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401(k) UPDATE

3RD QUARTER 2014

Reassess Your Retirement Plans

Approximately five years before you plan to retire, thoroughly reassess your retirement plans and ensure that all significant financial pieces are in place. Once you retire, you probably won't have the option of going back to your former job. So before you retire, consider these points:

✔ **Take a serious look at your retirement plans.** You're close enough to retirement that you should have a good feel for your retirement expenses and expected income. While you may be anxious to retire, remain flexible about your retirement date. Working an additional year or two can add substantially to your retirement savings and may boost retirement benefits.

✔ **Get a fix on your Social Security and pension benefits.** Make sure you know exactly how much you can expect from Social Security and defined-benefit plans. How much will your benefits increase if you delay retirement by one year, five years, etc.? If you retire before full retirement age for Social Security purposes, do you plan on still working? Be aware that for those under full retirement age for Social Security purposes, earnings over $15,480 in 2014 will cause you to lose $1 of benefits for every $2 of earnings over this threshold. Make sure you understand your distribution options for any defined-benefit plans. In most cases, those decisions are irrevocable.

✔ **Determine how much income your retirement investments will generate.** As a general rule of thumb, you can multiply your retirement investments by 4% to get an idea of how much you can withdraw annually. You can go through a more detailed analysis, reviewing a wide range of variables for a more precise answer. However, the younger you retire, the more conservative your withdrawals should be, since your funds will have to last for a longer time period.

Continued on page 2

The Benefits of Low-Correlated Assets

By combining assets with low correlation, you can potentially improve portfolio returns while reducing risk. Correlation is a statistical measure of how one asset class performs in relation to another asset class. Correlations can range from +1 to –1. A correlation of +1 means the two assets move very closely together in the same direction. Combining assets with a high positive correlation will not provide much risk reduction. A correlation of –1 indicates the assets move in opposite directions, a rare event in the investment world. A correlation close to 0 means no relationship exists in the price movements of the two assets.

Combining assets with consistently high correlations to each other does little to reduce risk. The greatest combination benefit to a portfolio seems to be achieved by combining assets with consistently low correlations, which results in substantially reduced risk.

When selecting investments for your portfolio, don't just look at their risk and return characteristics. Also consider the diversification aspects for your overall portfolio. ❍❍❍

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Reassess

Continued from page 1

✔ **Investigate work options.** If you plan to work at least part-time during retirement, have you decided what you'll do and how much it will pay? Make sure you investigate your options, including asking your current employer about part-time opportunities.

✔ **Finalize living arrangements.** Determine whether you want to stay in your current home or move to another one, either in the same city or a different location. At this point, you should be able to determine whether you'll have a mortgage and how much equity you'll have in your home. While most retirees continue to live in their current home, explore whether it makes sense to downsize, freeing up home equity for investments or retirement income.

✔ **Deal with health insurance and long-term-care costs.** Two of the most significant costs in retirement are medical care and long-term care. Make sure you have plans to deal with both. If you are retiring at age 65 or later, you'll be eligible for Medicare, although a spouse under age 65 will not. You will probably need supplemental coverage with Medicare. If you are retiring before age 65, make sure you know exactly how much coverage will cost you, especially if coverage is not provided by your employer. Now is also a good time to take a look at long-term-care insurance, since premiums get significantly more expensive as you age.

✔ **Live with your retirement budget for a couple of years.** Want to really make sure your retirement budget is reasonable? Try living with your retirement budget for a couple of years. If you can do so without increasing your debt, you can be reasonably confident that your budget will work during retirement. ❍❍❍

A Retirement Account Is Not a Retirement Plan

A retirement account is simply a vehicle to save for retirement, while a retirement plan includes many factors — when you want to retire, how much you will need every month, your assets and investments, your debts, Social Security benefits, health care, emergency fund, and more. Some factors to consider include:

Are you contributing enough? If you're like most Americans, the answer is probably no. In 2012, on average, Americans contributed about $2,700 to their 401(k) plans; even if matched at 100%, $2,700 a year is not enough for most people to make it through retirement. There is a lot of room to contribute far more than average before hitting the annual 401(k) contribution maximum of $17,500 (that's the limit in 2014 per IRS rules; it typically increases a bit each year). But if you don't have a plan — if you don't know how much you'll need to have saved when you retire — you won't know how much you need to contribute every month. For most people, not knowing results in not contributing enough.

