invest

IT'S YOUR FUTURE

Get Back on Track

The new year is an ideal time to make sure you're on track with your retirement savings goals. Taking into account the recession and the recent market turmoil, consider the following ways to use your retirement savings plan to your advantage.

KEEP RETIREMENT SAVING A PRIORITY

No matter how volatile the financial markets, keep on contributing to your workplace retirement plan. One of the most compelling benefits is company matching contributions. For example, a company might contribute 50 cents or more for every dollar you save up to 6% of your salary. Try to contribute at least enough to trigger the maximum company match—otherwise, you're passing up an opportunity for "free" money. (In 2009 you can contribute up to $16,500 to your 401(k), plus a $5,500 "catch-up" amount if you're age 50 or older.)

Your *pre-tax* contributions to a 401(k) plan come out of your paycheck before taxes are withheld—so the contributions will lower your tax bill for the year in which you make them. *(Your plan might also offer the option to make Roth after-tax contributions that may generate investment earnings which may never be taxed.)* Your plan also shelters any investment growth from current taxes, allowing savings to potentially grow much more quickly than they could in a taxable account.

REBALANCE AFTER A TOUGH YEAR

If you're like many investors, your stock funds lost money in 2008, while your bond funds either posted small losses or remain stable. As a result, stocks probably account

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Reflecting on 2008

It's helpful to know that sticking to a long-term investment strategy may help you ride out troubled times. Take a moment to review what led to the 2008 market crisis and consider the lessons learned.

From Main Street to Wall Street

The problems of 2008 had their roots earlier in this decade, when real estate prices soared and mortgage lenders began issuing increasingly larger loans to individual borrowers. Lenders then sold the mortgages to other banks and financial companies.

These financial institutions bundled huge numbers of mortgages together and sold bonds based on the bundles of loans. In their most

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inside

More Than Meets The Eye

taking action

In a bear market, when stock prices are low, it's easy to lose sight of the rewards that come with investing in your workplace retirement plan. Here are the three main benefits to keep in mind:

1) Lower taxes
Boosting the amount you save on a *pre-tax basis* in a traditional retirement plan can have an *immediate* financial impact. Your contributions will reduce your taxable income, lowering your tax bill for this year. They might even drop you into a lower tax bracket, potentially saving you thousands more in taxes.

2) The magic of compounding
Saving more today can pay big dividends tomorrow, especially if those savings are in a tax-sheltered retirement plan. The reason: Because retirement plans shield investment earnings from taxes, more of those earnings are left to potentially earn gains of their own. The process of investment earnings generating future gains is known as compounding, and it can have an enormous impact over time.

Consider this: The stock market produced annualized gains of about 10% during the 25 years through mid-October 2008—despite big losses in 2008—based on the S&P 500 for that period. Let's say that during the same period, a 40-year-old investor saved $5,000 a year in her company-sponsored 401(k) plan and earned an 8% annualized return on her investments. Her account would grow to almost $395,000 over 25 years. By contrast, if she invested the same amount through an account *outside of a tax-deferred arrangement*, taxes would reduce her gains each year—and she'd likely wind up with about $309,000.[1]

3) The company match
Many employers match their employees' contributions to company-sponsored retirement plans, so if you don't contribute you are missing out on this "free" money. For example, your employer might offer to match 50% of your contributions up to 6% of your salary. If you make $50,000 a year and contribute $3,000, you'll receive an additional $1,500 from your employer. Thanks to compounding, that additional $1,500 per year will add almost $120,000 to your nest egg in 25 years, assuming an 8% annualized return.

Building your retirement savings will give you a better chance of reaching your retirement goals. Don't let a bear market distract you from those goals. ■

[1] Assumes 8% annual return in both accounts. Taxable account pays 20% combined annual tax on income and capital gains.

Tax Time

April 15 is still months away. But if you'd like to maximize your deductions, consider the following:

snap shot

- Make your full individual retirement account (IRA) contribution for 2008 (up to $5,000, plus an additional $1,000 "catch-up" contribution if you are age 50 or older). Depending on your income, you may be able to deduct contributions to a traditional IRA from your 2008 taxes.
- If in 2008 you paid someone to care for a child under age 13, or for a spouse or dependent who is not able to care for himself or herself, you may take advantage of a federal tax credit that provides reimbursement for up to 35% of those costs. For more information, see IRS Publication 503, "Child and Dependent Care Expenses," or consult your tax adviser.
- If you're a teacher, you may deduct up to $250 of your personal expenses for classroom supplies—even if you don't itemize your deductions. ■

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Reflecting on 2008

basic form, the bonds gathered payments from thousands of mortgage holders and the money was used to pay interest to investors.

