MorganStanley
SmithBarney

Dialogues » WEALTH STRATEGIES FOR DISCUSSION

Baby Boomers are redefining retirement, and we take a fresh approach to helping clients plan for this new set of values and associated challenges. We advise clients at every stage of retirement planning to be financially prepared in order to live fully during their retirement years.

THIRD QUARTER
2009

COURTESY OF
HARVEY W. MACLARY & GAIL M. CHICKERSKY

2751 Centerville Road
Two Little Falls Centre, Suite 104
Wilmington, DE 19808
Phone: 302-636-5550
Fax: 302-994-9352
Tollfree: 877-801-4593
http://fa.smithbarney.com/maclarychickersky

HARVEY W. MACLARY
Vice President-Wealth Management
CERTIFIED FINANCIAL PLANNER℠

GAIL M. CHICKERSKY
Financial Advisor
Chartered Retirement Plans Specialist

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.

Seven Strategies for Investing

During Volatile Markets

» The markets don't always behave the way we'd like them to: Geopolitical turmoil, natural disasters, interest rates and world events can have a profound effect on market movements. If recent market volatility has you concerned about the economy, you are not alone; this is a confusing time for many investors. Some have decided to stay the course, while others are sitting on the sidelines waiting for the market to rebound. However, since no one can predict how the markets will perform, it's important to develop an investment strategy that can help you stay on the right track to meeting your long-term financial goals. Here are some strategies that you can implement that may help to manage risk during these uncertain times.

Work with a Financial Advisor. There are a lot of do-it-yourself investment resources available to investors today. However, none of those resources can replace the experienced, personal service we can provide. We can offer an understanding of your complete financial picture, not just your investments. Additionally, in periods of market volatility when you need the most support, we can provide:

- Access to important decision-making research and information;
- Ongoing monitoring of your investment portfolio, while anticipating your changing needs; and
- A comprehensive market-volatility plan.

Have a plan. Developing a financial plan is one of the best ways to meet your long-term goals. Your plan should also include an action plan to address market volatility, which should be developed well in advance of a turbulent market. Having a market-volatility plan will help you to set realistic goals and appropriately manage your return expectations.

Invest regularly. It may not seem intuitive, but investing regularly—even during market downturns—can help to reduce your overall costs. Dollar cost averaging is one of the best ways to invest regularly, since you're investing a fixed amount on a fixed schedule, regardless of how the markets perform. Investing regularly can also have intrinsic benefits: It encourages discipline and may also ease the anxiety of daily market fluctuations.

Diversify. If you've ever heard the saying, "Don't put all your eggs in one basket," then you already have a basic understanding of diversification. Diversifying your portfolio can reduce risk and volatility if the assets have little or no correlation to each other.

Investing in mutual funds is one way to achieve portfolio diversification, since mutual funds are typically a diversified investment. There are also several other ways to diversify and potentially reduce portfolio volatility:

- Within an asset category, such as purchasing different types of mutual funds;
- Among asset categories, such as purchasing stocks and bonds; and
- Outside the United States, since some markets move opposite to the U.S. stock market.

Put volatility to work for you. Do you think of the glass as half empty or half full? Your perspective can affect the investment decisions you make during market downturns. Investors who view market volatility negatively can make irrational decisions. A down market can be an opportunity for you to build your portfolio and take advantage of lower unit costs.

Stay invested. You are probably anxious during times when the value of your investments has decreased. As a result, you may be tempted to move out of the market, sit on the sidelines and wait for the market to rebound. However, since no one knows how the markets will move, how do you know you're leaving at the right time? Also, how will you know when it is the right time to get off the sidelines and start investing again?

If you have worked with a Financial Advisor, your investment strategy was developed to help you meet your long-term goals. Timing the market could potentially jeopardize your financial plan—and your future goals.

Be patient. There will always be uncertainty in the markets; market volatility is a natural part of the investment cycle. Although it may take some time, markets do rebound.

In the meantime, call us to help you develop an action plan for market volatility and continue to focus on your long-term investment goals rather than short-term market moves. ■

Asset allocation and diversification strategies do not guarantee a profit or protect against loss.

A periodic investment plan such as dollar cost averaging does not assure a profit or protect against a loss.

International stocks are subject to certain risks of overseas investing including currency fluctuations and changes in political and economic conditions, which could result in significant market fluctuations. These risks are magnified in emerging markets.

Mutual fund investments are subject to market risk, including the possible loss of principal. They are sold by prospectus only. The prospectus contains the investment objectives, risks, fees, charges and expenses, and other information regarding the mutual fund and variable annuity contract and its underlying investments, which should be carefully considered before investing. Prospectuses are available through your Financial Advisor or at www.smithbarney.com. Read the prospectus carefully before you invest or send money.

