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THE FINANCIAL FORMULA

Giving You The Financial Information You Need

November 2011

Welcome to the November '11 edition of The Financial Formula! Please email or call me if you have any questions - Happy Thanksgiving!

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In This Issue

FAQs for Near-Retirees

The following frequently asked questions about retirement income should help those nearing retirement know if they are on track to meet their income needs.

Three-Step Retirement Planning Strategy for Couples

Communication is one of the foundations of a successful relationship. It also can help you and your partner structure a solid retirement planning strategy.

What You Need to Know About Currency Risk

Given the current weakness of the U.S. dollar, it is critical that U.S. investors understand the risks (and potential rewards) involved in foreign currency diversification -- and take steps to protect their portfolios.

Defining Your Own Retirement

In the coming decades, "retirement" will mean something different to each of us. Regardless of your decision, you'll need to design a financial plan suited to your specific vision of the future.

FAQs for Near-Retirees

While studies indicate that many people are likely to need between 60% and 80% of their final working year's income to maintain their lifestyle after retiring, low-income and wealthy retirees may need closer to 90%.

After years of saving and investing, you can finally see your retirement on the horizon. But before kicking back, you still have some important planning to do. The following frequently asked questions about retirement income should help you begin the final stages of retirement planning on the right foot.

1. When should I begin thinking about tapping my retirement assets and how should I go about doing so?

The answer to this question depends on when you expect to retire. Assuming you expect to retire between the ages of 62 and 67, you may want to begin the planning process in your mid to late 50s. A series of meetings with a financial consultant may help you make important decisions such as how your portfolio should be invested, when you can afford to retire, and how much you will be able to withdraw annually for living expenses. If you anticipate retiring earlier, or enjoying a longer working life, you may need to alter your planning threshold accordingly.

2. How much annual income am I likely to need?

While studies indicate that many people are likely to need between 60% and 80% of their final working year's income to maintain their lifestyle after retiring, low-income and wealthy retirees may need closer to 90%. Because of the declining availability of traditional pensions and increasing financial stresses on Social Security, future retirees may have to rely more on income generated by personal investments than today's retirees.

3. How much can I afford to withdraw from my assets for annual living expenses?

As you age, your financial affairs won't remain static: Changes in inflation, investment returns, your desired lifestyle, and your life expectancy are important contributing factors. You may want to err on the side of caution and choose an annual withdrawal rate somewhat below 5%; of course, this depends on how much you have in your overall portfolio and how much you will need on a regular basis. The best way to target a withdrawal rate is to meet one-on-one with a qualified financial consultant and review your personal situation.

4. When planning portfolio withdrawals, is there a preferred strategy for which accounts are tapped first?

You may want to consider tapping taxable accounts first to maintain the tax benefits of your tax-deferred retirement accounts. If your expected dividends and interest payments from taxable accounts are not enough to meet your cash flow needs, you may want to consider liquidating certain assets. Selling losing positions in taxable accounts may allow you to offset current or future gains for tax purposes. Also, to maintain your target asset allocation, consider whether you should liquidate overweighted asset classes. Another potential strategy may be to consider withdrawing assets from tax-deferred accounts to which nondeductible contributions have been made, such as after-tax contributions to a 401(k) plan.

If you maintain a traditional IRA or a 401(k), 403(b), or 457 plan, in most cases, you must begin required minimum distributions (RMDs) after age 70 1/2. The amount of the annual distribution is determined by your life expectancy and, potentially, the life expectancy of a beneficiary. RMDs don't apply to Roth IRAs.

5. Are there other ways of getting income from investments besides liquidating assets?

One such strategy that uses fixed-income investments is bond laddering. A bond ladder is a portfolio of bonds with maturity dates that are evenly staggered so that a constant proportion of the bonds can potentially be redeemed at par value each year. As a portfolio management strategy, bond laddering may help you maintain a relatively consistent stream of income while limiting your exposure to risk.[1]

When crafting a retirement portfolio, you need to make sure it generates enough growth to prevent running out of money during your later years. You may want to maintain an investment mix with the goal of earning returns that exceed the rate of inflation.

[1]*Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and changes in price.*

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It's important for you and your partner to evaluate all of your portfolios at the same time to see whether the overall investment mix is well diversified.

