OnTrack

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No More PENNY CANDY

There really was a time when you could buy all sorts of wrapped candies for a penny apiece. Today, you'd be hard pressed to find *anything*, candy included, that costs just a penny. That's inflation for you.

Steady Erosion

Inflation* has been relatively modest in recent years. Compared to the double-digit inflation rates of the past (e.g., 13.3% in 1979 and 12.4% in 1980), the rates of the past several years (e.g., 1.5% in 2010 and 3.0% in 2011) seem downright tame. However, even a low rate of inflation will put a serious dent in your buying power over time.

Above Average Increases

Some costs have been rising even faster than the "official" inflation rate, most notably college costs and medical expenses. With more and more health care costs being passed on to retirees, health care inflation could have a particularly detrimental effect on your retirement finances.

Inflation Deflates Buying Power

No one knows how much inflation we will experience in the future. But here are some hypothetical scenarios that show the potential impact of inflation on your purchasing power.

Today you have	At an annual inflation rate of	In 10 years you'll need	In 20 years you'll need
$20,000	3%	$26,878	$36,122
$20,000	5%	$32,578	$53,066

This example is for illustrative purposes only. Your actual savings may be more or less than $20,000, and the actual inflation rate may be different. Source: NPI

Inflation-beating Strategies

Taming inflation can be particularly challenging for retirement investors. Fortunately, you can combat inflation's effect on the savings you're building. Here are two strategies to consider:

- Choose at least some investments that have the potential to provide inflation-beating returns, such as stock funds or portfolios.
- Increase the amount you're saving for retirement every chance you get.

Into the Future

Penny candy may be gone forever, but inflation is probably here to stay. Someday you might tell your grandchildren how much cheaper things were back in 2012. But as long as you plan and invest wisely, you should still be able to take them out for popcorn and a movie.

** As measured by the CPI, the Consumer Price Index*

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INVESTING 101

Your career as a retirement investor begins when you start contributing to a retirement account and continues throughout your working years. You don't need an advanced degree to save and invest for retirement. However, having a working knowledge of terms and strategies can help you make better investment decisions. Here's a quick quiz to see how well you know the basics.

Questions

1. Which type of investment (asset class) listed below is most likely to barely keep pace with inflation?

A. Stocks

B. Bonds

C. Cash alternatives

2. Which type of investment listed below has the greatest potential for long-term growth?

A. Stocks

B. Bonds

C. Cash alternatives

3. What is diversification?

A. Asking several different people for investment advice

B. Investing in several different investments to reduce exposure to potential investment loss

C. Putting money into an investment over several years instead of all at once

4. What is asset allocation?

A. Setting a portion of your earnings aside for retirement

B. Specifying how your plan assets should be distributed at retirement

C. Dividing an investment portfolio among different asset classes

5. What is compounding?

A. Buying the same number of shares of the same investment on a set schedule

B. Combining a group of investments into one fund

C. Earning a return on the earnings your investments generate as well as the original amounts you invest

6. What is market timing?

A. Attempting to determine the best times to get in and out of the market

B. Making investment decisions at a particular time or on a certain day

C. A strategy that is popular with buy-and-hold investors

7. Which of these factors should retirement plan investors consider when selecting investments?

A. Risk tolerance

B. Investing time frame

C. Both A and B

Answers

1. C. Any type of investment may underperform the inflation rate for a period of time. However, over longer periods, earnings on cash alternative investments (as compared to the other major asset classes) are the most likely to barely keep pace with inflation.

2. A. While past performance doesn't guarantee future results, stocks historically have produced higher long-term returns than bonds or cash alternative investments.

3. B. Diversification is the strategy of putting your money into several investments rather than just one. You can further diversify by spreading your investments among the different asset classes: stocks, bonds, and cash alternatives. Having a diversified portfolio does not ensure a profit or protect against loss in a declining market. However, it reduces the likelihood that you'll suffer a significant overall loss when the value of one security or asset class declines.

4. C. Asset allocation is the strategy of spreading your investments among different asset types (e.g., stocks, bonds, and cash alternative investments). Your asset allocation should reflect your risk tolerance, time horizon, and goals. Like diversification, asset allocation does not guarantee a profit or protect against losses.

5. C. Compounding occurs when your investment earnings are reinvested and start generating more earnings. Over time, tax-deferred compounding can help your retirement account grow.

6. A. Market timing involves trying to get in and out of the market at the best times. However, predicting market movements accurately and consistently is very difficult. Even professional investors have a hard time successfully timing the market.