Are your investment allocations right for you? How you allocate your money — the types of investments you have — should depend on where you are on the path to retirement. Stocks involve more risk but typically yield a higher return, while bonds carry potentially less risk but typically yield a lower return.

Generally, the further away you are from retirement, the more money you should have in stocks and the less money you should have in bonds. As you get closer to retirement, you should reallocate your funds toward more bonds and less stocks. Why?

Because if you are too conservative when you're young (not invested enough in stocks), your investments won't grow like you need them to. But if you're too aggressive as you near retirement (invested too much in stocks), market volatility could derail your retirement plans.

Have you strategically chosen your accounts? The government incentivizes us to save for our retirement by giving certain types of tax advantages to qualified retirement accounts. But those advantages vary.

For some, you may contribute pretax dollars (but that money is taxed when you take it out in retirement). For others, you can take out tax-free money in retirement, but contributions are made after taxes.

So you need to think strategically about how and where you are investing for retirement. In addition to the tax implications associated with different investment vehicles, you also need to look at fees associated with the account. And beware, if you're planning to retire early, many types of retirement accounts will penalize you heavily for early withdrawals.

If your employer offers a 401(k) plan and matches contributions, it always makes sense to contribute at least as much as your employer will match. But for most Americans, that 401(k) plan alone is not sufficient.

To ensure that you are saving enough to retire when and how you want to, you need to have a road map to get from here to there. ❍❍❍

What Is a Reasonable Rate of Return?

The assumed rate of return used in your investment program will determine how much you need to save to reach your financial goals and how much you can withdraw annually from your portfolio after retirement. Use a rate that is too high and you may not accumulate the amount you need or be able to withdraw enough during retirement.

But what is a reasonable long-term rate of return?

Typically, the assumed rate of return for an investment program is the average annual return for some historical period. Data is readily available going back as far as 1926. But does looking at history still make sense in the current market environment?

Consider the following points when deciding on an assumed long-term rate of return:

When selecting what historical period to consider, keep in mind that returns can vary substantially over different time periods. As a starting point, you may want to consider average returns for the period from 1926 to present, making adjustments from there.

Understand the difference between arithmetic and geometric returns. For the period from 1926 to 2013, the arithmetic average annual return for the Standard & Poor's 500 (S&P 500) was 12.1%, while the geometric average return was 10.1%.* The arithmetic average is a simple average of the sum of each annual return divided by the number of years used. The geometric return calculates the return earned over the years, calculating the change in value over a specified period. Basically, you calculate how $1 would grow over the years based on actual year-by-year returns, determining what rate of return would produce the ending value. Typically, the geometric return will be equal to or lower than the arithmetic return.

Don't forget to factor in inflation. When determining how much you want to have saved by a future date, your figure is stated in terms of today's dollars. Due to inflation over the years, that amount will not have the same purchasing power as it has today. You will need a higher amount at that future date for the same purchasing power. Thus, you should factor inflation into your assumed rate of return. From 1926 to 2013, inflation has averaged 3% annually.*

Returns tend to regress to the mean. There is a tendency for the stock market, when it has had above- or below-average returns for an extended period, to revert back to the average. So, following an extended period of above-average returns, it is possible that the market may go through a period of below-average returns. Thus, you may want to lower your expected annual return.

Use conservative estimates. When deciding between a lower or higher expected return, it is usually more prudent to use the lower return. While a higher return means that you will need to save less annually, you run the risk of not meeting your savings goals if actual

returns are lower. Which is better — to have too much money saved when you are ready to retire or not enough? If you save too much, you can always reduce your savings in later years or spend more in retirement. The alternatives are far less attractive if you don't have enough money saved.

So what is a reasonable long-term rate of return to use in investment programs? Starting out with the average geometric return (since this is more conservative than the arithmetic return) from 1926 to 2013 of 10.1% and subtracting the long-term inflation rate of 3% would result in a return of 7.1%. You may even want to use a more conservative return than that if you feel the stock market may go through an extended period of below-average returns.

* The S&P 500 is an unmanaged index generally considered representative of the U.S. stock market. Investors cannot invest directly in an index. Past performance is not a guarantee of future returns. Returns presented are for illustrative purposes only and are not intended to project the performance of any specific investment vehicle. Source: *Stocks, Bonds, Bills, and Inflation 2014 Yearbook*.

