

Will Your Income Last?

Retirement Income— The Short Story

1. Life expectancy is progressing at such a rate that many people may spend as many years in retirement as they did working.
2. Strategically choosing a mix of assets tied to your income needs—and remaining disciplined enough not to react emotionally to short-term whims of the market—is a crucial first step to retirement funding.
3. You need to find comfort in a portfolio withdrawal rate that will balance the risk of running out of money with the possibility of being too conservative and not enjoying the retirement you've worked for.
4. Health care costs are likely to be the biggest expense of your retirement but are also the biggest unknown.
5. No matter which asset allocation or portfolio withdrawal rate you choose, inflation will likely be your biggest financial enemy.
6. Generally, it can be more tax efficient to spend down taxable accounts before tax-deferred accounts.
7. Flexibility and control of your money, over what could be a decades-long retirement, will allow you to adjust to unpredictable expenses and lifestyle changes over time.

Seven Key Considerations for Retirement Income

Faced with a growing list of variables, some of which you have no control of, you may be uncertain if your money will last as long as you do. This uncertainty often leads to procrastination or uninformed choices at a time when prudent decisions are even more important than when you were accumulating your retirement nest egg.

Everyone has the opportunity to retire by design, rather than accept default options for the unprepared. But many retirees have no formal plan. The “I’ll figure it out as I go” mentality often wins out. This becomes particularly troublesome as life expectancy advances and assets are consumed.

Saving and planning aren’t as difficult as is often perceived and the long-term rewards can be gratifying via a dignified, financially independent retirement.

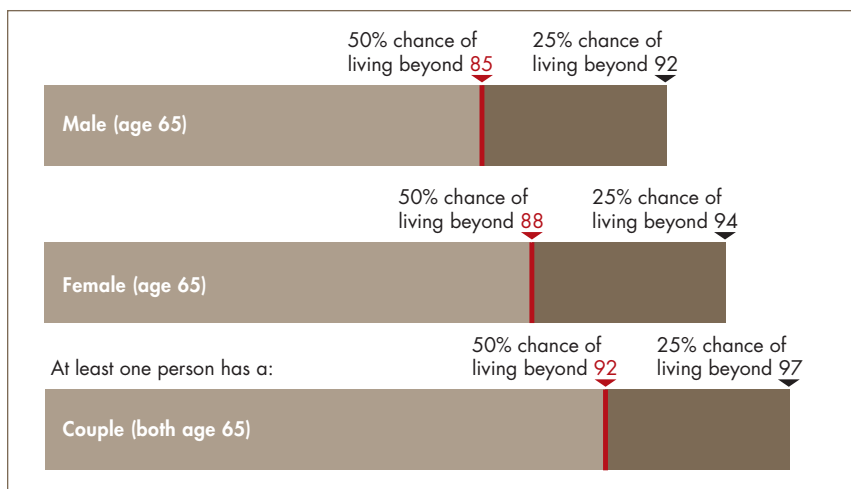
Consider the following key elements that may impact your finances during retirement. Your ability to accommodate these factors with planning may be crucial to the long-term comfort of your retirement. By taking the time to plan, you can work toward confidence that you’ll be just as prepared for funding the 30th year of your retirement as you are your first.

Longevity

The biggest risk to your income is the hardest to plan for.

We don’t know how long we’ll live but we do know that life expectancies are rising to levels beyond what many people assume. Typically, people look to their relatives to estimate life expectancy without considering the significant medical advances that occur over the difference of a generation.

“Your behavior around market events and their impact on your strategy may be far more indicative of your financial security than the actual performance of markets over time.”



Source: 1996 U.S. 2000 Annuity Male & Female Tables

Abundant evidence indicates we are living healthier, more active, longer lives. Many of today's Baby Boom generation could live well into their 90s according to estimates from the Society of Actuaries.

Individually, healthy 65-year-old males today have a 50% probability of reaching 85 and 25% chance to live beyond 92. Women have even better life expectancy. A healthy 65-year-old woman is 50% likely to reach 88 and has a 25% probability of living past 94.