Three-Step Retirement Planning Strategy for Couples

Communication is one of the foundations of a successful relationship. It also can help you and your partner structure a solid retirement planning strategy.

Planning for two can be more complex than planning for one. It's not unusual for two individuals to have very different plans and financial resources -- for example, one may have more money set aside or may be eligible to collect retirement benefits significantly earlier than the other.

If you're part of a dual-income couple, be sure to review the following considerations.

Step One: Talk About the Future

If you and your partner expect to retire at different times or need to negotiate priorities regarding how you'll spend time and money during retirement, it's important to start talking about the future now.

First, make sure your planned retirement dates are realistic. Next, estimate your combined retirement income needs as well as the amount of money you're each likely to have accumulated by retirement. If it looks like you may be facing a shortfall, try to contribute as much as possible to your employer-sponsored retirement plan while you still can.

Step Two: Make Sure You Are Properly Diversified

Within a single portfolio, diversification involves spreading your money among different types of investment options so that any losses in one area may be offset by potential gains elsewhere.[1] With two or more retirement accounts, the same theory applies. It's important for you and your partner to evaluate all of your portfolios at the same time to see whether the overall investment mix is well diversified. For example, if you and your spouse have similar investment portfolios, your overall level of risk could be higher than you realize, since a decline in one portfolio would likely be accompanied by a similar decline in the other. If that's the case, you might want to rebalance your asset allocation by shifting money that's already in your accounts to different asset classes (stock funds, bond funds, or cash investments) or by directing future contributions to the under-represented asset classes.[1]

Step Three: Get on the Same Page

When laying the groundwork for a financial future that includes your significant other, ask yourselves the following questions:

- Do you understand each other's "financial personality"? It's never too late to have an honest discussion about financial habits and objectives. Try to look past your differences and focus on shared goals.
- Have you calculated how much money you are likely to need to fund a financially secure retirement? Do both of you think this amount is realistic? It's tough to work together toward a shared goal if the two of you have different ideas about what exactly that goal is.
- Have you consulted a financial professional? Making a date to discuss your entire range of goals may put you in a stronger position financially to survive unforeseen circumstances.

Regardless of your particular situation, a little advance planning can make the transition to retirement much more pleasant for both you and your better half.

[1] *Diversification and asset allocation do not ensure a profit or protect against a loss in a declining market.*

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Currency risk is an essential element of international investing and is only one risk of investing across borders.

What You Need to Know About Currency Risk

The U.S. dollar continues to fall against other major world currencies -- and the consensus among economists and analysts is that the greenback's downward spiral may likely continue over the long term.

General investment wisdom states that to hedge a portfolio against the falling dollar, investors should diversify into foreign currency holdings. One of the easiest ways to do that is to acquire shares of U.S. companies with multinational operations, such as Microsoft and Exxon. Yet recent research suggests that this strategy may not be as effective at providing adequate currency diversification as many investors think. A study found that roughly 80% of the international income of multinational companies is hedged back to U.S. dollars.[1] Furthermore, the larger the company, the more completely hedged those earnings tend to be.

So where does this leave investors who think they are gaining global currency exposure through purchases of global U.S. firms? According to the study, many investors are getting only about one-fifth the diversification effect they assume -- perhaps much less.

Given the current weakness of the U.S. dollar, it is critical that U.S. investors understand the risks (and potential rewards) involved in foreign currency diversification -- and take steps to protect their portfolios.

Currency Risk 101

Strategies for managing a portfolio's foreign currency exposure fall into three broad categories.

1. **No hedge.** The simplest approach used by international portfolio managers and investors is to not hedge the currency risks at all. Proponents of this approach say that not hedging foreign currency exposure helps diversify a portfolio. Others believe that currency fluctuations tend to wash out over an extended period of time.
2. **100% hedge.** Some go to the other extreme and hedge 100% of their currency exposures. This group believes that foreign exchange rates are highly unpredictable and that currency risks in non-dollar securities should always be fully hedged. But hedging costs tend to reduce overall returns over time, compared with an unhedged portfolio.
3. **Actively managed hedging.** The third strategy falls somewhere in between. Those who use an actively managed hedging approach hedge selectively: sometimes no hedge, sometimes a partial hedge, and sometimes a full hedge. The selective approach is gaining in popularity. Most investment firms now offer some kind of currency service, and some firms with substantial international investments even appoint a separate manager to handle currency as a distinct asset class.