7. C. It's important for retirement investors to consider both factors when choosing investments. Generally, risk tolerance refers to how comfortable you are with the potential for sustaining investment losses. Your investing time frame is how long you have until you'll begin to access your savings (ideally in retirement). When retirement is far off, you may be able to tolerate more risk since you have more time for your investments to recover from any losses. As the number of years until retirement decreases, your risk tolerance will generally decrease as well.

Stock investing involves a high degree of risk. Stock prices fluctuate and investors may lose money. Bond prices may fluctuate due to interest-rate changes. Investors may lose money if bonds are sold before maturity. Cash alternative investments may not be federally guaranteed or insured and it is possible to lose money by investing in cash alternatives. Returns on cash alternative investments may not keep pace with inflation, so investors could lose purchasing power.

No Such Thing as "SAFE" Investing

Finding out that an investment has lost value can be upsetting. So why not just put all your retirement savings into low-risk cash alternatives?* Limiting your investment selections to these so-called "safe" investments may *seem* like a good idea. But in reality, you're trading the risk of losing money for another type of risk: low potential returns.

Not Enough Growth

When it comes to investing, risk and return are related. As risk decreases, return potential generally decreases, too. If you put everything into money market or other cash alternative investments, the growth of your retirement account may not keep up with inflation and you could lose purchasing power. Although there's little risk of losing the amount you invest in cash alternatives, you risk earning returns that are too low to outpace inflation and reach your goals.

The Upside of Risk

Including some higher risk investment types, such as stocks and bonds, in your retirement portfolio gives you an opportunity to earn higher potential returns. The further away you are from retiring, the more investment risk you may be willing to take because your long time frame gives you more time to recover from losses. As retirement gets closer, it's generally wise to decrease your portfolio's risk exposure.

Variety Is Key

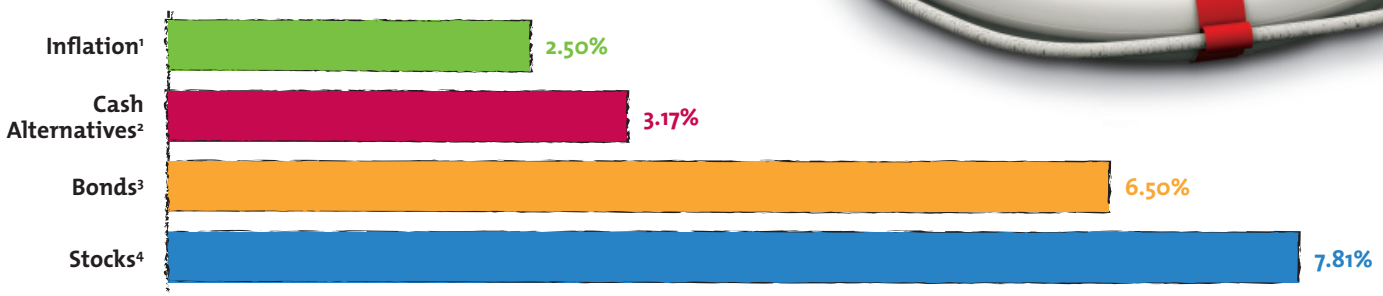
Choosing all low-risk investments can be anything but safe for retirement investors. Instead, choosing a well-diversified** mix of investments — which could *include* cash alternatives — may be the best way to meet your retirement investing goals.

** Cash alternative investments may not be federally guaranteed or insured, and it is possible to lose money by investing in cash alternatives.*

*** Diversification does not guarantee a profit or protect against losses.*

A Long-term Look

20-year Average Annual Total Return (through December 31, 2011)



[1] Represented by the Consumer Price Index (CPI). [2] Measured by U.S. Treasury bills. [3] Measured by Barclays Capital U.S. Aggregate Bond Index, an unmanaged index of U.S. government, corporate, and mortgage-backed securities. [4] Measured by the S&P 500 Index, an unmanaged index of stocks of 500 major corporations.

Past performance does not guarantee future results. Your investment results will be different. This chart is for illustrative purposes only and does not represent the performance of any particular investment. Investments cannot be made in an index. Stocks have greater return potential, but are more volatile than other investment types. Unlike stocks and corporate bonds, government bonds and Treasury bills are guaranteed by the U.S. government and, if held to maturity, offer fixed rates of return and stable principal.

Source: NPI

This newsletter is designed to provide useful information about retirement plans and investing your plan account savings. While the information contained herein was obtained from reliable sources, it cannot be guaranteed as to completeness or accuracy. Before acting on any of the information provided, consult your professional advisor.

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