Keep in mind that research indicates that married individuals have better longevity than single people. If you consider a healthy 65-year-old couple, research estimates indicate that at least one of them has a 50% chance of reaching 92 and a 25% chance of celebrating a 97th birthday.

If good genes and general health are in your favor, you may live longer. Clearly, ongoing planning beyond basic assumptions is necessary to fund potentially decades of life after work.

Asset Allocation

The allocation of your assets (your mix of stocks, bonds, and cash) is a critical component of many other key considerations. Your withdrawal needs—considering expenses within reason—and risk tolerance, may heavily influence the makeup of your investment portfolio.

Frequent assumption implies that, in retirement, you should invest in conservative assets that aren't likely to suffer losses from year to year. This may be prudent if your time horizon is short, or if you only require a conservative amount of income to fund annual expenses, but starting what could be a 30-year retirement, your need to maintain exposure to growth-oriented equity markets may be key to outpacing inflation.

Of course, this may expose you to unfavorable markets at unpredictable times. Sticking with your strategy and not overreacting to down cycles may help keep you from buying high and selling low, locking in losses at a time when your portfolio can least afford them. Your behavior around market events and their impact on your strategy may be far more

“If you are too conservative, due to anxiety of running out of money, you risk not living retirement to the fullest. If you are too aggressive, assuming you can change your spending habits or your investment strategy later in retirement, you might end up with very few choices, dependent on safety nets.”

indicative of your financial security than the actual performance of markets over time. Investors are often their own worst enemy due to ill-timed, often emotionally driven, choices to predict or chase investment performance.

It's critical to implement a strategy that you are comfortable with for the long term. Risk tolerance varies widely from person to person, however. If you are averse to any losses—even if it means that, over time, you may have to make sacrifices in your lifestyle—growth-oriented investments may not be for you.

It's important to consider the longevity potential of different asset mixes. Your expenses, and therefore, your withdrawal rate are significant factors in your optimal asset mix.

Portfolio Withdrawal Rates

If you are too conservative, due to anxiety of running out of money, you risk not living retirement to the fullest. If you are too aggressive, assuming you can change your spending habits or your investment strategy later in retirement, you might end up with very few choices, dependent on safety nets.

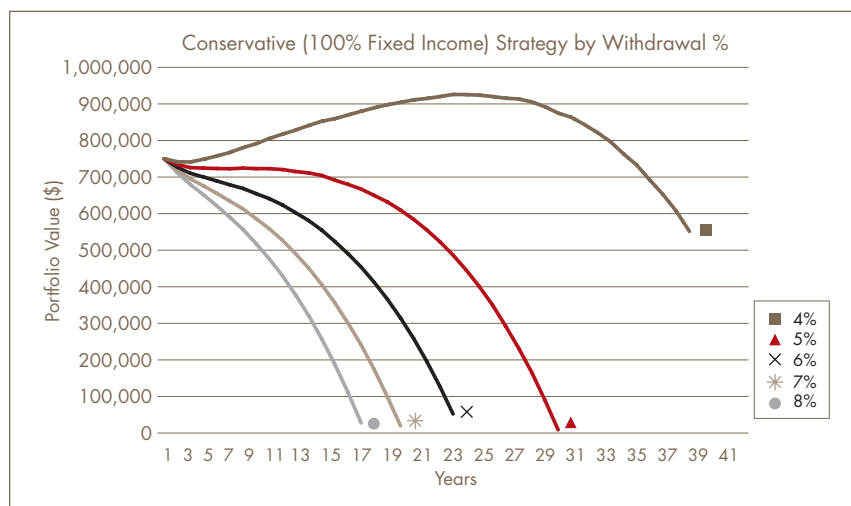
It's a delicate balance when you don't have a known time horizon to plan around. Multiple risks are interrelated with the way in which you manage cash flow in retirement.

Consider the following hypothetical scenario exhibiting portfolios at different withdrawal rates. These portfolios are put through a modeling process to determine reasonable expectations for how long they might last based on assumed conditions.

