Rebuild your nest egg

17 moves to secure your future now

WHEN BAD INVESTMENTS happen to good people, there's only one thing to do short of weeping: Turn to Plan B. That's where most of us are now. We're viewing the shards of our broken nest eggs and making choices we'd hoped to avoid. We might have to work harder to slash debt, cut spending, and save more.

We also might need to continue working longer than we had expected and to change our living situation. Plan B means seizing the reins in every area of our finances over which we have control.

Most investors can take some of those steps, and many already have, according to a survey of our online subscribers, ages 55 to 75, by the Consumer Reports National Research Center. Half of survey respondents close to retirement said they're eating out less, and almost half said they have cut back on entertainment. About a third have used their credit cards less and cut spending on groceries and household goods. About 20 percent have paid off most or all of their credit-card debt.

And no wonder. Fifty-one percent of retired readers and 55 percent of those just short of retirement reported investment losses of 20 percent or more between November 2007 and November 2008. Most of those losses occurred last fall. Two-thirds of respondents were pessimistic about the prospects of recovery in the next 12 months. Two-thirds said they were worse off financially than they had been a year before.

Brittney Saks, a personal financial specialist and partner with PricewaterhouseCoopers Private Company Services practice in Chicago, says she tries to give her clients advice on dealing with worst-case scenarios. "Ninety-five percent of the time, you'll be fine," she says. "But right now we are in that 5 percent."

No doubt stocks will come back. People who held on to their investments after Black Monday in 1929 and through the Great Depression did recover their money, but it took about 25 years. No one can accurately predict whether the current financial funk will be as dire or last as long.

So in this report, we outline 17 actions you can take now, whether you're already retired or are close to retirement, or you have decades to go. And on page 20 we pinpoint the best places to stash a cash cushion against more bumps in the road.

Take control where you can

The market's plunge has clarified for investors how they really felt about losing money. Some who thought they could handle risk lost their nerve and bailed. Financial advisers as a rule warn against a major retreat in a market free fall; you're selling at a loss, and you'll probably miss the inevitable rebound, which individual investors historically can't anticipate. Indeed, sticking to an investment plan in thick and thin is a mantra among financial planners.

But if you've truly been spooked by the market plunge, reconsider your balance of bonds and stocks based on your new understanding of risk. "That knot in their stomach is what we're talking about when we talk about risk tolerance," says Mickey Cargile, managing partner at WNB Private Client Services in Midland, Texas.

One guideline for asset allocation among those saving for retirement—subtract your age from 110 and put that percentage in stocks—might seem risky now, leaving a 60-year-old with 50 percent in stocks. You might rest easier with a more conservative allocation. Just be aware that such an approach could result in lower returns. "You cannot realistically be more conservative unless you're willing to cut the spending," says Robert Glovsky, a certified financial planner and president of Mintz Levin Financial Advisors in Boston.

How do you get to a new ratio of stocks to bonds? With stocks beaten down in price relative to bonds, your portfolio might already be weighted more heavily to bonds. If you still have more in stocks than you're comfortable with, plan for a gradual shift—say, by directing all or a portion of new retirement-plan contributions to a fixed-income investment such as a bond fund. After that, check your allocation each year to see whether it's intact, and if not, rebalance by selling shares in the overweighted assets and buying those that are below optimal levels.

