The Importance of a Steady Investment Approach for Retirement Success

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Executive Summary

Unified Trust Company examined the impact of the current financial market crisis on a typical plan participant still in the accumulation phase. Many of these participants right now are asking themselves two major questions. First, *"Is it worthwhile to continue to contribute to the plan?"* And second, *"Is it prudent to hold in my account a diversified portfolio with equities, or should I be completely holding fixed income?"*

We examined three possible decade-long equity market outcomes (delayed recovery, steady recovery or no recovery—i.e. stagnant) to see the impact on the strategies for the plan participant. We also examined whether or not contributing to the plan and maintaining a steady asset allocation balanced between equities and fixed income made sense.

Our conclusion is that a plan participant in the accumulation phase should maintain a balanced asset allocation, in conjunction with continuing contributions and continuing rebalancing. Rebalancing was the dollar equivalent of about 1 ½ years of added contributions. The largest ending account balance occurred in both the delayed and steady equity recovery scenarios using rebalancing and continuing contributions. The delayed equity recovery gave a higher balance than the steady recovery.

An often overlooked impact of continuing contributions, dividends and rebalancing is the steady increase in the number of equity shares held over time. Even with minimal market returns the effect of additional equity shares has a powerful impact on ending account value.

We found even if the stock market is stagnant over the next decade, the benefit gained by moving to a fixed income portfolio <u>now</u> is minimal. For the 100% fixed income investor only the worst-case scenario (the stagnant market) provided a greater ending account balance, but just a minimal extra benefit. If a contributing participant invested in 100% fixed income during the stagnant market scenario they would accrue approximately 12.1% more than a participant using a diversified rebalanced portfolio. However, in the delayed market recovery scenario, the contributing participant using a diversified rebalanced portfolio would have 26.4% more than the contributing participant in the fixed income portfolio.

Background

This past year will go down on record as one of the worst years for the financial markets. The harsh economic climate has created a great deal of uncertainty around the world. That's because during 2008, which began with a moderate real estate slowdown, ended with the nation caught in the grip of its most severe economic downturn in a generation. The U.S. and global stock market losses last year of a heart stopping -35% to -55% were the worst since well before World War II—in fact since 1931.

The United States and other countries are caught in the grip of what will likely be a long and painful recession. This nation's economic difficulties which have been apparent in housing for more than a year and in other areas for a shorter span of time worsened noticeably in the fourth quarter. That period, which ended with one of the poorest holiday shopping seasons on record, may have seen U.S. gross domestic product tumble by -5%, or so.

Even worse, it is clear that the economics are still not favorable for 2009—at least through the first half of the year. The U.S. recession that the National Bureau of Economic Research declared began in December 2007 will likely linger through at least mid-2009 under pressure from a broad range of issues, including very tight credit, nonexistent consumer confidence and a fall in housing prices that has not yet hit bottom.

To be sure, investor confidence has been hurt by months of unrelenting declines in the value of 401(k)s, IRAs, and other such vehicles. Plans of retirees and of those much younger also have been revised by the painful market slide. Keeping a long-term perspective doesn't make it easier to live through the current downturn, but it does reinforce the notion that steady investors will get through it.

For many investors this bear market feels different. In fact, every bear market is different, but past market downturns have been similar. With this difficult situation as a backdrop we wanted to examine the impact of different market scenarios on the average 401(k) plan participant.

