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Retirement Report

NEWS AND UPDATES FOR PLAN SPONSORS AND FIDUCIARIES OF DEFINED CONTRIBUTION PLANS

Fourth Quarter 2012 Market Review

Little movement was seen in the domestic major market asset classes over the fourth quarter. For the year, domestic equity finished with strong double digit gains and fixed income finished with decent single digit gains. International equity, on the other hand, posted strong single digit gains over the quarter, outpacing domestic equity for the quarter and for the year. This reversed a trend seen over the last couple of years, where international equity had lagged domestic equity to, in many cases, a pretty healthy degree. While domestic equity posted an attractive positive 16.4 percent return for the year (Russell 3000 Index), international equity posted a 17.9 percent return (MSCI EAFE Index). U.S. fixed income posted a modest, but healthy, return of 4.2 percent (Barclays US Aggregate Index) for the year.

In 2012, the lion's share of net new assets mostly flowed into bond funds. While these investors probably weren't disappointed by the single digit positive returns earned over the year, many missed out on the spectacular gains in the stock market. Whether or not investors expected this, stocks, it turned out, had much going for them in 2012. Strong corporate earnings lifted stocks throughout the first half of the year. At the end of the year, stocks, as well as most risk-based assets, benefited from Federal Reserve (Fed) stimulus programs such as Operation Twist and QE3. It was a slightly different story overseas, as many economies entered into recession. This prompted many foreign central banks to add stimulus programs to their economies. This has put more downside pressure on global interest rates. Domestic interest rates ended the year at historically low levels, as witnessed by the U.S. 10-year treasury at 1.76 percent. The Fed recently stated they would not increase rates until unemployment fell below 6.5 percent (as long as inflation remained in check). With unemployment at 7.8 percent (as of 12/31/12) and only edging downward slowly, low rates could be with us for the foreseeable future.

With interest rates at such low levels, 2013 could end up being a challenging year for investors. While rates may or may not rise in 2013, fixed income investors are not earning much in yield. Investors should be aware that increases in interest rates, even small ones, could →

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Are Bonds the Next Bubble?

Over the past few years investors have been flooding assets into bonds and bond mutual funds. Apparently they are seeking safety, avoidance from volatility in the stock market, and are buoyed by statements supportive of low borrowing rates extending into the future, made by the Federal Reserve. The major focus of bond purchases by the Fed is long term bonds.

We are currently experiencing a multi-year rally in the bond market. Long term government bond funds have experienced an average annual gain of 15% over the past three years (Wall Street Journal Jan. 6). Many believe that the current US government bond yields are at an unsustainable low level, particularly given the expectation of higher inflation.

While it is expected that the Fed can hold short term interest rates steady at current low levels, there is certainly more risk that longer term (10 and 30 year treasury issues) rates tick up during 2013 and beyond as the Fed stops purchasing these issues. (The US Treasury note yield is at 1.91% as of January 4, up from 1.88% as of the start of 2012.)

While interest rate risk is found in all types of bonds, Treasury bonds are at risk in particular because of the Fed's involvement in this sector. If the yield on the 30 year U.S. Treasury bond rises 1% (from year end 2012) the value of bonds could fall as much as 20%. In this scenario, long term bond funds could experience negative returns. Because many expect interest rates to go nowhere but up, conversations about a bond "bubble" have gone hand in hand.

Treasury bonds are commonly found in most U.S. bond funds. The Barclay's Aggregate U.S. bond fund index has over 30% of its allocation to Treasury bonds! While we may or may not be in a bond bubble, it is important that investors realize that in a rising rate environment, bond funds can provide you with negative returns.●

Market Review (continued from pg. 1)

wipe out positive yields. Even equity oriented investors could be challenged with a rise in rates. On the political front, new issues, such as the debt ceiling take center stage now that the fiscal cliff is behind us. Economic issues will also be important in 2013, as investors look to companies to keep up their strong earnings numbers. Amid all these risks and uncertainty, now may not be a bad time to invest in the capital markets after all. As has been true over time, diversification will likely remain the best strategy.

The U.S. equity market posted a small positive 0.2 percent return for the quarter (Russell 3000 Index). Performance was mixed across the U.S. equity styles. The best performing U.S. equity style was small value, returning a positive 3.2 percent (Russell 2000 Value). The worst performing U.S. equity style was large growth, returning a negative 1.3 percent (Russell 1000 Growth). Value was the dominate style in the U.S. equity space over the quarter.

Developed international equity outperformed U.S. equity for the quarter, returning a positive 6.6 percent (MSCI EAFE). Similar to domestic equities, the small and mid cap value oriented styles outperformed their larger cap growth counterparts for the quarter. Europe ex UK was the best performing region, returning a positive 8.6 percent for the quarter (MSCI Europe ex UK). The United Kingdom was the worst performing region, returning a positive 4.2 percent (MSCI United Kingdom).

The broad fixed income market posted a small gain for the quarter, returning a positive 0.2 percent (Barclays Capital U.S. Aggregate). The strongest returns were found in the High Yield Corporate bond sector returning 3.3 percent (BC High Yield Corporate) for the quarter. Global fixed income underperformed the broad U.S. fixed income market, returning a negative 0.50 percent (BofA ML Global Broad Market) for the quarter. ●

Employees Eager for More Support

When it comes to retirement readiness, most employees are eager for more support, and they want their employer to automatically increase their savings rate.

A survey of retirement plan participants released by State Street Global Advisors1 discussed how employers play an increasingly larger role in helping to make it easier to save for retirement. Respondents to the survey indicated that they want advice and guidance from experts when making decisions that impact their overall retirement readiness. It is even more important at critical inflection points like a job transition and enrollment in their current plan.

The SSGA survey points to an emerging group of young investors that they call "Generation DC." The report shows that that there is a desire to learn more about retirement readiness despite the fact that they are more likely than their older peers to be automatically enrolled into their retirement plan.

Here are some key findings from the survey:

- 74% of employees surveyed want clear examples that will show them how their savings will pay off in the future
- 71% want employers to increase their savings rate by 1% automatically each year
- 62% of employees 25 and younger said they want their employers to show them how to spend less so they can save more, compared to 53% of all employees surveyed
- 82% of employees 25 and younger stated they are on track to save enough to meet their retirement goals, while the average of all employees surveyed was only 63%
- 48% of employees 25 and younger stated that they had increased their savings outside of the workplace in the last 12 months, while the average of all employees surveyed was only 37%●

1. SSgA DC Investor Insights Survey, January 2013

COMMUNICATION CORNER: 2013 Plan Limits Memo

This month's sample employee memo is titled, "2013 Plan Limits". This memo spells out the 2013 contribution limits for retirement plans. As a reminder, we post each monthly participant memo online via the Fiduciary Briefcase™ (www.fiduciarybriefcase.com) in both English and Spanish.

For assistance, please contact your plan consultant.●

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