Companies around the world invested heavily in these mortgage-related securities. The companies also built up enormous debts of their own—and relied heavily on income from mortgage-related securities to make their own debt payments.

A snowball effect
Companies could pay their debts only as long as other debtors kept making debt payments of their own. The financial system, which relied heavily on that chain of payments, unraveled in four steps:

1) Real estate prices fell across the U.S.
2) Defaults rose as overextended homeowners became unable to meet their mortgage payments.
3) Higher mortgage defaults reduced the value of securities backed by mortgages, so companies that held mortgage-backed securities suddenly had much smaller assets. As a result, investors who owned stocks in these companies sold off their shares.
4) Lenders couldn't tell which firms were financially healthy, so they stopped extending credit to businesses—putting the brakes on the economy.

Sweet Charity

snap shot

Charitable donations are gifts that can give twice. Donate cash or other items to qualifying nonprofit organizations such as Goodwill and the American Red Cross, and you typically receive a tax reduction in return. To claim the tax write-off, you must itemize your deductions (if you're a homeowner, you probably already do) and you need to have the documentation that proves you actually made the gift. Here's a breakdown of the paperwork you need for gifts of various sizes and types:

Value	Cash	Noncash
Under $250	Canceled check, bank records or receipt showing your donation.	Receipt showing the charity's name, date and location, as well as a detailed description of the goods you donated.
$250-$500	Written receipt from the charity; bank records are not sufficient.	Same as above.
$500 and above	Same as above.	Same as above, as well as IRS Form 8283, "Noncash Charitable Contributions."

Between January and mid-November stocks fell more than 40%. On December 1, the National Bureau of Economic Research announced that the economy had been in recession since December 2007. Federal Reserve policy makers earlier had predicted the economy would contract through the middle of 2009. If correct, the recession would be the longest since the Great Depression.[1]

Lessons from the crisis

Know your risk. Be sure your mix of stocks, bonds and cash is appropriate for the amount of time you have before you reach your goals. If you have 10 years or more before you plan to draw on your savings, you should have enough time for stocks' growth potential to make up for the past year's losses.

Keep investing. Dedicating the same amount at regular intervals—for example, by having money automatically withdrawn from your paycheck and deposited in your workplace retirement plan—allows you to purchase more fund shares when they are cheaper, and fewer when they're more expensive.

Don't panic. If you sell stock funds in a falling market, you won't be able to recoup your losses when the market recovers and you're no longer invested. ■

[1]Bloomberg News

Get Back on Track

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for a smaller percentage of your portfolio than they did at this time last year—which could reduce your chances for long-term growth. *Historically*, stocks do generally recover from downturns, given time. You don't want to miss the rebound, so take the opportunity now to get your investments back into balance.

The Art of Rebalancing

The following table shows how a $50,000 portfolio can get out of balance if stocks lose 25%, bonds gain 5% and cash returns 2%. The portfolio would then be worth $42,675. This investor could get back into balance by selling shares of some of her bond and cash funds, and shifting the proceeds into stock funds.

	Beginning of the year		End of the year		After rebalancing	
Stocks	65%	$32,500	54%	$24,375	65%	$27,739
Bonds	30%	$15,000	40%	$15,750	30%	$12,802
Cash	5%	$2,500	6%	$2,550	5%	$2,134

FREE UP ADDITIONAL FUNDS FOR SAVING

Your retirement savings likely declined during the past year, so you'll need to find ways to save more. One of your top priorities should be to reduce credit card debt so that you stop paying monthly interest charges. Try to find ways to cut certain household expenses; you can direct the savings toward paying off credit cards. Eventually you'll free up cash that you can add to your retirement savings.

Getting back on track with your retirement savings goals will take time. But by keeping up retirement plan contributions, rebalancing your portfolio and budgeting at home you'll be well positioned for the year ahead. ■

smart moves from

SmartMoney

THE WALL STREET JOURNAL MAGAZINE

Thinking Outside of the Box

Q: The value of my home is now less than the mortgage I owe on it. What factors should I consider in either selling or holding onto my home?

A: One major factor you should consider is what it would cost you to sell your home. Selling may require you to hire a broker, whose commission would further reduce your ability to pay off your debt. For example, say you sell your home for $200,000 and you owe $210,000. After a 7% commission, you would receive just $186,000—leaving you owing $24,000. You *might* be better off staying put, chipping away at your mortgage and waiting for the real estate market to recover, even if it takes a few years. As your debt declines and your home value increases, your home gradually will come to be worth more than you owe.

