WORTH A LOOK

News & Investment Insights for Retirement **Plan Participants** • Vol. 11/No. 2/Summer 2008

2 WHAT TO DO WITH YOUR TAX RELIEF CHECK

3 OVERCOMING YOUR FEAR OF LOSS

4 BEST PRACTICES: IN PLAYING CATCH UP

Seven Steps to Surviving a Rocky Ride

What should you do when investment markets get turbulent, as they have in recent months? Doing as little as possible could be the best solution, especially if you are investing for a long-term goal. Here are seven steps to surviving a rocky ride.

1 – Don't Panic.

Staying calm can save you money and stress. If you react every time the markets hit a jolt, you could be doing a lot of worrying—and buying and selling needlessly. That could put your money and your savings goals at risk. If you have a health condition, such as an ulcer or high blood pressure, panicking could worsen it. Don't fixate on the market, and stay away from up-to-the-minute market reports, particularly if your focus is decades away. Instead, take a deep breath, relax, and move on.

2 – Don't Time the Market.

In order to time the market successfully, you must make the right short-term market forecast not just once but twice. What are the odds of that? Most people are not successful at this, partly because they react after the market has already made a decisive move up or down. Or they anticipate a turnaround far too early. Instead of actively trading, some regrouping and reviewing might help.

3 – Regroup and Review.

Take a step back and reflect on your long-term investment strategies. Regardless of short-term market swings, are you doing the right things in order to meet your goals? Review your progress. Consider corrective actions if needed—perhaps increase your retirement contributions if you have fallen behind or shift your asset allocation if that makes sense as part of your long-term plan. Most importantly, get back to basics.

4 – Buy and Hold.

The more you trade in and out of the market, the greater the potential for costly mistakes. Not only do you risk making the wrong decision or acting at the wrong time, but frequent activity in an investment account can cut into your returns through higher transaction costs and potential tax liabilities.

5 – Asset Allocation.[1]

The most important factor in determining your investment returns is your asset allocation. A couple of landmark studies in 1986 and 1991 determined that asset allocation was responsible for more than 90% of the variability of investment returns among pension funds.[2] Why focus needlessly on the remaining 8% when you can achieve so much simply through asset allocation?

(Continued on page 4)

Dear Participant:

Investment markets can be volatile, and the past year has tested the patience and peace of mind of many investors as stocks and bonds have been more turbulent than usual.

To help you through this challenging time, we tackle the topics of "Surviving a Rocky Ride" and "Overcoming Your Fear of Loss."

We also offer practical tips on what you can do with your economic stimulus tax relief check, which many people have received in the past few weeks, and how to play catch-up with your retirement contributions if you hear the clock ticking and you feel you need to save more.

Sincerely,

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Vice President
Worth A Look Publisher

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What to Do With Your Tax Relief Check?

From late April through mid-July, an estimated $168 billion in economic stimulus tax rebate checks were to be distributed to more than 130 million taxpayers. The base amount of $600 per single taxpayer or $1,200 for couples plus $300 for each dependent child could help people make ends meet, pay off debt, or climb out of a small financial hole.

The intent of the checks is to stimulate economic activity. But in reality, many people might not use the money for its original purpose. Some simply will use it to help pay their monthly bills, which include rising food and fuel costs. Many will use the cash to help pay down their family's mounting debt. Others might feel like it's a holiday in June or July and treat themselves to the latest flat-screen TV, laptop computer, or perhaps go on a shopping spree for smaller-ticket items.

Let's assume you are a married couple with two children and receive a $1,800 windfall. What could you do with it? Here are some typical recommendations by financial advisors:

1) **Build your emergency reserve fund.** It's a top priority precisely because you don't know when you'll need to tap it or what you'll need it for—it could be a job loss, illness, accident, or divorce. By having enough money handy to cover three to six months of living expenses, you'll be able to breathe easier—just in case you need it. A sum of $1,800 could kick-start this fund and you could keep building it by adding $100 a month or more.

2) **Pay down your credit card debt.** A credit card balance of $5,000 on which you pay 18% interest would cost you $900 a year in interest charges. You could probably find many better things to do with $900.

3) **Pay all current bills.** Don't let yourself fall behind on your monthly obligations. You could channel some money into a bill-paying account so that you're able to pay off what you owe each month.

4) **Save for retirement or college tuition.** You can add an extra percent to your 401(k) deferral. Or you might open a 529 college savings plan and put in $50 a month, and your savings will grow tax-deferred, and distributions for higher education expenses are free from federal income tax. It's hard to argue with contributing to your retirement fund or saving for your children's or grandchildren's education.