Currency risk is an essential element of international investing and is only one risk of investing across borders. Others include possible increased taxation as well as political uncertainties. Your financial advisor can explain the pros and cons of international investing in more detail.

[1]*Source: Merk Investments LLC, "U.S. Investors Overexposed to U.S. Dollar Risk," June 2011.*

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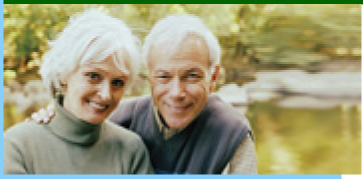

Defining Your Own Retirement

Retirement used to conjure up images of lazy days spent in a rocking chair. Today's retirement is very different. You might plan to open a business of your own. Or perhaps you'll return to school for that degree you never had the chance to complete.

As you move through the various stages of the new retirement, perhaps working at times and resting at others, your plan may require adjustments along the way.

Chances are, you'll have time to do whatever you desire. At the turn of the 20th century, the average life expectancy was 47 years. Today, the average American can look forward to about 78 years of life. What's more, the average life expectancy for today's 65-year-old has increased to 84, according to the National Center for Health Statistics.

So what does this redefined retirement mean to you? There is no one answer. In the coming decades, "retirement" will mean something different to each of us. Regardless of your decision, you'll need to design a financial plan suited to your specific vision of the future.

Income Is Key

A good starting point might be to examine your sources of retirement income. If you pay attention to the financial press, you've probably come across at least a few commentators who speak in gloom-and-doom terms about the future for American retirees, decrying a lack of savings and warning of the imminent growth of the elderly population.

True, there is widespread concern about at least one traditional source of income for retirees --Social Security. Under current conditions, Social Security funds could fall short of needs by 2037. But the reality is that Social Security was intended only to supplement other sources of retirement income. In fact, Social Security benefits on average account for only about 37% of the aggregate income of today's retirees. Even pension plans, once considered a staple of retirement income, only account for 17% of the retirement-income pie.[1]

This shift makes it even more important for individuals to understand their goals and have a well-thought-out financial plan that focuses on the key source of retirement income: personal savings and investments. Given the potential duration and changing nature of retirement, you may want to seek the assistance of a professional financial planner who can help you assess your needs and develop appropriate investment strategies.

As you move through the various stages of the new retirement, perhaps working at times and resting at others, your plan may require adjustments along the way. A professional advisor can help you monitor your plan and make changes when necessary. Among the factors you'll need to consider:

- **Time:** You can project periods of retirement, reeducation, and full employment. Then concentrate on a plan to fund each of the separate periods. The number of years until you retire will influence the types of investments you include in your portfolio. If retirement is a short-term goal, investments that provide liquidity and help preserve your principal may be most suitable. On the other hand, if retirement is many years away, you may be able to include more aggressive investments in your portfolio.
- **Inflation:** While lower-risk fixed-income and money market investments may play an important role in your investment portfolio, if used alone they may leave you susceptible to the erosive effects of inflation. To help your portfolio keep pace with inflation, you may need to maintain some growth-oriented investments. Over the long-term, stocks have provided returns superior to other asset classes.[2] But also keep in mind that stocks generally involve greater short-term volatility.
- **Taxes:** Even after you retire, taxes will remain an important factor in your overall financial plan. If you return to work or open a business, for example, your tax bracket could change. In addition, should you move from one state to another, state or local taxes could affect your bottom line. Tax-advantaged investments, such as annuities and tax-free mutual funds, may be effective tools for meeting your retirement goals. Tax deferral offered by workplace plans -- such as 401(k) and 403(b) plans -- and IRAs may also help your retirement savings grow.

Prepare Today for the Retirement of Tomorrow

To ensure that retirement lives up to your expectations, begin establishing your plan as early as possible and consider consulting with a professional. With proper planning, you may be able to make your retirement whatever you want it to be.

[1]*Source: Social Security Administration, Facts & Figures About Social Security, 2010.*

[2]Past performance is no guarantee of future results.

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