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Retirement Times

NEWS AND UPDATES FOR RETIREMENT PLAN SPONSORS AND FIDUCIARIES

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Portfolio Patriotism—Domestic market optimism or inadvertent asset allocation?

Globalization of the world economy has increased exposure to international investments, yet equity portfolios in general remain largely home biased today. This may be a good time for participants to reevaluate their asset allocation to see if they may be exhibiting a home country bias— or displaying overly optimistic expectations about the domestic market and/or pessimism about foreign markets.

After years of mediocre growth from developed international equity markets, we are finally starting to see signs of life abroad. The margin of outperformance for U.S. stocks has been rather large over the past five calendar years. The five-year annualized returns for the MSCI EAFE[1] (NR USD Index[2]), a proxy for international stocks, is up 6.5 percent[3], compared to the S&P 500[4] (TR[5]), a proxy for U.S. stocks, which is up an impressive 14.7 percent annualized. Year to date however, we are starting to observe a reversal in story as the MSCI EAFE is up 14.0 percent. Compare that to the S&P 500, which is up 8.7 percent[6].

Why now? International equities are looking attractive from a valuation standpoint as the U.S. Cyclically Adjusted Price

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[1]MSCI EAFE® (Europe, Australia and Far East) Index - is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US & Canada. As of December 2003 the MSCI EAFE Index consisted of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom. EAFE is a registered service mark of Morgan Stanley Dean Witter, Discover & Co.
[2]Net returns U.S. Dollar
[3]Data from Morningstar
[4]S&P 500 Index is an unmanaged group of securities
[5]Total returns
[6]Morningstar. As of 5/31/2017.

Women in Retirement: 60 Percent Not Saving Enough

In November 2016, the Texas Conference for Women surveyed attendees about their retirement savings and found that almost a whopping 60 percent weren't socking away enough. In fact, many weren't even sure if they were going in the right direction. One person responded, "I don't know if I'm on track, and that's the worst part."

Many women are doubtful that they can retire comfortably, if at all. Consider these results of the 17th Annual Transamerica Retirement Survey:

- Women believe they'll need to save $500,000 in order to feel financially secure in retirement; among those who estimated their savings needs, 56 percent said they "guessed."
- Most women (64 percent) don't have a back-up plan if they're forced into retirement sooner than expected.
- Women's total household retirement saving is $34,000—no change since 2012—whereas men now have $115,000, up from $50,000 in 2012.
- Women's emergency savings is $2,000; men's is $10,000.

Retirement Pitfalls

Some of your participants may be facing these struggles as well. Retirement planning is a daunting task, and women have different struggles than men:

- **Gender pay gap:** Women tend to earn less, which translates to lower earnings and savings, as well as reduced Social Security benefits.
- **Cultural expectations:** Women are more likely to take time out of the workforce to care for children and/or aging parents.
- **Longevity:** Women have longer life expectancies, so they have greater savings needs.

But it's not just a gender issue: many Americans, men and women alike, struggle to prepare for retirement. Why?

1. While many are experts in their particular career, what does the average participant really know about saving and investing? For many, the answer is "not much." It's certainly not part of the curriculum at most schools. Simply put, people don't know what people don't know.
2. We live in a culture where spending beyond a person's means is the norm. In fact, the average household debt, according to Nerdwallet, is staggering. Households in the U.S. have an average of $16,000 in credit card debt, $27,000 in auto loans, $48,000 in student loans and over $190,000 in mortgages. How can anyone get ahead if they're saddled with debt?

Taking the Power Back

The outlook looks gloomy, but it doesn't have to be. Encourage your female participants to sit down and review where they are. They need to learn and gain the knowledge needed to help move forward. Most of all, they should make a plan and write it down. Nobody would plan a cross-country road trip without a map to guide them. Participants shouldn't approach retirement without a roadmap of how to get there.

For more information on financial wellness programs, please contact your plan advisor.

Auditing Recordkeeper Statements—A Fiduciary Duty?

Adhering to prudent standards includes auditing quarterly statements from the recordkeeper. However, there is no explicit requirement for plan fiduciaries to do so.

With regard to plan assets, fiduciaries have the explicit duty to ensure that:

- employee deferrals are contributed in a timely manner;
- the plan does not engage in prohibited transactions; and
- plan assets are used exclusively to pay plan benefits and defray reasonable plan expenses.

Fiduciaries must act prudently in carrying out these duties. A bright-line test for the exact definition of prudent does not exist. It depends upon the facts and circumstances.

The plan trustee has the duty to keep plan assets safe. If you are the plan trustee, you should oversee how your recordkeeper handles plan assets. Auditing their quarterly statements helps to accomplishing this.