Basic Assumptions

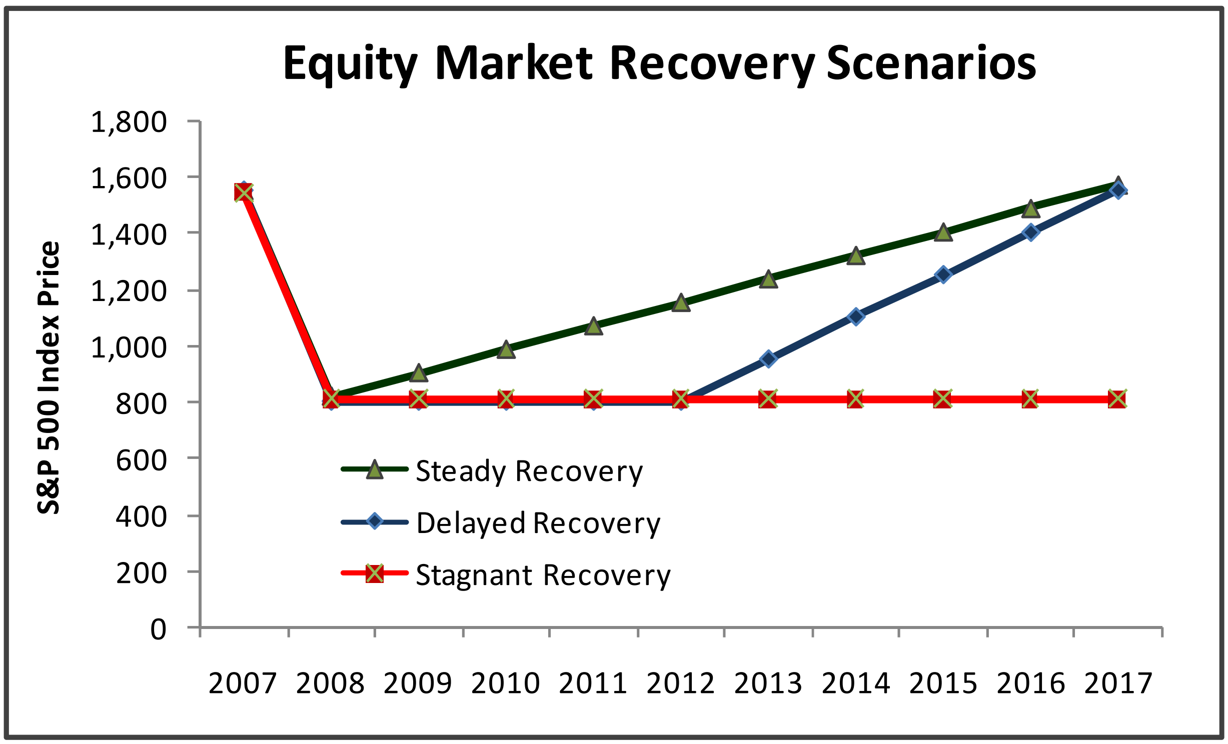
The plan participant is still in the accumulation phase. He had a $100,000 401(k) account balance at the end of 2007, and due to the 2008 market he only had $78,587 at the end of 2008. (The results were an investment loss of -26.41% in 2008 counting new contribution cash flow.) When contributing he saves $5,000 per year. His investment choices consist of either the 60% equity and 40% fixed income portfolio, or 100% fixed income. The annual equity dividend is 2.00% and the annual fixed income interest coupon is 5.00%.

Possible Equity Market Scenarios

We examined three possible decade-long equity market outcomes to see the impact on the strategies for the plan participant. The delayed recovery scenario assumed no recovery in stock prices for the next four years, and then a gradual recovery back to the peak index prices for the S&P 500 (1,550 reached in 2007) by the end of 2017. The steady recovery scenario assumed a recovery in stock prices beginning in 2009 and also reaching a full recovery to 2007 prices by the end of 2017.

Finally the stagnant equity market recovery scenario assumed no recovery in stock prices for the next nine years. We assumed the S&P 500 would stay at the current price level of roughly 800 until the end of 2017. We also examined whether or not contributing to the plan and maintaining a steady asset allocation balanced between equities and fixed income made sense.

These are not predictions of the future, but rather an examination of three possible outcomes.



1. Delayed Equity Market Recovery. The delayed recovery scenario assumed no recovery in stock prices for the next four years, and then a gradual recovery to the peak prices reached in both 2000 and 2007 for the S&P 500 at 1, 550. We assumed the S&P 500 would stay at the current price level of 800 for the next four years and then recover over 2013- 2017 to reach its 2000 and 2007 peaks of 1,550.

Since the S&P 500 also peaked at roughly 1,550 in early 2000, this scenario would imply no change in stock prices for an 18 year period ranging from early 2000 to end of 2017.