What you can do

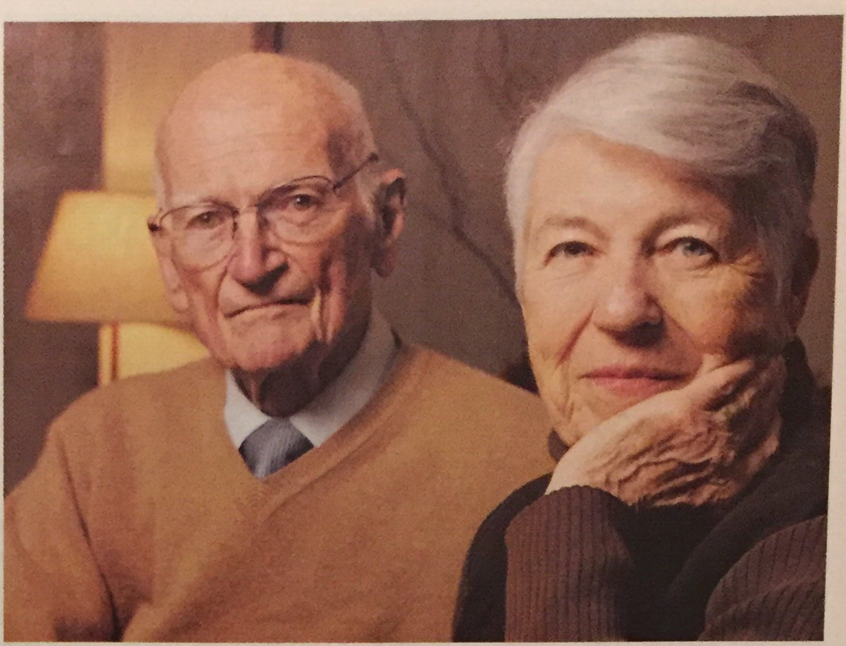
Plump up your cash cushion. If you've raided your emergency fund of late or never had one to begin with, devote the next few months and years to building it up, or at least not touching it further. A cash fund helps ensure that you won't have to dip into equities when they're down and that you won't have to borrow in a pinch.

You might need to rethink when you can retire.

If you can, pad that cushion with new savings, not with invested funds. "If you don't have a cushion today, I wouldn't go and create it by selling stocks because you'll be selling at a loss," Glovsky says. Financial advisers generally recommend that workers have three to six months of expenses in an emergency fund; retirees should have at least one year's worth.

Track your spending. That exercise helps target spending weaknesses, such as Starbucks and Stolichnaya. Write down all expenditures for a month or more and then put them into categories, such as mortgage, utilities, groceries, travel, and entertainment. You can create your own system or use budgeting software, such as Intuit's Quicken or Microsoft Money.

Redirect tax savings. If you're due for a large refund this spring and don't expect your tax liability to change much in 2009, reduce your federal tax withholding now. The average refund was about $2,400 in 2008. Cut your withholding and put the additional money toward expenses or to build up your emergency fund.



SCALING BACK Albert Kee and Muriel Burrows are limiting their gifts and vacations.

Retirees

Keeping the nest intact

The first step in many retirees' Plan B is rethinking the plans they made for their retirement lifestyle. Muriel Burrows, 83, and her husband of 23 years, Albert Kee, 85, have had that reckoning. Even before the market took a toxic turn, the Scotia, N.Y., couple had downsized from a house to a condo. With Burrows' nest egg now shrunk by 30 percent and Kee's down more than 8 percent, they've postponed vacations and major purchases. They're cutting charitable contributions, birthday presents, and cash gifts to their blended family of 10 grandchildren and one great-grandchild. "We did what everybody says you're supposed to do," Burrows says. "It worked for a long time, but it's not working anymore."

In recent years, some financial advisers have recommended that retirees—and all investors—increase their exposure to stocks. The rationale: As we live longer, the growth potential of stocks might help ensure that we don't outlive our money. That is usually good advice, but retirees who accepted that line of thinking are paying a steep price today. Although 51 percent of retirees in our survey reported losing at least 20 percent of their sav-

Survey: The rewards—and risks—of planning ahead

People who had planned ahead were more satisfied with their retirement prospects, even in the current market tumult, our survey showed. Here are some of our findings:

Planning took many forms. Among pre-retirees, 90 percent planned in one or more of these ways: read books or articles, talked with friends or relatives, consulted a financial planner, used software or online calculators, or took a course. The more methods people used, the more satisfied they were.

Using a financial pro gave no edge. Unlike our 2007 survey, clients of financial planners said this year that they were no more satisfied with their retirement planning than those who'd educated themselves. Both groups said they lost money at about the same rate. Those with financial planners had a net worth that was about $230,000 greater than those who did their own planning, though we don't know whether they were richer to begin with.