5) **Pay for home repairs.** If you have neglected some area of home upkeep, a windfall of close to $1,800 could defray certain costs, such as a new roof, repainting, repaving, or re-flooring.

6) **Make your home more green.** Invest in improved energy efficiency, which will pay dividends by reducing your energy use over the next five or 10 years or longer. This could include energy-efficient windows and ENERGY STAR-rated appliances and heating systems. Some states offer rebates for purchasing ENERGY STAR-rated appliances and other "green" improvements.

7) **Treat yourself.** Indulge in that home entertainment center or must-have electronic item. If you have been savoring a major purchase, why not go for it now that you have the money to pay for it?

There are so many choices. Whatever you do, think your options through and try to make a decision that makes sense today and will sit right tomorrow and next year.

Overcoming Your Fear of Loss

"The only thing we have to fear is fear itself."

Investors would be wise to heed these famous words of Franklin D. Roosevelt, which gave Americans hope during the Great Depression of the 1930s. Studies, including some by noted psychologists Daniel Kahneman and Amos Tversky, have found that investors consistently are more concerned with avoiding the pain associated with losses than with seeking the satisfaction of investment gains. In other words, the joy of earning or winning money can't compete with the pain or fear of losing money.

In one study, Kahneman and Tversky asked people a couple of questions to distinguish the difference between two decisions that involved possible gains and losses of an equivalent expected value.

1. You have $1,000 and you must choose one of the following:
   - A) Take a 50% chance of gaining $1,000 and a 50% chance of gaining $0.
   - B) Take a 100% chance of gaining $500.

Faced with this choice, 84% chose answer B, which suggests they were "risk averse" and willing to settle for a modest gain, despite having a decent chance (50/50) of earning more.

2. You have $2,000 and you must opt for one of these two choices:
   - A) Take a 50% chance of losing $1,000, and a 50% chance of losing $0.
   - B) Take a 100% chance of losing $500.

Faced with this choice, 69% chose answer A. This suggests that most people were willing to accept risk of loss when there was the same possibility (50/50) of avoiding a loss.[1]

What implications does this have?

As a group, people are much more likely to sell their investment gains and to hold onto losses. While this may not seem very rational—why sell winners and keep losers?—it is consistent with human nature. Who would want to make 100% sure that they'll lose money? Who wants to admit that they made a mistake?

What does this mean to you as an individual investor?

- First, be aware of the irrational tendency to hold onto losing investments.
- Put a plan in place to help you override the fear of loss or to help you overcome your worst tendencies as an investor. For example, get help from a financial planner, or put your investments on autopilot.

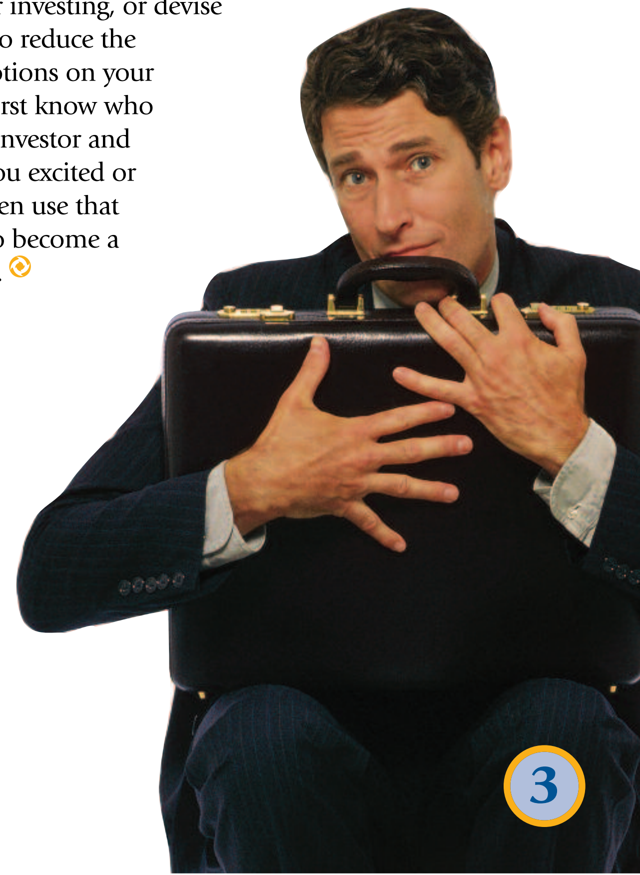
Make it automatic

Automating various aspects of investing can reduce the second-guessing that often occurs in decision-making. For example, if you have money automatically placed in your retirement plan through a payroll deduction, it spares you from thinking about whether to invest, when or how much. This is a form of dollar-cost averaging, which can also be advantageous, as it may instill the discipline of investing regularly and steadily through market ups and downs. The hardest time (psychologically) to invest can be the best time to invest.