Staggering Retirement:

When One Spouse Leave the Workforce

When one half of a working couple decides to bid adieu to the working life, it can be a major life change for both partners, with its fair share of pitfalls and unknowns. If you or your spouse is considering this step, some of these questions will inevitably arise in your discussions: Are we financially prepared? Can we maintain our lifestyle on just one income? What will we do about health insurance?

Staggered retirements can be financially complex, especially if the retiring spouse immediately must begin drawing on a nest egg. More typically, one-retirement couples have to evaluate varying Social Security benefits and pension estimates. If savings are tapped before age 60 there might be early-withdrawal penalties for 401(k) and other retirement plans.

You'll also need to figure out how much money you'll need every month to maintain your standard of living—or to achieve the one you envision for retirement. This process will involve analyzing your accumulated wealth, forecasting future income and crafting a budget consistent with your expense and income predictions.

Your investment strategy should also be reviewed, since goals often change in retirement. But depending on your investment time horizon and other key factors, your primary objective may still be long-term growth, meaning you would likely focus on managing risk, investing in growth-oriented stocks and holding investments for the long term. We can help you calculate the funds you will need to make your staggered retirement a reality—and help you adjust your investment portfolio accordingly.

OTHER IMPORTANT CONSIDERATIONS

Health insurance is another vital consideration for one-retirement couples, particularly when retirement occurs before Medicare eligibility begins at age 65 or before a company pension plan with health benefits kicks in. Couples must decide whether the retiring spouse is better off covered under the working spouse's plan or through coverage offered by a previous employer. In addition, COBRA coverage—federal legislation that allows some workers and their family members to maintain health care coverage after working—lasts only 18 months in most states. If neither the working spouse's plan nor the retiree's previous employer offers coverage, more expensive private insurance may need to be purchased.

Besides developing a comprehensive financial plan, you and your spouse or partner also need to think about the psychological implications of retirement, as well as retirement on different schedules. Winding down gradually may help ease the transition.

Many successful retirees find meaning and purpose in life's next chapter, whether through a second career, volunteer work, new interests or old hobbies. As with the financial side of planning for retirement, the key is to take control of the situation, rather than having the situation take control of you. ■

Discussions You Should Have *Before* Retiring

Planning for retirement should begin years before you think about ending your career. Having the right discussions with your Financial Advisor can lead to new strategies. The sooner you know where you stand, the more options you'll have to help build the lifestyle you envision for retirement.

Here are five questions that you and your spouse or partner should answer and then discuss with us before retiring:

- How do we want to spend our time and what kind of lifestyle do we plan to live?
- What will it cost to fulfill our goals and what will our budget look like?
- Where will the income we need to finance our goals come from (e.g., retirement accounts, stocks and bonds, Social Security)?
- How will we manage health risks—and do we have adequate health insurance and long-term care insurance?
- Are our legal documents in order, with updated wills, living wills and clear instructions—if we're incapacitated—as to who should have durable power of attorney on financial decisions and who should serve as health care proxy for medical care decisions

The New Retirement Reality

Last year was an extraordinary year, the effects of which have carried over into 2009 and are expected to continue for years to come.

» Devastated investment portfolios, massive job losses, declining housing prices and volatile financial markets have prompted many analysts—and even the President—to dub this "the worst economic crisis since the Great Depression."

Like many investors, you probably saw your investment portfolio decline significantly, and your confidence in the financial markets has likely declined with it. Despite your uncertainty and prevailing unpredictable economic conditions, you still need to continue planning for your retirement, even though it may not be the retirement you had envisioned. Some retirement challenges—rising health care costs, potential long term care needs, inflation and changing spending habits—are just as important as they were before the current recession. However, you have two new challenges to consider: rebuilding your retirement assets after significant losses, and doing so within a more concise time frame.

The truth is, with continued market volatility many investors will not be able to retire at the age, or into the lifestyle, they had planned. In fact, it is estimated that someone earning $150,000 at retirement will need to replace 84% of that salary to continue the same preretirement standard of living.[1] And with unemployment rates at their highest level in decades, fewer people have the option of extending their time in the workforce to supplement depleted assets. **Welcome to The New Retirement Reality.**

FACING THE NEW RETIREMENT REALITY

If you are wondering how you will be able to rebuild your retirement assets given these circumstances, all is not lost. While there is no blueprint for the current economic situation and rebounding from your losses will be difficult, you *can* still plan for the some of challenges you may face as you approach retirement.