Those who'd planned took more risks. Retirement-planning strategies encourage investors to diversify beyond safe vehicles such as bonds and CDs. Our respondents who had planned were less conservative, in general, than those who hadn't. Before the meltdown, that approach benefited them, according to our 2007 survey. But it proved punishing during the unusually severe market downturn of recent months. So pre-retirees who had done more planning reported worse losses, on average, than those who hadn't planned.

Planners put off retirement. Forty-three percent of respondents who had done four or more planning activities said they would now delay retirement for a year, compared with 28 percent of those who had done nothing. Greater losses might have forced the decision.

About our survey. The Consumer Reports National Research Center polled more than 19,000 of our online subscribers on Nov. 6, 2008. The sample is representative of our online subscribers ages 55 to 75, including retirees, pre-retirees, and partly retired subscribers. In general, our subscribers tend to be older and more educated, and have a higher net worth, than the general population.

ILLUSTRATION BY CHRISTOPH NIEMANN

PHOTOGRAPH BY GARY GOLD

ings, aggressive investors—those who owned more stocks or other risky investments—were twice as likely as conservative investors to have reported losses of 30 percent or more. Thirty-two percent of retirees reported becoming more conservative investors since last fall's equity rout.

What you can do

Focus on factors you can control, such as rebalancing your portfolio, limiting discretionary spending, prioritizing annual withdrawals from your IRA and other retirement vehicles, minimizing taxes, and going back to work, if that's an option.

Consider your withdrawal rate. In general, financial planners say an annual withdrawal rate of about 4 percent from your total investments is optimal to ensure the money lasts as long as you do. The chart below shows how your withdrawal choices affect the longevity of your assets.

Know what to tap first. The right withdrawal strategy can help you make your money last and reduce your tax liability. A study published recently in the Journal of Financial Planning notes that in most economic situations, withdrawing from your bond holdings before touching your stocks can extend the life of a retirement portfolio by up to 3.8 years.

To minimize taxes, first start withdrawing any minimum required distributions from your tax-deferred retirement accounts (if you're 70½ or older). Then begin withdrawals from other accounts in this order:

- Taxable investments with losses.
- Investments in taxable accounts with little or no gain or loss, such as cash.
- Money in taxable accounts that qualifies for long-term capital-gains treatment.
- Money in taxable accounts with short-term gains or in tax-deferred accounts with relatively small gains.
- Retirement accounts subject to ordinary income taxes.
- Money in Roth IRAs and Roth 401(k)s, subject to no tax. Because tax rates might rise, keep those gems as long as you can.

Pick up extra money by working. For those with the ability, working even part-time can help mitigate a financial burden. Twenty-two percent of our respondents said they're working part-time, and 22 percent of those who are fully retired said they wish they could work again. Employers might be willing to hire experienced older workers.

Don't abandon moving plans. Your $400,000 home may have lost $100,000 in value, leaving you with less to spend on housing elsewhere. But values are down in many areas, and moving to a lower-cost area might still be worth that trade-off.

You can do a side-by-side comparison of crime statistics, climate, and cost of food and housing in pairs of cities, at *www.bestplaces.net*, a site produced by Fast Forward. It also has a cost-of-living calculator you can use to determine how much you'll need to maintain your current standard of living elsewhere. The Retirement Living Information Center Web site, at *www.retirementliving.com*, has a "Taxes by State" guide that lets you do state-by-state comparisons of income, property, sales, estate, and other tax rates.

Keep tabs on your pension. If you have a traditional pension, check how well it is funded by examining its federal 5500 Form. You can find it at *www.freeerisa.com*. A fact sheet explaining how to read the numbers is available from the Pension Rights Center, at *www.pensionrights.org*. If a plan's assets cover 80 percent or more of its liabilities, that's considered good. If you're expecting a relatively large pension benefit and the company seems headed for bankruptcy, check the "maximum monthly guarantees" that the government's Pension Benefit Guaranty Corp. (*www.pbgc.gov*) will pay if it takes over the plan.

Be wary of reverse mortgages. The federally insured variety lets homeowners 62 or older borrow part of their home equity. Usually, the principal and accrued interest are paid off after the homeowners die or move out. The fees can be high, making this income-producing option far less attractive if you know you'll move eventually. And with home values down, you might get far less than you need from a reverse mortgage.