Jane and Joe Investor, each age 65, have accumulated \$250,000 in taxable-account assets and \$500,000 in tax-deferred retirement accounts. They are ready to retire and seek insight about investment strategy and how much they can reasonably withdraw. Their tax-deferred assets are taxed at a marginal rate of 35% upon withdrawal. Their taxable savings includes dividend payments and realized capital gains that are taxed at 15%. Inflation is expected to grow at 3% per year and they would like their annual withdrawals to be bumped accordingly.

The following asset allocation mixes are analyzed at the indicated withdrawal rates to demonstrate differences in how long Jane and Joe could expect their savings to last. These are median results from thousands of possible scenarios. Keep in mind that more, and less, favorable results are possible. Particularly in considering possible outcomes that equate to running out of money before you run out of time, it is important to consider the potential magnitude of not reaching your cash flow or bequest goals. Falling short by \$1000 may not be a problem. Falling short by \$100,000 could be traumatic.

Example 1—Conservative Investment Strategy



To get a better understanding about the possible range of outcomes, please consider the following table. Here, the simulated outcomes for only the 5% withdrawal rate are highlighted. The median numbers (also illustrated in the chart) represent the middle outcome of thousands of possible scenarios. The 95th percentile numbers reflect what could happen if markets are exceptionally favorable with the prescribed asset allocation over the time period. The 5th percentile represents what is essentially the worst-case scenario.

EXPECTED PORTFOLIO VALUE (5% ANNUAL WITHDRAWAL)

Year	5th percentile (worst case)	25th percentile	Median (displayed above)	75th percentile	95th percentile (best case)
10	594,449	664,337	715,121	773,757	861,426
15	503,028	594,484	667,090	747,403	883,161
20	331,367	455,257	555,350	665,694	864,139
30	Money runs out in year 26	Money runs out in year 29	8,946	210,743	559,324

Important: The projections demonstrated in this illustration are generated by Russell’s Portfolio Strategy Desk analytical tools. The output of these tools, regarding the likelihood of various investment outcomes, are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results. Results may vary with each use over time.

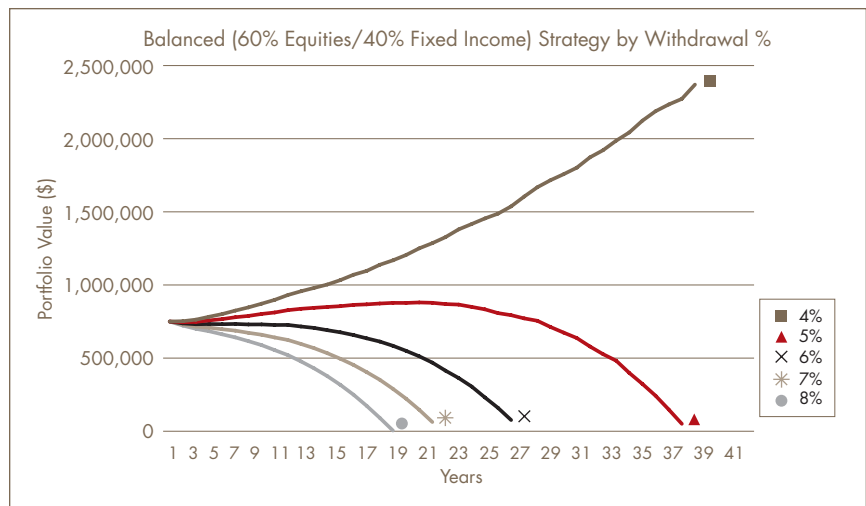
Please review disclosure at the end of this document detailing methodology, including limitations and key assumptions.

The results are based on Monte Carlo simulation which is used to test the portfolio with respect to investment objectives. The simulation generates thousands of possible portfolio growth scenarios that incorporate asset class return assumptions, investment horizon, cash flows, estimated taxes, and annual rebalancing. The scenarios are then summarized by calculating the median portfolio value and percentiles. Half of the simulated outcomes fall between the 25th and 75th percentiles and nine out of every ten fall between the 5th and 95th. The structure underlying the asset return model has two key elements: a bond yield model, and a system of equations that relates returns for other asset classes to changes in bond yields.

The simulation considers cash flows, estimated taxes, and annual rebalancing.

“Your cash flow needs are likely to change in response to many variable factors throughout retirement. Therefore, expense considerations become as critical as income planning.”