Get Your 401(k) Plan on Track

To make sure you have sufficient funds for retirement, you need to get your 401(k) plan on track. To do so, consider these tips:

✔ **Increase your contribution rate.** Strive for total contributions from you and your employer of approximately 10% to 15% of your salary. If you're not able to save that much right away, save what you can now and increase your contribution rate every six months until you reach that level. At a minimum, make sure you're contributing enough to take advantage of all employer-matching contributions.

✔ **Rebalance your investments.** Review your allocation annually to make sure it is close to your original allocation. If not, adjust your holdings to get your allocation back in line. Selling investments within your 401(k) plan does not generate tax liabilities, so you can make these changes without tax ramifications.

✔ **Don't raid your 401(k) balance.** Your 401(k) plan should only be used for your retirement. Don't even think about borrowing from the plan for any other purpose. Sure, that money might come in handy to use as a down payment on a home or to pay off some debts. But you don't want to get in the habit of using those funds for anything other than retirement. Similarly, if you change jobs, don't withdraw money from your 401(k) plan. Keep the money with your old employer or roll it over to your new 401(k) plan or an individual retirement account.

✔ **Seek guidance.** It is important to manage your 401(k) plan carefully to help maximize your future retirement income. If you're concerned about the long-term impact of the recent market declines, call for a review of your 401(k) plan. ❍❍❍

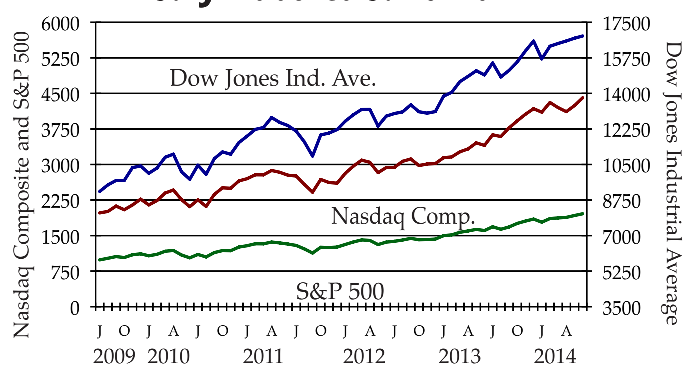
Market Data

	Month End			% Change	
	Jun 14	May 14	Apr 14	YTD	12 Mon
Dow Jones Ind.	16826.60	16717.17	16580.84	1.5%	12.9%
S&P 500	1960.23	1923.57	1883.95	6.1	22.0
Nasdaq Comp.	4408.18	4242.62	4114.56	5.5	29.5
Wilshire 5000	20568.65	20092.62	19705.45	6.0	22.6
Gold	1315.00	1250.50	1288.50	9.4	10.3
				Dec 13	Jun 13
Prime rate	3.25	3.25	3.25	3.25	3.25
Money market rate	0.43	0.40	0.41	0.43	0.45
3-month T-bill rate	0.03	0.03	0.02	0.07	0.06
20-yr. T-bond rate	3.17	3.12	3.23	3.61	3.11
Dow Jones Corp.	2.71	2.69	2.88	3.11	3.18
Bond Buyer Muni	4.53	4.48	4.64	5.13	4.77

Sources: *Barron's, Wall Street Journal*

Stock Indices

July 2009 to June 2014



Past performance does not guarantee future results.

Thoughts about Retirement Planning

While the maximum annual contribution to 401(k) plans is $17,500, the average amount actually contributed, excluding employer-matching contributions, was $2,733 (Source: Bloomberg, 2013).

During the last five years of their lives, Medicare recipients spent $38,688 in out-of-pocket costs (Source: Mount Sinai School of Medicine, 2013).

The average monthly Social Security benefit for retired workers is $1,237 (Source: Social Security Administration, 2013).

The average cost of a private room in a nursing home is $248 per day or approximately $90,000 per year (Source: MetLife Mature Market Institute, 2013).

Only 12% of individuals age 54 take advantage of 401(k) catch-up contributions (up to $5,500 as of 2014) (Source: Fidelity Investments, 2013).

Approximately 62% of couples nearing the end of their careers disagree on their anticipated retirement ages (Source: *Money*, November 2013).

The average single man who turned 65 in 2010 contributed $61,000 to Medicare on an inflation-adjusted basis, but can expect to receive $180,000 in benefits (Source: Urban Institute, 2013). ❍❍❍