When funds decline, what should you do?

To ensure that your retirement money lasts at least as long as you do, withdraw about 4 percent per year. The CR Money Lab examined three ways to deal with a nest egg that's 25 percent smaller. Using historical stock and bond returns over the past 82 years, we found that the higher the withdrawal rate and the more conservatively you invest, the sooner you'll run out of money. The older you are, the less impact a change of strategy will have. There's no guarantee, though, that your assets will grow at the rates we used.

Plan specifics	The dream	Plan B: Withdraw at same rate	Plan C: Withdraw same amount	Plan D: Move to safer investments
AGE 60				
Portfolio value	$600,000	$450,000	$450,000	$450,000
Withdrawal rate	4%	4%	5.3%	5.3%
Amount available	$24,000	$18,000	$24,000	$24,000
Money runs out at age ...	95+	95+	87	83
AGE 70				
Portfolio value	$400,000	$300,000	$300,000	$300,000
Withdrawal rate	4%	4%	5.3%	5.3%
Amount available	$16,000	$12,000	$16,000	$16,000
Money runs out at age ...	95+	95+	95+	93
AGE 80				
Portfolio value	$250,000	$187,500	$187,500	$187,500
Withdrawal rate	4%	4%	5.3%	5.3%
Amount available	$10,000	$7,500	$10,000	$10,000
Money runs out at age ...	95+	95+	95+	95+

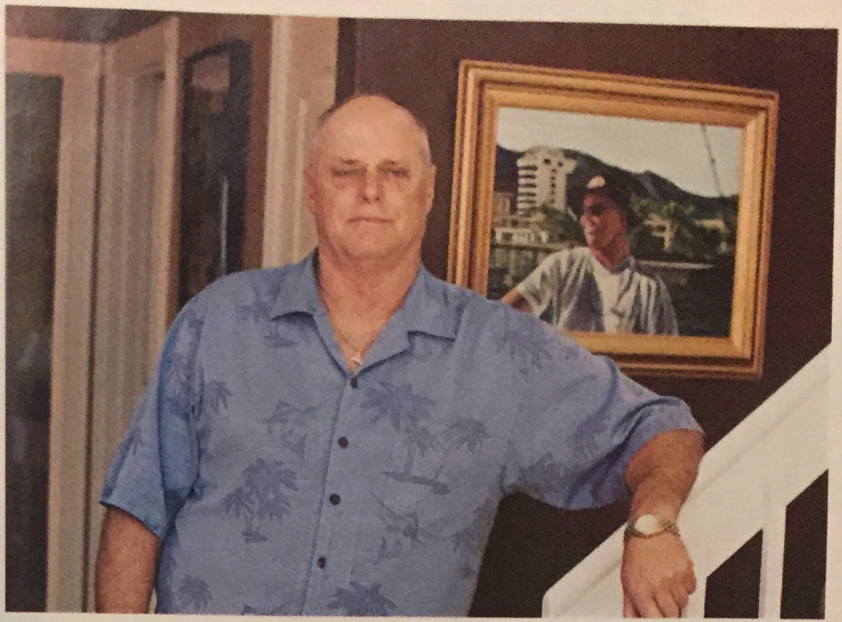
Portfolio split between an investment in a large-cap stock index (60%) and long-term U.S. government bond index (40%). Calculations assume an annual, inflation-adjusted rate of return equal to the average annual performance from 1926 through late 2008. Plan D assumes a 40% stocks/60% bonds allocation. Note: Some figures have been rounded.

Pre-retired

Work longer, keep saving

Life on the sea has been good to boat captain Jay Champlin. It's what has happened on land that has been trouble. The 60-year-old divorcé, who skippers a private yacht, had hoped to sell his home in Jupiter, Fla., within a couple of years and gradually cut back his hours. But declines of about 40 percent in his home's value and 30 percent in his modest retirement savings have forced him to change course. "Like everyone else, I'm going to have to keep working and buckle down," Champlin says.