Example 2—Balanced Investment Strategy



EXPECTED PORTFOLIO VALUE (5% ANNUAL WITHDRAWAL)

Year	5th percentile (worst case)	25th percentile	Median (displayed above)	75th percentile	95th percentile (best case)
10	411,278	635,161	837,151	1,080,460	1,601,187
15	248,923	567,786	867,442	1,269,241	2,095,686
20	Money runs out in year 20	426,426	878,086	1,515,105	2,883,908
30		Money runs out in year 28	674,332	2,043,683	5,237,536

Clearly, in the median outcome projections, most people can afford to withdraw 4% of their nest egg annually (\$20,000 per year on \$500,000 of savings) with limited concern of running out of money.

Keep in mind that Social Security benefits, pensions, and/or annuities you may also have, are not factored in here. When to take Social Security is also a key retirement income consideration. It is covered thoroughly in a separate article. Social Security can essentially be treated as a separate fixed-income asset that may allow you to take more equity-based risk in your investment portfolio if it suits your objectives.

Also consider whether or not you intend to have money remaining at your death to potentially leave to heirs or charitable causes. Your ending wealth desires may influence your chosen withdrawal rate.

Given the worst-case scenarios such as the 5th percentile possibilities documented above, it may be prudent at some point to shift assets to an annuity intended to provide lifetime income, rather than realizing a doomsday scenario of running out of money.

Of course, the notion of withdrawing a set amount from your nest egg forever isn't realistic for most people. Your cash flow needs are likely to change in response to many variable factors throughout retirement. Therefore, expense considerations become as critical as income planning.

“Over an extended retirement, inflation’s impact could drastically decrease the value of each dollar you brought in to retirement.”

Living Expenses and Health Care

You have the ability to control some of your spending and you can make lifestyle decisions to tie your expenses to your withdrawal strategy, but some expenses are uncontrollable.

The commonly given guidance is that retirees will need 70-80% of their pre-retirement income. If you’re particularly frugal, retain good health, and want to pass on as much of your money as possible, you might not even need 70%. If you still have a mortgage to pay or other debt, expect to be well-traveled, to help put your grandkids through school, or to pursue an expensive hobby, you could need every bit of your pre-retirement income, or more.

The most crucial expense that broadly impacts your retirement financial situation is health care. If you are among the fortunate retirees who retain health care coverage from an employer, your concerns may be lessened. Many people do not have this luxury.

Data from the Employee Benefit Research Institute (EBRI) indicates a steady decline in employer-sponsored retiree health coverage. As of the latest data in 2001, among retirees from organizations with at least 500 employees, only 29% of early retirees and 23% of Medicare-eligible retirees had employer-sponsored coverage. Of course, the majority of Americans work for companies with fewer than 500 employees, where rates of coverage are much lower. As of 2000, private establishments offered health-care coverage to 11% of Medicare-eligible retirees and 12% of early retirees¹.

Almost everyone over 65 feels the impact of Medicare and its future is currently in more dire shape than that of Social Security². Medicare’s future may contribute significantly to the escalation of your out-of-pocket medical costs.

According to EBRI, a 65-year-old couple of average life expectancy but without employer-provided health care coverage may need as much as \$295,000 just to cover insurance premiums and out-of-pocket expenses during retirement³.

Long-term-care insurance may become an essential element of your complete financial plan.

Inflation

When you’re working, rising wages typically counter cost-of-living increases. The absence of wages combined with regular withdrawals form a doubly troublesome retirement funding issue. You may not have consistently rising income and your dollar’s purchasing power continues to erode due to inflation.