If you're having trouble meeting your mortgage payments, call your lender. Lenders generally prefer to work with you to keep you in your home, rather than foreclosing. You can also contact the federal HOPE for Homeowners Program, which is designed to help homeowners at risk of foreclosure, at (800) 225-5342.

CORRECTION: In the Fall 2008 issue, our answer to the question, "Is there a rule of thumb about the amount of debt it's safe to carry?" cites 40% of pre-tax household income as the recommended guideline. In the subsequent example, we use income of $6,000 per month for monthly debt payments of $2,400. While the $6,000 figure is correct, it should have been stated as before-tax, not after-tax, income. We regret the error.

Q: My spouse and I each have 401(k)s to which we contribute the maximum amount allowed by our employers. Should we also invest in IRAs?

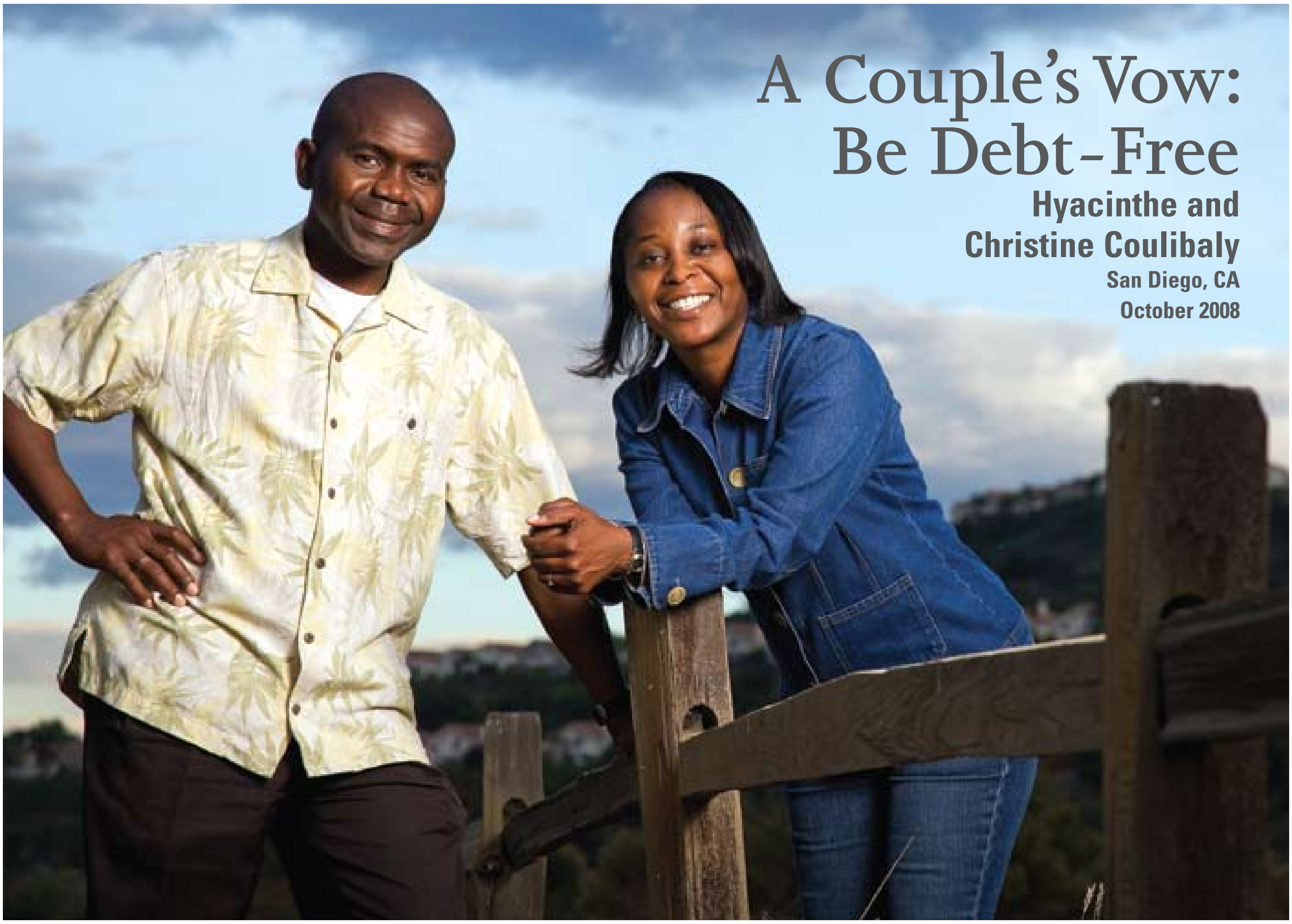
A: An IRA is a great place to put additional retirement savings, because your investments in the account can generate tax-sheltered compound growth. (For more on compounding, see "More Than Meets the Eye" on page 2.) You can make contributions to an IRA for 2008 anytime before April 15, 2009—as much as $5,000 ($6,000 if you're age 50 or older). The same contribution limits apply to 2009.