» **Assess the Damage:** Your first step in planning for The New Retirement Reality is to assess your current situation: Have your assets declined? How much time do you have until you retire? What will you need to do to make up the shortfall?

We can help you evaluate your current financial situation, and determine where you will need to focus your attention to help you meet your retirement goals.

» **Redefine Your Retirement:** If your retirement assets are significantly less than they were a year ago, you may have to redefine your expectations for your ideal retirement lifestyle. Ask us for a Smith Barney *Paying for Retirement* budget worksheet to help you recalculate your retirement spending needs.

Fight the Fear: It's hard to plan for the future during such an uncertain time. In fact, many investors are hesitant to invest, fearful lest they lose more of their savings if the financial markets continue to perform poorly. However, traditional sources of income are no longer enough to fund retirement, so you will need to be invested—either through an employer-sponsored plan or independently—to improve the likelihood of rebuilding your retirement assets. Can you afford to wait until the market rebounds?

How Much Will You Need to Maintain Your Standard of Living in Retirement?

Salary at retirement	**$150,000**
Amount required to maintain preretirement standard of living	**$126,000**
Less Social Security benefits	$34,500
Amount that must come from savings/retirement plan	**$91,500**

[1] *Source: 2008 Replacement Ratio Study, Aon Consulting Worldwide and Georgia State University, August 2008*

PROTECTING YOUR REMAINING ASSETS

If you knew last year that we would be experiencing such volatile markets today, wouldn't you have taken steps to protect your assets? If you are worried about losing your existing retirement assets, there are strategies that can help you plan for retirement and protect assets from future market downturns.

One such strategy is a variable annuity with an optional withdrawal benefit,[2] which can:

- » Provide guaranteed lifetime income[3] for you and your spouse, and
- » Protect your retirement assets from negative market movements.

If the market continues to decline, you are guaranteed[3] to recoup at least your initial investment through lifetime withdrawals. And if the market rebounds, you will also have the opportunity to lock in those market gains.

As you consider the new challenges you will face in The New Retirement Reality, one thing is certain: You must continue to plan and invest to meet your retirement goals. Call us to learn how to protect your remaining retirement assets and guarantee retirement income for the rest of your life. ■

Can You Afford to Wait? A Historical Look at Market Performance

You may be concerned about the unpredictable financial markets, and as a result, you may want to wait until things get better. Below is a sample of several magazine covers that were published during turbulent market conditions. Although past performance is no guarantee of future results, you can see how investing—despite market volatility—yielded positive long-term results.

Trying to Build Confidence

January 30, 1978

DOW Jones: 772.44
10 years later: 1,958.22

$1,000 invested in the Dow Jones on the day this issue hit the stands would have been worth **$2,535** ten years later.

The Ax Falls

March 2, 1981

DOW Jones: 977.99
10 years later: 2,909.90

$1,000 invested in the Dow Jones on the day this issue hit the stands would have been worth $2,975 ten years later.

America's Banks Awash in Troubles

December 3, 1984

DOW Jones: 1,182.42
10 years later: 3,745.62

$1,000 invested in the Dow Jones on the day this issue hit the stands would have been worth **$3,168** ten years later.

The Crash

After a wild week on Wall Street, the world is different

November 2, 1987

DOW Jones: 2,014.09
10 years later: 7,442.08

$1,000 invested in the Dow Jones on the day this issue hit the stands would have been worth **$3,695** ten years later.

High Anxiety

Looming recession, government paralysis and the threat of war are giving Americans a case of the jitters

November 15, 1990

DOW Jones: 2,545.05
10 years later: 10,707.60

$1000 invested in the Dow Jones on the day this issue hit the stands would have been worth **$4,207** ten years later.

Source: *TIME magazine & Dow Jones Industrial Average*

Past performance is no guarantee of future results.

The Dow Jones Industrial Average is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange and the Nasdaq. Investors cannot invest directly in an index.

[2] Optional benefits are available at an additional cost and may require assets to be invested in one or more of the available asset allocation portfolios.

[3] Guarantees are based on the claims-paying ability of the issuing insurance company. Such guarantees do not apply to the investment return or the safety of the underlying funds in the annuity.

Annuities are long-term investments designed for retirement purposes and are subject to investment risk, including the possible loss of principal. Withdrawals (and certain deemed distributions) are subject to ordinary income tax, and if taken prior to age 59½ may be subject to a 10% federal income tax penalty. Additionally, changing annuities may result in surrender charges and other fees. Surrender charges may be imposed with a new contract, or the period of time for which surrender charges may apply will increase with a new contract. The new contract may be subject to additional insurance and investment-related fees as well as increased risks.