¹ Employee Benefit Research Institute Issue Brief #254 February 2003

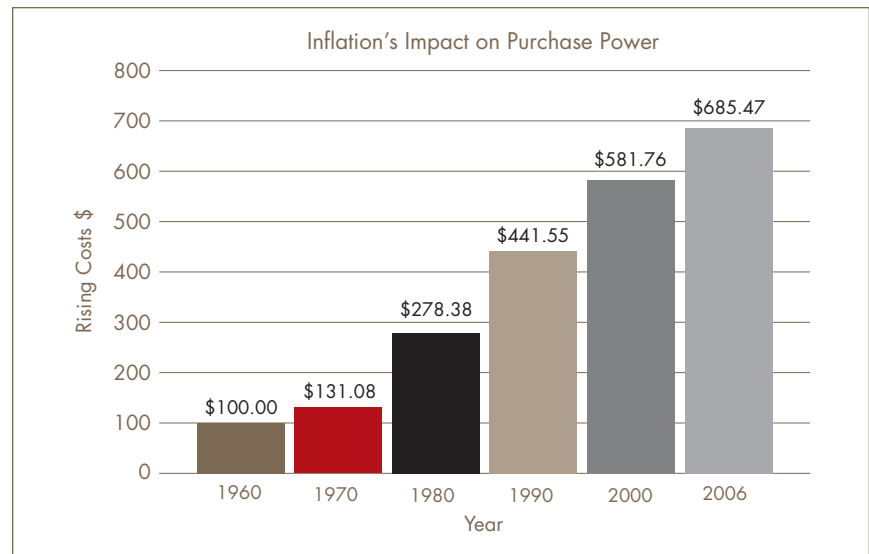
² Social Security Administration. Status of the Social Security and Medicare Programs. A Summary of 2006 Annual Reports. www.ssa.gov/OACT/TRSUM/trsummary.html

³ Employee Benefit Research Institute Issue Brief #295 July 2006

“The longer you let tax-deferred investments compound, the more valuable the tax deferral becomes.”

Again, not everyone feels the same impact. For example, if you don't drive much and have a smaller home to heat and power, you won't be affected as much by energy inflation as retirees who spend a lot of time on the road and have larger homes to maintain. Overall inflation averaged 3.43% per year from 1913-2006 according to inflationdata.com.

Over an extended retirement, inflation's impact could drastically decrease the value of each dollar you brought in to retirement. Using data from the U.S. Department of Labor, Bureau of Labor Statistics, you can see in the chart below that what you paid \$100 for in 1960 cost \$685.47 by 2006. For many, protection of principal and outpacing the diminishing purchasing power of inflation are the paramount necessities of any



Source: Bureau of Labor Statistics

investment.

Which Assets Should You Tap First

In most scenarios, the suggested order to draw down your assets is:

1. Taxable accounts
2. Tax-deferred retirement accounts (IRAs, employer defined contribution plans, etc.)
3. Tax-free retirement accounts (Roth IRA, Roth 401k)

If you don't optimize the withdrawal of your assets, you'll risk sacrificing more money than necessary to cover taxes.

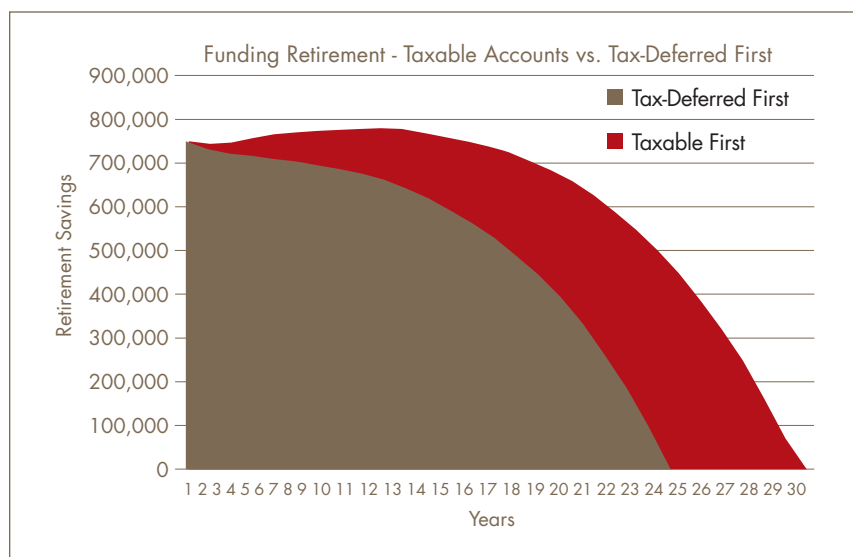
You can draw on your taxable accounts at any time. The longer you let tax-deferred investments compound, the more valuable the tax deferral becomes.