The following table spells out IRA eligibility for a married couple in which both spouses participate in workplace retirement plans and file taxes jointly. ■

IRA type	You're eligible if:
Roth Contributions come out of after-tax money, but your retirement withdrawals generally won't be taxed.	Your combined 2009 adjusted gross income (AGI) is $166,000, phasing out at $176,000.
Traditional, Tax-Deductible You can deduct contributions from your taxable income the year you make them, but you'll pay income tax on withdrawals.	Your combined 2009 AGI is $89,000, phasing out at $109,000.
Traditional, Non-Deductible Contributions come out of after-tax money, and investment earnings are taxed when you withdraw them. (Consider this type of IRA only if you don't qualify for either of the other two.)	You earned income in 2009.

Do you have a question about investing or managing your retirement savings plan?

Write to us at *Invest* Editor, c/o Custom Solutions from SmartMoney, 1700 Broadway, 20th Floor, New York, NY 10019, or send us an e-mail at smartmoves@smartmoney.com.
We regret that we're unable to respond to all the questions we receive. If we print your question, your name will be withheld.



A Couple's Vow: Be Debt-Free

Hyacinthe and Christine Coulibaly
San Diego, CA
October 2008

reality check

Hyacinthe and Christine Coulibaly are facing serious financial trouble. They owe more than $107,000 in back taxes, credit card bills and student loans. And, like many families impacted by the recession, their home mortgage is "upside-down," exceeding the value of their San Diego townhouse by $100,000. Worse, their expenses surpass their income by nearly $4,000 a month—so the debts keep growing. "We are robbing Peter to pay Paul," says Christine.

The Coulibalys recently met with financial advisor Cathy Pareto and resolved to address their predicament head-on. "They have a huge deficit to overcome," says Pareto, who is based in Coral Gables, Florida. "I don't make this recommendation lightly, but filing for bankruptcy may be their best option."

FINDING WAYS TO PAY

Christine, 46, and Hyacinthe, 49, already work two jobs each, plus Christine is taking college classes that eventually will qualify her for a raise and promotion. A bankruptcy filing might help the Coulibalys straighten out their finances while Christine works toward increasing her salary.[1]

But filing for bankruptcy would have serious near-term consequences: It would stay on their credit reports for 10 years, making it hard to get a new loan, job, insurance policy or car. In the long run, though, it may be the couple's best option if they want to continue building savings. The couple has $35,000 in retirement accounts. Pareto says they shouldn't even consider withdrawing that money to pay down debt. "They would have to pay taxes and possibly an early-withdrawal penalty, and they'd lose the chance for long-term investment returns," she says.

PROTECTION FOR SAVINGS

Filing Chapter 7 bankruptcy would eliminate the Coulibalys' debts while allowing them to continue contributing to their retirement accounts—a big relief. But Chapter 7 is available only to debtors who fall under certain income levels, and the Coulibalys' combined $115,000 annual income may be too high. They'll have to undergo "means testing" to see if they qualify: The courts will determine whether they have enough cash to repay a portion of their debts, based on their income and fixed expenses such as taxes and mortgage payments.

If the court finds the Coulibalys can't repay any of their debts, they can file for Chapter 7. However, if the court determines that the Coulibalys can repay some of their debts, their only option is Chapter 13. Under Chapter 13 the Coulibalys would make a monthly payment to a bankruptcy trustee, a court-appointed official who would distribute the money to their creditors over a three-to-five year period. While they're paying off their old debts, the Coulibalys' would be unable to secure new credit or contribute to their retirement.[2]

KEEPING THEIR BIGGEST ASSETS

One bright spot: Under either type of bankruptcy, the Coulibalys' savings in their 401(k) and

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403(b) plan accounts would be protected, and they would keep their home as long as they continue making their mortgage payments. After ridding themselves of their debts, Pareto says they should look for ways to contribute more to their retirement savings.