Variable annuities are sold by prospectus only. The prospectus contains the investment objectives, risks, fees, charges and expenses, and other information regarding the variable annuity contract and the underlying investments, which should be considered carefully before investing. Prospectuses for both the variable annuity contract and the underlying investments are available from your Financial Advisor or if you do not have a Financial Advisor, please visit smithbarney.com to locate one near you. Please read the prospectus carefully before you invest.

Insurance products offered through SBHU Life Agency, Inc.

Time Is Money:

Deciding When to Take Social Security

One of the few things you can control about Social Security is when to start collecting it. Should you take it when you become eligible at age 62, wait until "normal" retirement age (a function of your birth date) or consider delaying your benefits past normal retirement age?

To help you make this decision, consider that, on average, Americans are living longer than ever before. Clearly, the longer you expect to live, the more sense it makes to delay taking Social Security. But of course, each person's circumstances and needs are different—here's a look at how timing can affect the benefits you receive.

EARLY BENEFITS

The soonest you can collect Social Security is age 62. But taking payments at 62 will result in a permanently reduced benefit, ranging from a 20% reduction for people born in 1937 up to 30% for those born in 1960 or later. You may want to consider early benefits if you need income but prefer to leave your portfolio intact, or if you intend to invest the benefits to try to earn a more competitive return (though there's no guarantee you will do so).

FULL BENEFITS

Eligibility for full Social Security benefits varies according to the year you were born. Depending on how long you worked and how much you earned over your lifetime, the maximum benefit you could collect at normal retirement age (65 years and 10 months) is $2,185 per month in 2008. Consider waiting for full benefits if you plan to work until age 65, if you want to ensure a larger survivor's benefit for your spouse or if family history and good health may lead to an above-average life expectancy. Refer to the Social Security website (http://www.socialsecurity.gov/OACT/quickcalc/when2retire.html) to calculate your "breakeven" age, when the accumulated value of higher benefits from postponing retirement will start to exceed the value of lower benefits from choosing early retirement.

THE DOLLAR BENEFITS OF EARLY, NORMAL AND DELAYED RETIREMENT

Assumptions
Date of Birth: 01/01/1948
Current Earnings: $100,000

	Monthly Benefit in Future Dollars[1]
Start at Age 62	$1,612
Start at Age 66	$2,392
Start at Age 70	$3,680

Source: Social Security Administration Web Site: Quick Calculator

[1]Assumes increase in future prices and earnings

AGE TO RECEIVE FULL BENEFITS AND REDUCTION FOR EARLY BENEFITS

Year of Birth	Normal Retirement Age	Percentage of Full Benefits at Age 62
1937 or earlier	65	80.0
1938	65 and 2 months	79.2
1939	65 and 4 months	78.3
1940	65 and 6 months	77.5
1941	65 and 8 months	76.7
1942	65 and 10 months	75.8
1943 – 1954	66	75.0
1955	66 and 2 months	74.2
1956	66 and 4 months	73.3
1957	66 and 6 months	72.5
1958	66 and 8 months	71.7
1959	66 and 10 months	70.8
1960 or later	67	70.0

Source: Social Security Administration 2008

DELAYED BENEFITS

If you continue working beyond your normal retirement age, you will be eligible to collect a permanently increased Social Security benefit when you do retire. Approximately 8% more per year will be added automatically to the permanent benefit amount for every year you wait. Delaying benefits past age 70 will generally add nothing more to your monthly benefit.

To help assess your situation, refer to your personalized Social Security Statement, which estimates the monthly Social Security benefits you may qualify for (go to http://www.socialsecurity.gov/mystatement for a copy of your statement). Decisions regarding retirement, including when to take social security, can have a significant impact on your financial security. Talk to us today about scheduling a personal retirement check-up, or about our wide-ranging collection of resources available to assist you in your planning needs. ■

It's Up to You

You will not automatically receive Social Security benefits when you become eligible. You must apply for the benefits, which can be done online, by calling 1-800-772-1213 or by visiting a Social Security office. And remember, Social Security benefits are taxed as ordinary income in the year of payment.equal parts.

Don't Let Health Care Costs Hamper Your Retirement

Today, your health insurance premiums and medical expenses could be eating into a huge part of your retirement savings—and the future doesn't offer much encouragement. Health care costs will probably continue to grow faster than inflation, and a lot of employers are reevaluating if they will be able to continue to offer the same level of retiree health insurance coverage.

In a recent study from Phoenix Marketing International, a U.S.-based marketing-research firm, investors with $1 million or more in investable assets said that the rising cost of health care was their number-one concern.