Your tax-deferred accounts won't allow you to delay withdrawing assets forever. Except for tax-free Roth accounts, you need to begin making required minimum distributions from retirement accounts by

“If interest rates change or your cost of living rises beyond expectation, you’ll want flexibility and control of your money to adapt to a changing lifestyle and economic environment.”

April 1 of the year after you turn 70½. These distributions are adjusted annually to consider your age and the account balance at the end of the previous year.

Let’s return to Jane and Joe Investor, the 65-year-old couple, for an example of the difference made by withdrawing taxable assets first. They had a portfolio of \$250,000 taxable assets (15% taxes) and \$500,000



Source: Russell Portfolio Strategy Desk. Please see disclosures for methodology details.

in tax-deferred accounts (35% marginal income taxes). They expect a 7% average annual return on a moderate asset allocation of 40% stocks and 60% bonds. They want to withdraw \$35,000 (after taxes) each year, adjusted upward by a 3% inflation factor annually.

By withdrawing taxable assets first, extending the compounded growth of tax-deferred assets, Jane and Joe’s portfolio survives an extra seven years and generates nearly \$500,000 of additional income to fund their retirement. In this scenario, required minimum distributions from tax-deferred accounts begin after five years. From year six (at age 70) forward, the annual withdrawal is comprised of cash flow from taxable and tax-deferred accounts until the taxable savings is extinguished.

If you have a particularly large retirement plan balance you may consider deviating from the above order for tax reasons. By starting before your required minimum distribution date, each year’s distribution would be smaller, potentially lessening taxes as compared to fewer, larger distributions later in life.

Of course, how you choose to tap your assets depends on your personal circumstances. Consult your tax advisor or financial professional to determine the best strategy for you.

Giving Up Liquidity and/or Ownership of Assets

You may think that locking in fixed rates via CDs or insurance-based guaranteed income options solves your cash flow problem. This could be troublesome, though. If interest rates change or your cost of living rises beyond expectation, you'll want flexibility and control of your money to adapt to a changing lifestyle and economic environment.

If you exchange control to purchase guaranteed income (perhaps your best option if you are entirely averse to investment risk) you must be prepared to live within financial constraints.

Getting the Most Out of Your Retirement Dollars

No matter the risks or pitfalls, the goal for most retirees is to create steady cash flow to cover expenses with the flexibility to adapt to changing lifestyle or costs and the potential to preserve or even grow assets if markets are favorable.

Everyone's personal situation is impacted to different extents by different variables. Even if you are a do-it-yourself investor and don't have anxiety about matching your assets and liabilities over what could be a three-decade retirement, you may benefit from a second opinion.

It's a lot to absorb and processing with clarity is sometimes difficult because our money and our financial independence are emotional issues. A financial professional may provide valuable guidance to reduce uncertainty.

Fund objectives, risks, charges, and expenses should be carefully considered before investing. A prospectus containing this and other important information can be obtained by calling 800-787-7354 or by visiting www.russell.com. Please read the prospectus carefully before investing.

LIMITATIONS

The hypothetical scenarios are for illustration only, and are not intended to reflect the return of any actual investment. Results are based on combinations of Russell's asset class return expectations.

These expectations are created with proprietary models incorporating historical index data for the CRSP Market Cap Series (U.S. Equity), Lehman Brothers Aggregate Bond Index (Fixed Income), MSCI All Country World Index (International Equity), NAREIT Equity REIT Index (Real Estate) and U.S. 30-day Treasury Bill (Cash) from 1973 to present. These indexes represent asset classes that, when combined in a portfolio, we believe create a well-diversified investment. Other investments not considered may have characteristics similar or superior to those being analyzed. Forecasts are updated twice a year. Because our assumptions about the capital markets evolve over time, results of the calculations may vary over time.

ASSET CLASS ASSUMPTIONS

20 Year Horizon, Updated December 31, 2005

Asset Class	Mean Returns	Risk	Minimum	Maximum
U.S. Equity	8.9%	18.0%	0%	100%
International Equity	8.9	19.1	0	100
Real Estate	7.7	16.1	0	10
Fixed Income	6.3	2.9	0	100
Cash	4.6	3.3	0	100

International equity constraint: Limit exposure to 30% of total equity.