2. Steady Equity Market Recovery. The steady recovery scenario assumed a recovery in stock prices beginning in 2009 and reaching a full recovery to 2000 and 2007 prices. We assumed the S&P 500 would stay at the current price level of 800 and then gradually recover to its 2007 peak of 1,550 by the end of 2017.

Since the S&P 500 peaked at roughly 1,550 in early 2000, this scenario would also imply no change in stock prices for an 18 year period from early 2000 to end of 2017.

3. Stagnant Equity Market with No Recovery. The stagnant equity market recovery scenario assumed no recovery in stock prices for the next nine years. We assumed the S&P 500 would stay at the current price level of roughly 800 until the end of 2017.

Since the S&P 500 peaked at roughly 1,550 in early 2000, this scenario would imply nearly 50% negative return in stock prices over an 18 year period from early 2000 to end of 2017.

Possible Plan Participant Behavior

Five possible plan participant behaviors were examined. These cover the ranges of behavior from maintaining the recommended current status quo to a "despondent" participant giving up.

1. Continue Contributions and Re-Balance a Diversified Portfolio. This scenario assumes that the participant contributes 5% of compensation each year and maintains a 60% equity 40% fixed income portfolio that is rebalanced one time at the end of each year.

2. Continue Contributions and Omit Re-Balancing in a Diversified Portfolio. This scenario assumes that the participant contributes 5% of compensation each year and does not rebalance a 60% equity 40% fixed income starting portfolio.

3. Continue Contributions and Move to a 100% Fixed Income Portfolio. This scenario assumes that the participant contributes 5% of compensation each year and changes the portfolio allocation to 0% equity and 100% fixed income portfolio.

4. Discontinue Contributions and Freeze Current Portfolio. This scenario assumes that the participant ceases to contribute and maintains the portfolio allocation at the 60% equity and 40% fixed income portfolio.

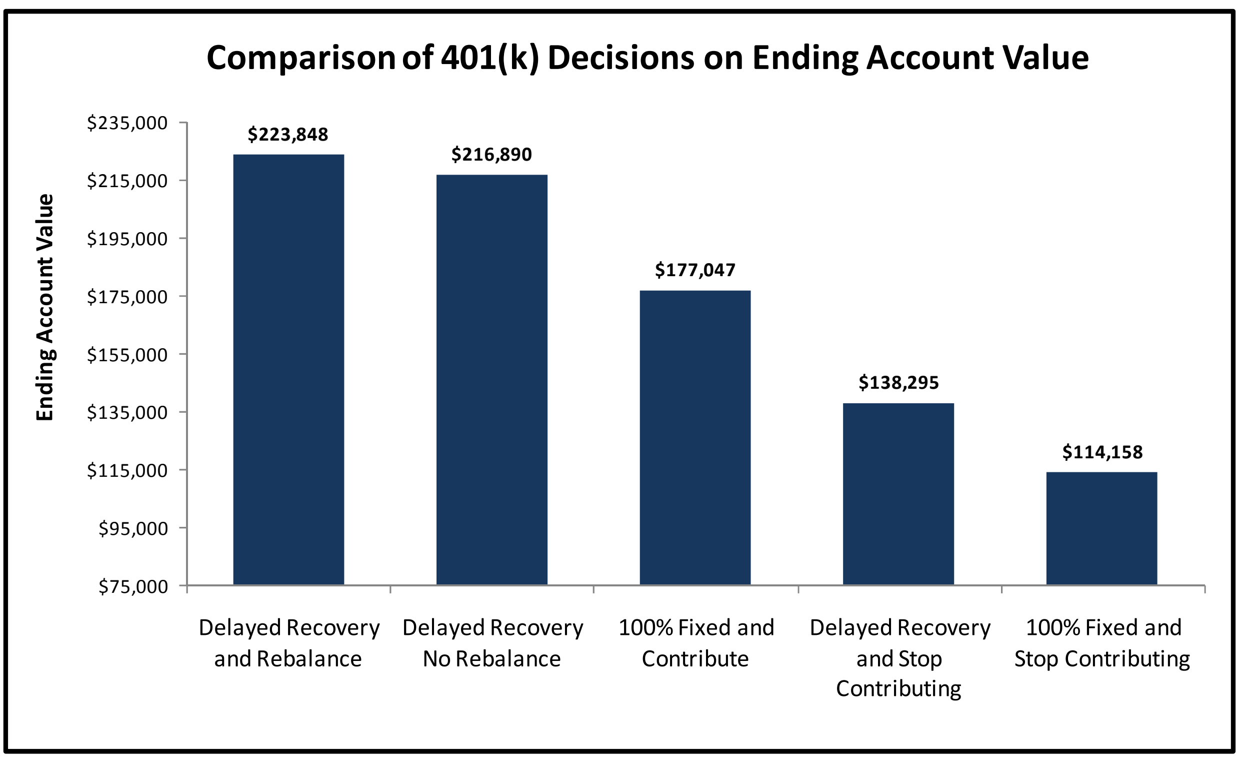
5. Discontinue Contributions and Move to a 100% Fixed Income Portfolio. This scenario assumes that the participant ceases to contribute and changes the portfolio allocation to 0% equity and 100% fixed income portfolio.

