Managed futures:** Investments in global markets including futures, options and forwards on traditional commodities, financial instruments and currencies.

To learn more about alternative investments and whether they might be appropriate for your investment portfolio, speak with us. As a Smith Barney client, you have access to a vast array of expertise and resources to help ensure that your wealth works hard for you. ■

As further described in the offering documents, an investment in alternative investments can be highly illiquid, is speculative and not suitable for all investors. Investing in alternative investments is only intended for experienced and sophisticated investors who are willing to bear the high economic risks associated with such an investment. Investors should carefully review and consider potential risks before investing. Certain of these risks may include:

- loss of all or a substantial portion of the investment due to leveraging, short-selling, or other speculative practices;
- lack of liquidity in that there may be no secondary market for the fund and none is expected to develop;
- volatility of returns;
- restrictions on transferring interests in the fund;
- potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized;
- absence of information regarding valuations and pricing;
- complex tax structures and delays in tax reporting;
- less regulation and higher fees than mutual funds; and
- advisor risk.

Individual funds will have specific risks related to their investment programs that will vary from fund to fund.

Actual results may vary and past performance is no guarantee of future results.

S&P 500 Index is an unmanaged, market value-weighted index of 500 stocks generally representative of the broad stock market. An investment cannot be made directly in a market index.

# Planning Beyond the Numbers

While it's never a bad time to revisit the fundamentals of investing, it's an especially good time to do so when volatile markets start making investors feel anxious and uncertain.

» It's during times like these that you'll hear a lot about *asset allocation*.

The goal of asset allocation—the spreading of funds across different asset categories, such as stocks and bonds—is to help you achieve your long-term financial goals with less risk. For asset allocation to be truly effective, your goals should be based on more than just market returns, industry sectors or coupon rates. They should correspond to your lifestyle, family and passions. Only when you've identified what's important to you can you calculate the cost—and only then can we help design your investment strategy accordingly.

How do you get started? Get ready to have a number of important conversations: with your spouse or partner, other integral family members and your Financial Advisor. These discussions should help clarify the lifestyle you wish to maintain when you are no longer in your peak-earning years. In addition to funding your vision of retirement (do you want to live like you do today, more modestly or more extravagantly?), you should consider how you will cover tuition expenses, legacy outlays and anything else you consider important, and still have enough for new opportunities. You should know what you want to get out of life so we can then build a plan for your money around that insight.

## LET'S TALK ABOUT RISK

Risk is a notion that gets thrown around a lot, in terms of how much of it can you tolerate for that extra return that may come with it. When you are thinking about your plan, it's important to consider risk. Ask yourself these questions:

- » How would I fund a large, unexpected expense or face a job loss, illness or other catastrophic event that occurred before the end of my investment time horizon?
- » How do I respond to every market swing? Nervously, or steadily?
- » What do I worry about when it comes to dispersing my money among various asset classes?
- » What would help me feel more secure about my financial future?

Also ask yourself if you are more of a conservative or aggressive investor—and why. If you consider yourself conservative, for example, is it because you had a bad past experience? Do you understand how issues such as the possibility of living longer than expected and inflation steadily reducing purchasing power factor into an allocation? These are the kinds of questions you should be discussing with your Financial Advisor. The more you can articulate who you are and what matters to you, the better equipped we will be to recommend a portfolio that helps fulfill your goals and ideals.

## GETTING DOWN TO BRASS TACKS

Now that you've thought about the hard part—the architectural plans, let's say—you can get started building the foundation, and that begins with a thorough evaluation of all your holdings. Together we should assess your current allocation, while also looking at any illiquid holdings (such as real estate or a business) and concentrated positions you may have (say to one stock or one type of asset class). You might be surprised just how undiversified you could be despite all your “diversification.” And once you have a plan in place, it's important to remember that events such as voluntary or involuntary retirement, the sale of a business or another asset, changes in family circumstances (like a child's marriage, the death of an elderly parent or even a divorce) will affect not only your asset allocation but also your entire financial picture. So, be sure to update us on any changes in your life.

As important as a sound asset allocation strategy is, it's only as good as the goals and ideals that you've identified. While the performance of your investment portfolio may look good on paper, is it good enough to allow you to get what you want out of your life? We can help you with more than just investment choices—together, you can bring your big picture into focus and create a comprehensive plan to help ensure you make it into the shot. ■

Diversification does not ensure against loss.

# Essential Retirement Plan Information

## 2009 Retirement Plan Limits Cost-of-Living Adjustments

» PLAN LIMITS	IRS CODE	2009	2008
Defined Benefit Plans Annual Benefit	415(b)(1)(A)	\$195,000	\$185,000
Defined Contribution Plans Annual Contributions	15(c)(1)(A)	\$49,000	\$46,000
Qualified Plan Annual Compensation Limit	401(a)(17) and 404(1)	\$245,000	\$230,000
Highly Compensated Employees <sup>1</sup> Compensation Level	414(q)(1)(B)	\$110,000	\$105,500
401(k) Elective Deferrals	402(g)(1)	\$16,500	\$15,500
401(k) Maximum Deferral with Catch-up <sup>2</sup>	414(v)(2)(B)(i)	\$22,000	\$20,500
SEP Minimum Compensation Amount	408(k)(2)(C)	\$550	\$500
SEP Compensation Limitation Amount	408(k)(3)(C)	\$245,000	\$230,000
SIMPLE Plans Maximum Deferral Limit	408(p)(2)(E)	\$11,500	\$10,500
SIMPLE Maximum Deferral with Catch-up <sup>2</sup>	414(v)(2)(B)(ii)	\$14,000	\$13,000
457 <sup>3</sup> Plans Maximum Deferral Limit	457(e)(15) and 457(c)(1)	\$16,500	\$15,500
457 Maximum Deferral with Catch-up <sup>2</sup>	414(v)(2)(B)(i)	\$22,000	\$20,500
Key Employee Compensation Level <sup>4</sup>	416(i)(1)(A)(i)	\$160,000	\$150,000
Social Security Wage Base		\$106,800	\$102,000

<sup>1</sup> Any individual who is a 5% or more owner of the employer is also considered a Highly Compensated Employee, regardless of his or her compensation.

<sup>2</sup> Catch-up provisions only apply to individuals age 50 or over under code sec. 414(v).

<sup>3</sup> A special 457 plan provision allows a participant to double the current year's maximum deferral limit not including the "catch-up" contribution. This election only applies to the three full calendar years prior to their normal retirement age under the plan.

<sup>4</sup> A key employee is defined as (1) an officer with compensation greater than \$160,000, (2) a 5% owner, or (3) a 1% owner with compensation greater than \$160,000.

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