READY FOR CHANGE

Whether or not the Coulibalys file for bankruptcy, they need to reform their spending habits. The couple will receive mandatory credit counseling if they file for bankruptcy, which should help them adopt a healthier financial lifestyle. Pareto suggests looking for an agency that's affiliated with the National Foundation for Credit Counseling.

Once they have turned their finances around, the Coulibalys can begin rebuilding credit and increasing retirement savings. They are ready to get started. "This process is going to bring up a lot of emotion, and some of it is going to be negative," says Christine. "But we're going to get through this, and we're going to do it together." ■

[1]The couple should seek the counsel of a local attorney who could advise them on whether to file for bankruptcy. New Providence, N.J.-based Martindale-Hubbell (martindale.com) and Seattle-based Avvo (avvo.com) provide worldwide legal search services that can help locate a reputable bankruptcy attorney.

[2]www.uscourts.gov

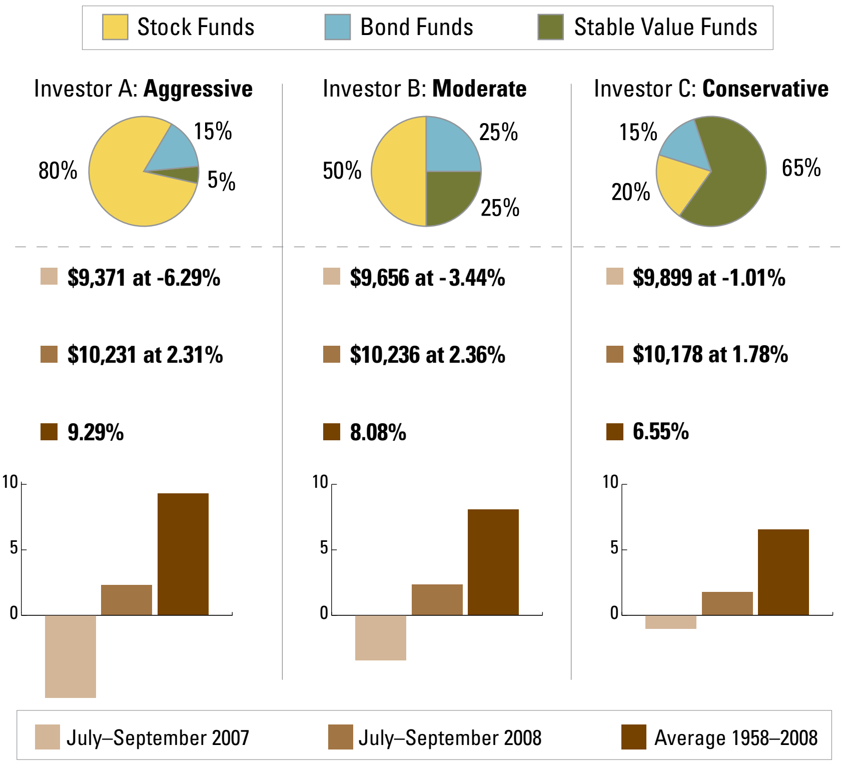
The Credit Crisis Takes Its Toll

trendwatch

Stocks continued the year's declines in the third quarter as the credit crisis worsened, sharply reducing prospects for growth. The period marked the third consecutive quarterly decline of stocks for 2008; most of its drop took place in September after a generally flat July and August. The stock market, as measured by the S&P 500 Index, ended the third quarter down 8.37%, following a 2.73% decline in the second quarter and a 9.4% drop in the first quarter. Investors' flight to security pushed bonds up 2.54% for the quarter. Stable value investments eked out a 0.43% return. ■

At a Loss

The following tables show how three hypothetical portfolios with initial investments of $10,000 fared during the third quarter of 2008, compared with the third quarter of 2007. They also provide the portfolios' annualized returns over the past 50 years.



Source: Ibbotson Associates. Stock fund returns are based on total returns of the Standard & Poor's 500 Index. Bond returns reflect intermediate-term government bonds with maturities of roughly five years. Stable value returns are based on returns of three-month Treasury bills.

New Limits

snap shot

With the arrival of the new year, Congress authorized increases in the maximum allowable contribution for workplace retirement plans. To get the most out of your retirement savings, take advantage of these new limits, in addition to the ongoing contribution limits for individual retirement accounts (IRAs). ■

2009 Contribution Limits

	Maximum contribution	Additional "catch-up" contribution for individuals 50 or older
401(k) and Roth 401(k)	$16,500	$5,500
IRA and Roth IRA	$5,000	$1,000