Market Scenario Whereby a Delayed Equity Market Recovery Occurs

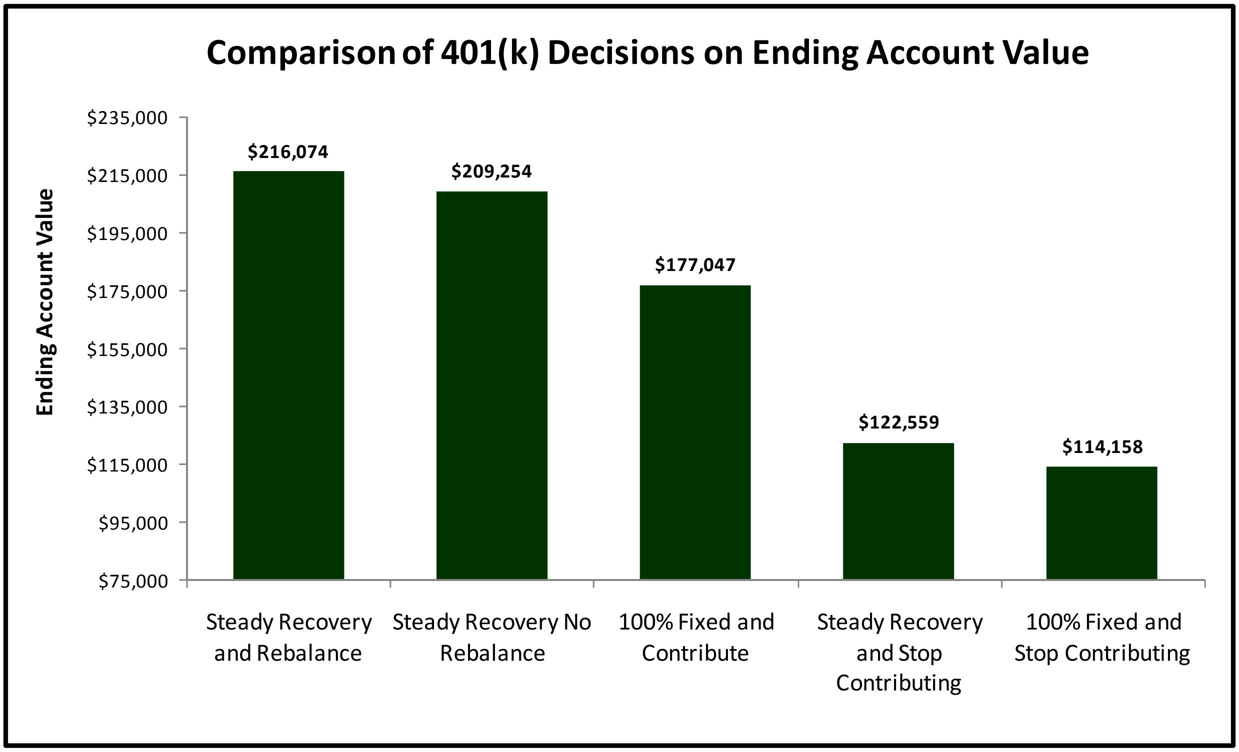
At first blush this would seem to be a very pessimistic scenario for most 401(k) participants still in the accumulation phase. They would continue to make contributions to their plan and see nonexistent price gains in the stock market over the next four years. No doubt it might appear to some that the equity market would never recover. However if the S&P 500 does reach its historical 2000 and 2007 prior highs of 1,550 by 2017 under this scenario the steady plan participant has the largest ending balance.