Portfolio Patriotism

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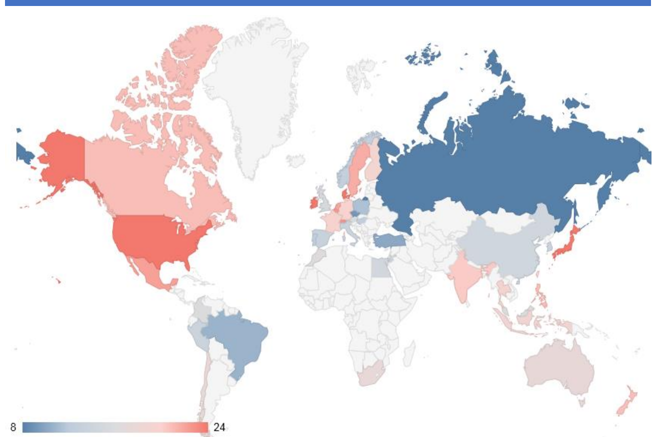
Earnings (CAPE[7]) ratio is well above its historic average (29.8x versus 16.8x respectively[8]). A global overview of CAPE can be seen in the chart to the right, suggesting the possible attractiveness of international equity from a valuation standpoint. This relative attractiveness is further supported with the expectation that domestic earnings will reach record highs within the next 12 months[9].

Focusing attention internationally, the Eurozone domestic demand rose 2.8 percent year over year as of the first quarter. This is the highest annual growth rate since Q3 2007[10]. The European Central Bank chief, Mario Draghi, ruled out further interest rate cuts in a sign that it's moving closer to an exit from its stimulus program. Election results in the Netherlands, France and Germany helped reduce uncertainty over government agendas. Lastly, the United Kingdom successfully continues to reduce unemployment (4.60 percent[11]) in spite of last year's Brexit vote.

Global Overview of Cyclically Adjusted Price Earnings Ratio (CAPE) [13]



Higher valuations and uncertainty around domestic political agendas underscore the need for broad diversification and careful portfolio management. However, when it comes to defined contribution (DC) investors and their equity portfolio allocations, the numbers tell an intriguing story. For the 2016 calendar year, the average DC participant[12] devoted 86 percent of their entire equity allocation to domestic stock.

[7] *Price earnings ratio is based on average inflation-adjusted earnings from the previous 10 years, known as the Cyclically Adjusted PE Ratio (CAPE Ratio), Shiller PE Ratio, or PE 10*
[8] *http://www.multpl.com/shiller-pe/*
[9] *Q3 2017 JPMorgan Guide to Markets*
[10] *Global Purchasing Managers' Index for Manufacturing*
[11] *https://ycharts.com/indicators/uk_unemployment_rate*
[12] *Fidelity recordkeeping system as of 12/31/16. For plans with $10-$20M in assets. Asset weighted average.*
[13] *Map from: http://www.starcapital.de/research/stockmarketvaluation*

As a result, it could be deemed that participants over-allocate to U.S. stocks by 33 percent[14] when compared to the MSCI All Country World Index (MSCI ACWI Indexes offer a modern, seamless, and fully integrated approach to measuring the full equity opportunity set with no gaps or overlaps. MSCI ACWI represents the Modern Index Strategy and captures all sources of equity returns in 23 developed and 24 emerging markets) (as of 3/31/17). DC investors might not realize that sticking mainly with U.S. stocks can actually increase portfolio risk and simultaneously reduce returns.

The remedy to this situation may be more global equity exposure. If you buy into the concept of a reversion to the mean and that valuations look better overseas than here in the U.S., then you should not be surprised if international markets begin to outperform. By adjusting their portfolio balances more toward global equities, DC investors have the potential to increase returns by offering more exposure to fast-growing segments[15] of the global economy while simultaneously increasing diversification.

Today, plan sponsors can help their participants strike a more appropriate balance by providing:

- **Access** to an actively and passively managed broad-based international equity strategy within the investment menu.
- **Education** to participants about the importance of diversification and the potential pitfalls of a home country bias.
- **Re-enrollment** into target date funds, which often have a greater weighting to equities outside the United States versus typical portfolios and offer ongoing professional management.

As Americans we're all patriots, but when it comes to investing, leave home country bias at the door.

[14]MSCI All Country World Index
[15]In relation to GDP. For example, the Nominal GDP Domestically is around 2.1% versus the global GDP of around 5.7%.
Using diversification as part of your investment strategy neither assures nor guarantees better performance and cannot protect against loss of principal due to changing market conditions.

COMMUNICATION CORNER: Financial Wellness Series—Part 2: Are You Reducing Your Debt?

This month's employee memo is Part 2 of our seven-part series on financial wellness. Part 2 discusses ideas to reduce debt.

As a reminder, we post each monthly participant memo online via the Fiduciary Briefcase™ (fiduciarybriefcase.com).

Call or email your plan advisor if you have questions or need assistance.

Past performance is no guarantee of future results.

The target date is the approximate date when investors plan on withdrawing their money. Generally, the asset allocation of each fund will change on an annual basis with the asset allocation becoming more conservative was the fund nears target retirement date. The principal value of the funds is not guaranteed at any time including at and after the target date.

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