Be systematic

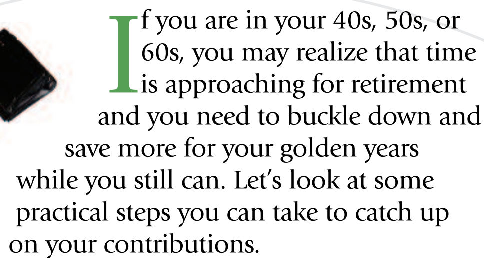
Similarly, when withdrawing money after you retire, use a systematic withdrawal plan. By regulating the amount and frequency of your withdrawals, you can limit the chance of making the costly mistake of selling all investments when they're at a low point. Just as diversifying into a variety of investments can lower risk, so can staggering the time when you buy or sell investments.

Whether you work with an advisor, automate your investing, or devise another plan to reduce the impact of emotions on your investments, first know who you are as an investor and what makes you excited or fearful, and then use that information to become a better investor.



[1] "Prospect Theory: An Analysis of Decision Under Risk," D. Kahneman and A. Tversky, Econometrica 47, March 1979, p. 263-291.

BEST PRACTICES: In Playing Catching Up



If you are in your 40s, 50s, or 60s, you may realize that time is approaching for retirement and you need to buckle down and save more for your golden years while you still can. Let's look at some practical steps you can take to catch up on your contributions.

Find out what you need. Begin by assessing how much income you'll need in retirement and how much of that will have to come from your savings (as opposed to Social Security benefits, a possible company pension, or other sources). Use a calculator, such as one on the Transamerica Web site: **www.TA-Retirement.com**. Click on "Employees," "Resources," and then "Investment Calculators."

Commit to saving. Once you can estimate a target for your desired or required nest egg, commit to saving what you need to in order to reach that goal.

Free the money. Use a variety of techniques to shift the money from its current uses.

- *Change priorities:* Make retirement savings your top priority. Put other items on a backburner if you have to.
- *Make it automatic:* Payroll deduction makes it easy. Also, you could arrange for automatic transfers from your bank account to an individual retirement account (IRA).
- *Make smart sacrifices:* As part of changing priorities, reflect on what sacrifices make the most sense. For example, if you are now an empty nester, perhaps you can do well with less living space. Downsizing could free up quite a lot of money in home equity. And a smaller, less expensive home likely will reduce your property taxes and utility bills.

Review your asset allocation. With retirement approaching, it's natural to want to ramp up your expected investment returns. But the problem is that with diminished time before you'll need to draw down the money, there's less time to recover from an investment loss. So, it can be a bit tricky to know just how to best allocate your assets.

One rule of thumb is to subtract your age from 120 to determine the percentage of your money that should be invested in stocks or stock mutual funds. For example, at age 60, you'd subtract your age from 120 to arrive at 60% to be allocated to stock funds, with the remaining 40% going to bond funds and stable value funds.

Monitor your performance and progress. Every year, do a full analysis and review of the performance of your investments and of your progress towards your investment goals. Make changes to your approach as needed.

By being dedicated and placing a top priority on catching up, you can do it!

Seven Steps to Surviving a Rocky Ride

(Continued from cover)

6 – Dollar Cost Average.[3]

By investing the same dollar amount through market highs and lows, you can accomplish a few important things. First, you avoid the second-guessing that people typically go through when unsure about a tough decision. Secondly, you can potentially lower your price per share by buying fewer shares when the share price rises and more shares when the price falls. And anything that keeps you contributing regularly towards your retirement or another major goal makes sense.

7 – Maintain a Long-term Focus. This may cure the temptation to time the market and it can make it easier to avoid panicking, to buy and hold, and to benefit from dollar cost averaging. Best of all: It may make short-term turbulence feel like a speed bump.

[1]Asset allocation and diversification do not assure or guarantee better performance and cannot eliminate the risk of investment losses.
[2]Gary P. Brinson, L. Randolph Hood, and Gilbert L. Beebower, "Determinants of Portfolio Performance," The Financial Analysts Journal, July/August 1986. Gary P. Brinson, Brian D. Singer, and Gilbert L. Beebower, "Determinants of Portfolio Performance II: An Update," The Financial Analysts Journal, Vol. 47, No. 3, May/June 1991.
[3]Dollar cost averaging does not guarantee a profit or protect against a loss.

WORTH A LOOK is published quarterly by Transamerica Retirement Services. The newsletter's mission is to provide timely, relevant information that participants in retirement plans administered by Transamerica can put to work as they develop investment strategies to achieve their financial objectives.

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TRS 3427-0608