The largest account balance was accrued by the participant who made continuing annual contributions and also rebalanced. The effect of rebalancing added an amount worth about 1 1/2 years of annual contributions to the ending account balance.

In the delayed market recovery scenario, the contributing participant using a diversified rebalanced portfolio ($223,848) would have 26.4% more than the contributing participant in the fixed income portfolio ($177,047). The participant by far the worst off was the one invested 100% in fixed income and who ceased to contribute. The contributing participant using a diversified rebalanced portfolio ($223,848) would have 96.1% more than participant holding 100% fixed income and also who ceased to contribute ($114,158).



2. Steady Equity Market Recovery. The steady recovery scenario assumed a recovery in stock prices beginning in 2009 and reaching a full recovery to 2000 and 2007 prices. We assumed the S&P 500 would stay at the current price level of 800 and then gradually recover to its 2007 peak of 1,550 by the end of 2017.



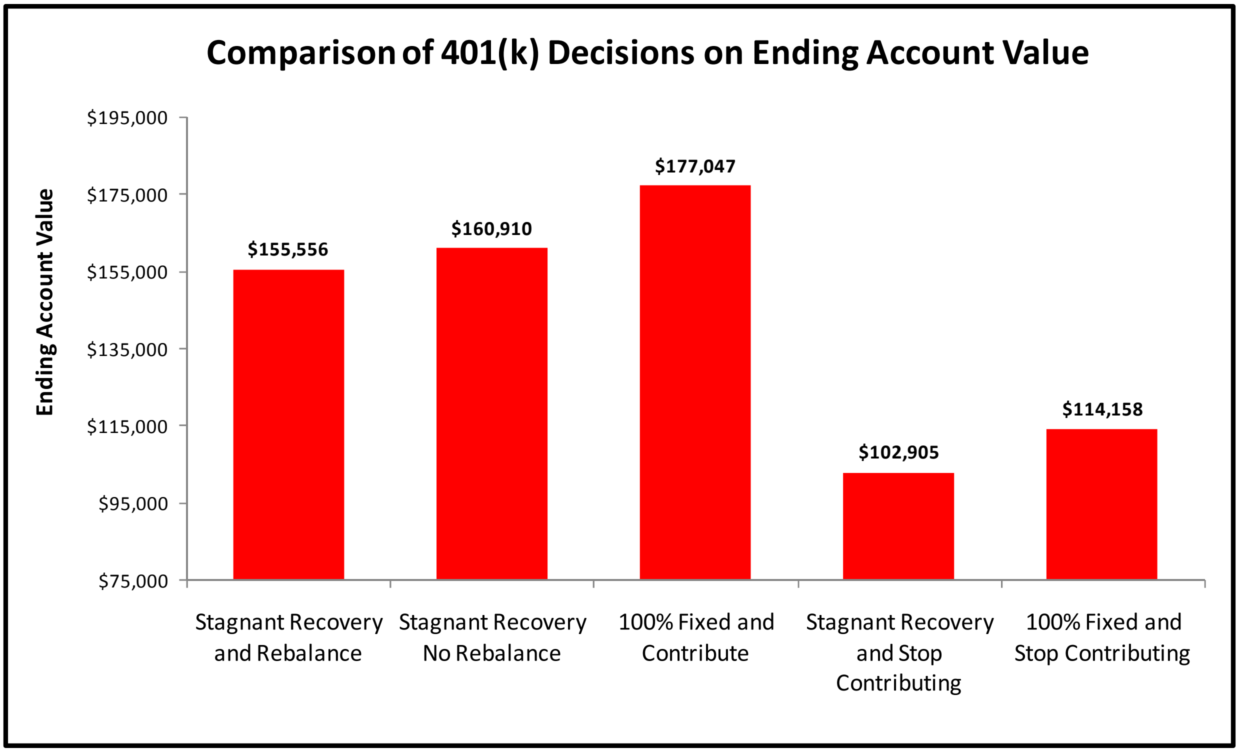
Again, under this scenario the largest account balance was accrued by the participant who made continuing annual contributions and also rebalanced. The effect of rebalancing again added an amount worth about 1 1/2 years worth of annual contributions to the ending account balance.