In our survey, working longer and postponing retirement was a dominant theme among people near retirement. Almost a quarter of pre-retirees said they're uncertain that they'll ever be able to stop working, up from 16 percent in a 2007 survey. More than one-third expected to postpone retirement for at least one year.



STORMY SEAS Boat captain Jay Champlin says he'll probably have to continue working.

Continue to fund your tax-deferred retirement plan.

That's also what financial planners advise. "Generally, they should plan to work a couple more years," Cargile says.

What you can do

Reset your retirement clock. If you're eligible for a pension, and assuming your employer's plan is healthy, working more years can add to your payout, which is often based on salary and number of years worked. Even those without a traditional pension—probably most of us—can use that time to shore up their nest eggs. If you're 50 or older, you can contribute up to $22,000 this year to tax-deferred accounts such as 401(k) plans. According to T. Rowe Price, working three years longer while saving 15 percent of your salary could raise annual retirement income from investments by 22 percent.

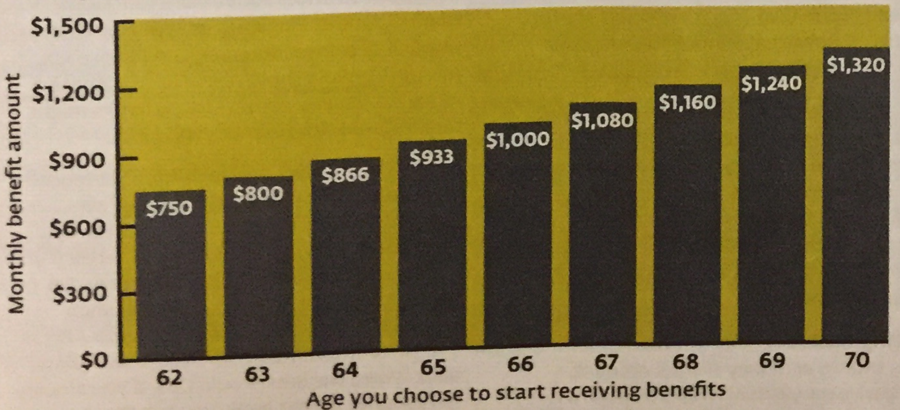
Keep on contributing. Hewitt Associates, a benefits consulting firm, says that only 4 percent of workers have stopped funding their 401(k) plans in this financial malaise. At the least, put enough in to get the full employer match. If your employer no longer matches, try to contribute at least as much as before. If you're able, make up for the match with a higher contribution.

Postpone Social Security payouts. If you expect to retire before qualifying for your full Social Security benefit, try to live without that money initially. As the chart below shows, if you start withdrawing at age 66 rather than the earliest possible age of 62, you'll boost your monthly benefit by one-third. Folks who need the money now can always opt to halt payments later and receive higher benefits; to trigger that, they'll need to pay back what they've already taken. For more information, go to the Social Security Administration's Web site, at *www.ssa.gov*.

Borrow with caution. Our warnings on reverse mortgages are even stronger for younger eligible homeowners. If you live long enough to spend the loan—a possibility if you're in your 60s—you could be back at square one but with far less home equity. Another option, borrowing from your 401(k), if possible, also has pitfalls. For one, if you leave your job or lose it, the loan must be repaid in full or it becomes a taxable distribution.

How much will you get from Social Security?

The longer you wait to start collecting, the more you'll get each month.



Note: This example assumes a benefit of $1,000 at a full retirement age of 66.
Source: Social Security Administration.

PHOTOGRAPH BY JASON NUTTLE

Younger workers

Follow the rules, keep the faith

Berlyann Paz of San Ramon, Calif., had a goal to save $1 million for retirement. "I don't think that's going to happen any more," she says. But Paz, a 35-year-old human-resources manager, probably has a good chance of exceeding her goal, given her saving habits and her remaining years of work before she retires. She and her husband, Wayne, 34, who works in the wireless industry, have 401(k) plans and IRAs from current and former jobs, as well as college savings funds for their daugh-

EARLY START Berlyann and Wayne Paz have time and good saving habits in their favor.

ters, Isabella, 4, and Makena, 6 months.