Correlations	U.S. Equity	International Equity	Real Estate	Fixed Income	Cash
U.S. Equity	1.00				
International Equity	0.61	1.00			
Real Estate	0.61	0.45	1.00		
Fixed Income	0.28	0.25	0.33	1.00	
Cash	0.26	0.27	0.34	0.81	1.00

At Russell, we have assisted some of the world's largest pension funds with their investment strategy for nearly 40 years. The same investment research and diversified portfolio construction these pension funds use to address their obligations is available to help you address your cash flow needs in retirement.

WITHDRAWAL STRATEGY ANALYSIS

The withdrawal rate analysis is based on modern portfolio theory and assumptions about various asset classes. The basic idea is that total portfolio risk, defined as the standard deviation of return, can be reduced by investing in several different investment categories such as stocks, bonds, and real estate. The key inputs to the analysis are the means, standard deviations, and correlations of the asset class returns.

The mean, or expected value, of a probability distribution of returns is the weighted arithmetic average of all possible outcomes, where the weights are the probabilities that each outcome will occur. Standard deviation is a statistical measure of the degree to which an individual value in a probability distribution tends to vary from the mean of the distribution. The greater the degree of dispersion, the greater the risk. Correlation is a relationship between two quantities, such that when one changes, the other does. If the quantities simultaneously increase or decrease in value, a positive correlation exists. If one increases as the other decreases, a negative correlation exists.

The Monte Carlo analysis takes into account cash flows and a simplified view of the investor's tax situation. It does not consider the return and risk differences due to holding a highly concentrated position, nor how long a security has been held. Other asset classes and investments that have not been considered in the proposal may produce different results. There may be other considerations that may be pertinent to your situation that are not considered.

Investment returns and the principal value of an investment will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Past performance is no guarantee of future results. Indexes do not include the deduction of fees and expenses, which would have lowered performance.

There are no assurances that the investment goals and objectives stated in this material will be met.

This material is proprietary and may not be reproduced, transferred, or distributed in any form without prior written permission from Russell Investment Group. It is delivered on an as is basis without warranty.

Russell Investment Group is a Washington, USA corporation, which operates through subsidiaries worldwide and is a subsidiary of The Northwestern Mutual Life Insurance Company.

Nothing contained in this material is intended to constitute legal, tax, securities, or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. The general information contained in this publication should not be acted upon without obtaining specific legal, tax, and investment advice from a licensed professional.

Bond investors should carefully consider risks such as interest rate risk, credit risk, securities lending, repurchase and reverse repurchase transaction risk. Greater risk is inherent in portfolios that invest primarily in high yield bonds. They are subject to additional risks, such as limited liquidity and increased volatility.

Cash is defined as short-term investments which typically involve instruments such as 90-day government Treasury Bills, high quality short-term notes and commercial paper issued by major financial institutions and blue chip companies. While highly liquid, cash generally has not kept pace with inflation.

Diversification and strategic asset allocation do not assure profit or protect against loss in declining markets.

Inflation may not maintain an even rate and may be more or less than the percentage indicated.

Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

Stock/equity investors should carefully consider risks such as market risk when investing. There are no guarantees when it comes to individual stocks. Any stock may go bankrupt, in which case your investment may be worth nothing. Although stocks have historically outperformed bonds, they also have historically been more volatile. Investors should carefully consider their ability to invest during volatile periods in the market.

Treasury Bills ("T-bills") are short-term debt securities issued by the U.S. government with maturities of usually one year or less. Fixed income investors should carefully consider risks such as interest rate risk, credit risk, securities lending, repurchase and reverse repurchase transaction risk.

IRS penalties may apply if withdrawals are taken from tax-deferred investments prior to the age established by IRS regulations.

Securities distributed through Russell Fund Distributors, Inc. member NASD, part of Russell Investment Group.

Copyright © Russell Investment Group 2007. All rights reserved.

First used June 2007

RFD 07-6641