In the steady market recovery scenario, the contributing participant using a diversified rebalanced portfolio ($216,074) would have 22.0% more than the contributing participant in the fixed income portfolio ($177,047). The participant by far the worst off was the one invested 100% in fixed income and who ceased to contribute. The contributing participant using a diversified rebalanced portfolio ($216,074) would have 89.3% more than participant holding 100% fixed income and also who ceased to contribute ($114,158).

Note that the steady market recovery scenario produced a smaller ending account balance than the delayed market recovery scenario for those participants who held any equities. An often overlooked impact of continuing contributions and rebalancing is the steady increase in the number of equity shares held over time. Even with minimal market returns, the effect of additional equity shares has a powerful impact on ending account value. This effect is greater the longer the market recovery is delayed.

3. Stagnant Equity Market with No Recovery. The stagnant equity market recovery scenario assumed no recovery in stock prices for the next nine years. We assumed the S&P 500 would stay at the current price level of roughly 800 until the end of 2017. This is clearly the most pessimistic of the three scenarios.

Since the S&P 500 peaked at roughly 1,550 in early 2000, this scenario would imply nearly -50% return in stock prices over an 18 year period from early 2000 to end of 2017.



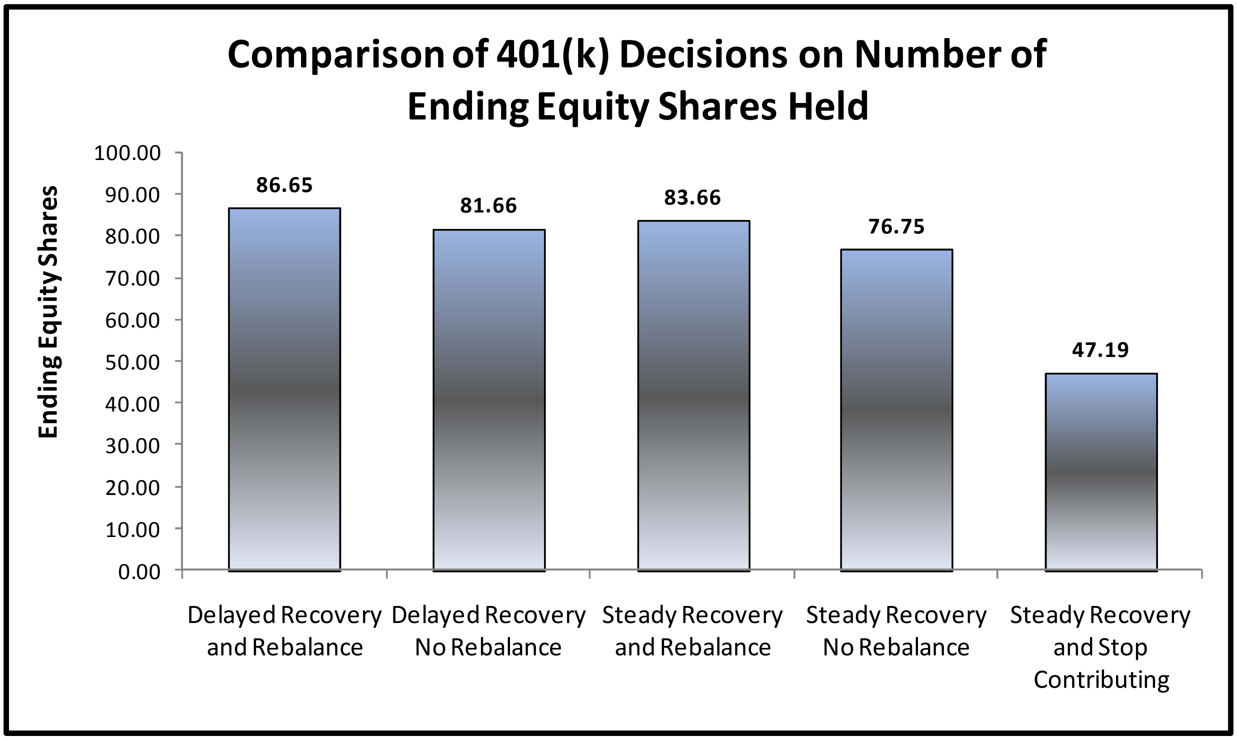
We found even if the stock market is stagnant over the next decade the benefit gained by moving to a fixed income portfolio <u>now</u> is minimal. For the 100% fixed income investor, only the worst-case scenario (the stagnant market) provided a greater ending account balance, but just a minimal extra benefit.