But Paz recognizes that the landscape has changed. The couple is cutting back on expenses such as gifts and cable-TV services, and sitting tight on listless investments. "We're going to have to work harder for much longer," she says.

What you can do

Stay in the market. With time on their side, young workers such as the Pazes can afford to allocate stocks more heavily, ratcheting slowly downward as they age. Indeed, with stocks at their lowest levels in years, long-term investors with guts can bag some bargains now.

Their plan should include regular contributions to an employer-matched tax-deferred retirement plan at work. Workers in lower tax brackets can also consider tax-advantaged Roth 401(k) or IRA accounts. Maximize returns by investing in funds with no fees and low expenses.

Fund retirement before college. It's never too early to begin saving for your children's education, but you shouldn't put all available cash there. Experts recommend giving priority to retirement saving. You can always borrow to pay for college, but not for retirement.

Pay down the mortgage. In the past we've advised against prepaying your mortgage in favor of making regular investments in an index fund. But in this environment, paying down a home loan might offer better returns than many other investments. Because of the tax deduction, a 6 percent fixed-rate mortgage actually costs a homeowner in the 28 percent tax bracket about 4 percent. That's your return on money you put toward paying down your mortgage, and it's certainly higher than recent stock market performance and somewhat higher than current after-tax returns of a five-year CD.

Adding just $50 to the monthly payment on a $200,000, 30-year fixed-rate mortgage at 6 percent can shrink the mortgage duration by about three years and save almost $28,000 over the life of the loan (not accounting for tax deductions). Bloomberg.com has a calculator (*www.bloomberg.com/invest/calculators/mortgage.html*) that will help you assess prepayment savings.

Start early and diversify. Survey respondents who said they started saving in their 20s and 30s were far more satisfied with their retirement prospects than were those who started later. They also reported higher net worth, though we don't know how much of that came from retirement savings. Diversifying savings vehicles also affected satisfaction with retirement plans. Those who used six or more—401(k)s, IRAs, taxable accounts, home equity, CDs, and real estate, for instance—were more satisfied than those who used three or fewer ways to save.

Where to stash your cash cushion

Last fall investment guru Jim Cramer urged millions of TV viewers to cash out money from stocks that they'll need in the next five years to weather the approaching storm.

Few of the financial planners we interviewed came close to that state of alarm. Many said that retirees should have at least one year's worth of expenses in cash (bank accounts or money-market funds). Another major portion of retirees' portfolios should be in fixed-income investments. Working people should have an emergency fund equal to about three to six months of expenses.

Safe and insured

Some of the best rates for super-safe, FDIC-insured savings, certificates of deposit, and money-market accounts have been offered by banks that were reportedly in trouble, such as Corus Bank in Chicago; Flagstar Bank in Troy, Mich.; and GMAC Bank, part of the financing arm of General Motors. Deposits in FDIC-insured banks are covered up to $250,000 per depositor. (That coverage is due to drop to its historical rate of $100,000 at the end of this year.) Go to *www.fdic.gov* for details on how to maximize your deposit-insurance coverage.

When a distressed bank is acquired by another bank, the money is still insured. It usually takes no more than two business days to access your money. The only risk is that the acquiring bank doesn't have to honor the interest rate offered by the prior bank. That makes long-term, high-rate CDs from troubled banks less attractive.

Finding the deals

For a savings or money-market account, compare bank yields on Web sites such as Bankrate.com with those you can get at local banks. In early December, for example, Flagstar Bank offered a money-market account with an annual percentage yield of 3.55 percent. Money-market accounts usually have a minimum balance requirement (although there is none at Flagstar) and limits on the number of transactions you can make each month. To avoid those restrictions, choose a regular savings account. Online banks might offer higher rates on those accounts.

Bank CDs are another safe option. Six-month and one-year CDs were both paying, on average, around 3 percent in December. You might be able to earn a tad more interest if you buy your CDs through a brokerage firm. For example, in early December Merrill Lynch offered three- and six-month CDs with APYs of 3.75 percent. Just make sure you know which bank issued the broker-sold CDs. If you already have money in that bank, you run the risk that your total deposits might exceed the FDIC coverage limits.