Not having a plan in place to take care of your health care costs could take a big bite out of the retirement savings you've worked so hard to accumulate. Having the right amount of funding ready begins with understanding how much you will need to save—and what your options are for saving.

Top Concerns Regarding Issues Related to Savings and Investments for Investors with $1 Million+ in Investable Assets (June 2007)

Concern	%
1. Rising cost of health care	57%
2. Protecting current wealth	55%
3. Increased energy prices	48%
4. Minimizing taxes	45%
5. Terrorism	36%

Data Source: Phoenix Affluent Marketing Service Tracking Program (U.S.) as of June 2007.

HOW MUCH WILL YOU NEED?

According to the 2007 Retirement Confidence Survey[1] from the Employee Benefit Research Institute®, assuming Medicare benefits remain at current levels, couples will need approximately $300,000 to cover health expenses in retirement if living to average life expectancy, and as much as $550,000 if living to age 95.

HEALTH SAVINGS ACCOUNTS

As health insurance costs have gone up, a new type of plan—the high-deductible health plan—has been designed for people who don't have a current, frequent need for health care but still want insurance coverage in case something unexpected happens. Because the premiums are lower (15% to 45% lower than other plans) the plan carries relatively high deductibles. But, to help pay these deductibles, the federal government has created legislation that lets people establish a tax-advantaged account known as a health savings account, or HSA.

An HSA combines an individual's current health insurance plan with a tax-deductible savings account. Small-business owners who offer a high-deductible plan as an employee benefit could also use an HSA. Proponents of HSAs believe they are important because they help reduce the growth of health care costs and improve the efficiency of the health care system.

HSAs were created to encourage people to save for their future health care expenses and adopt high-deductible health plans, which make clients more responsible for their own health care choices. In 2007, 3.2 million people were covered by HSA-type insurance plans. This growth is predicted to continue: 14 million HSA policies are expected to be opened by 2010.

We understand the risks and challenges involved in growing and protecting your wealth. Talk with us about putting a plan in place that takes into account the impact future needs in health care may have on your retirement. ■

[1]The 2007 Retirement Confidence Survey is based on telephone interviews using random digit dialing conducted in January with 1,252 Americans ages 25 and older. The margin of error for all respondents is plus or minus three percentage points. EBRI is a private, nonprofit research institute based in Washington, DC, that focuses on health, savings, retirement and economic security issues. EBRI does not lobby and does not take policy positions. www.ebri.org

Insurance products are offered through SBHU Life Agency, Inc.

Since life insurance is medically underwritten, you should not cancel your current policy until your new policy is in force. A change to your current policy may incur charges, fees and costs. A new policy will require a medical exam. Surrender charges may be imposed and the period of time for which the surrender charges apply may increase with a new policy. You should consult with your own tax advisors regarding your potential tax liability on surrenders.

Early IRA Withdrawals Can Be Costly

If you are thinking of taking early IRA withdrawals to fund a new venture, consider the consequences first.

People often want to tap their IRAs prior to age 59½ to change careers or fund other endeavors that require a good chunk of money. But be forewarned: It's generally unwise to take early IRA withdrawals. Not only will early withdrawals likely cost you money, but they also could adversely affect your retirement plan.

For starters, most early withdrawals from a traditional IRA incur income taxes and a 10% penalty. (Withdrawing nondeductible contributions only triggers the penalty.) And while certain strategies and situations allow you to avoid early withdrawal penalties, you will still pay income tax on the money you take out. For example, you can take annuitized distributions—often referred to as "substantially equal periodic payments"—for at least five years or until age 59½, whichever is longer—but you must adhere precisely to the Internal Revenue Service's formula. So, it's important to consult a professional before setting this up.

You can also make early withdrawals penalty free for a first-home purchase (up to $10,000 total), in case of complete disability, to pay education costs, to put toward high medical expenses (more than 7.5% of your adjusted gross income) or to cover health insurance premiums while unemployed.

Still, it's best to avoid withdrawals even if you won't be penalized, because any money you pull out of your IRA today will lose its ability to generate potential tax-sheltered gains. Such moves will make it much harder for you to meet your financial goals in retirement.

> "Early withdrawals likely cost you money, but they also could adversely affect your retirement plan."

We understand the risks and the challenges involved in growing and protecting your wealth. We can guide you in developing an overall financial plan that takes into account all of your personal goals and needs. ■

© 2009 Morgan Stanley Smith Barney LLC and its affiliates do not provide tax or legal advice. To the extent that this material or any attachment concerns tax matters, it is not intended to be used and cannot be used by a taxpayer for the purpose of avoiding penalties that may be imposed by law. Any such taxpayer should seek advice based on the taxpayer's particular circumstances from an independent tax advisor.