If a contributing participant invested in 100% fixed income during the stagnant market scenario they would accrue approximately 12.1% ($177,047 vs. $155,556) more than a participant using a diversified rebalanced portfolio.

This was also true for the non-contributing participant that chose to move their accounts entirely in fixed income as they would accumulate approximately 9.9% more ($114,158 vs $102,905). In addition this scenario did not show a benefit from rebalancing.

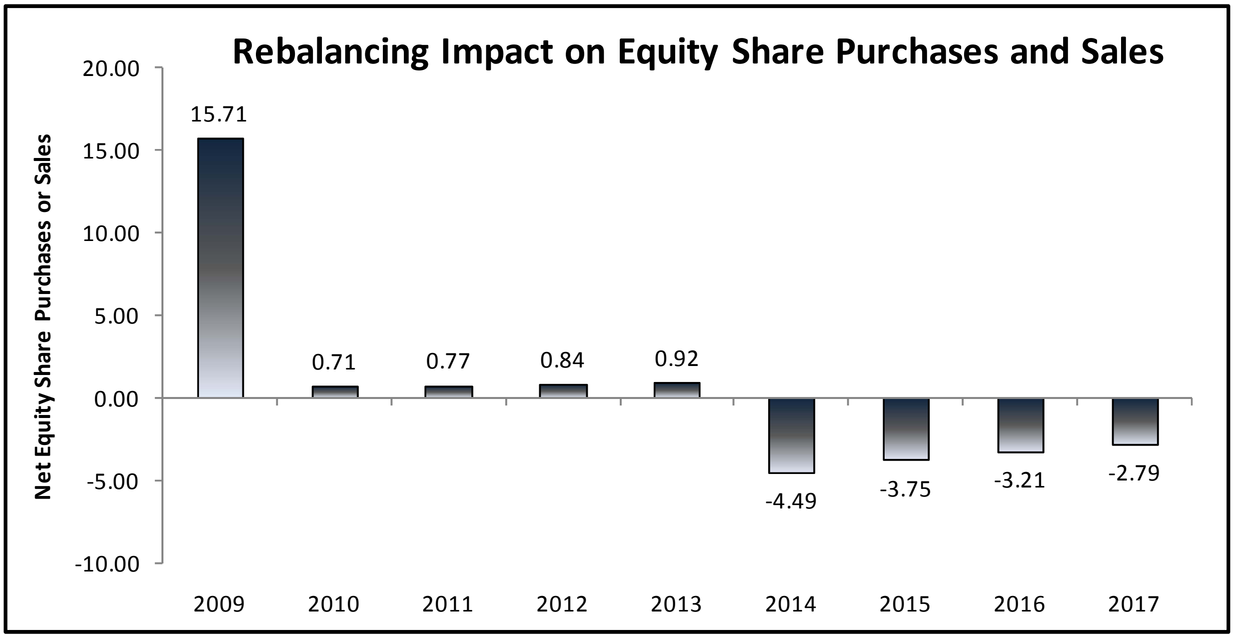
Powerful Impact of Additional Equity Share Purchases over Time

An often overlooked impact of continuing contributions and rebalancing is the steady increase in the number of equity shares held over time. Even with minimal market returns the effect of additional equity shares has a powerful impact on ending account value. This effect is greater the longer the market recovery is delayed. For this example, the equity shares are bought by the price of the S&P 500.

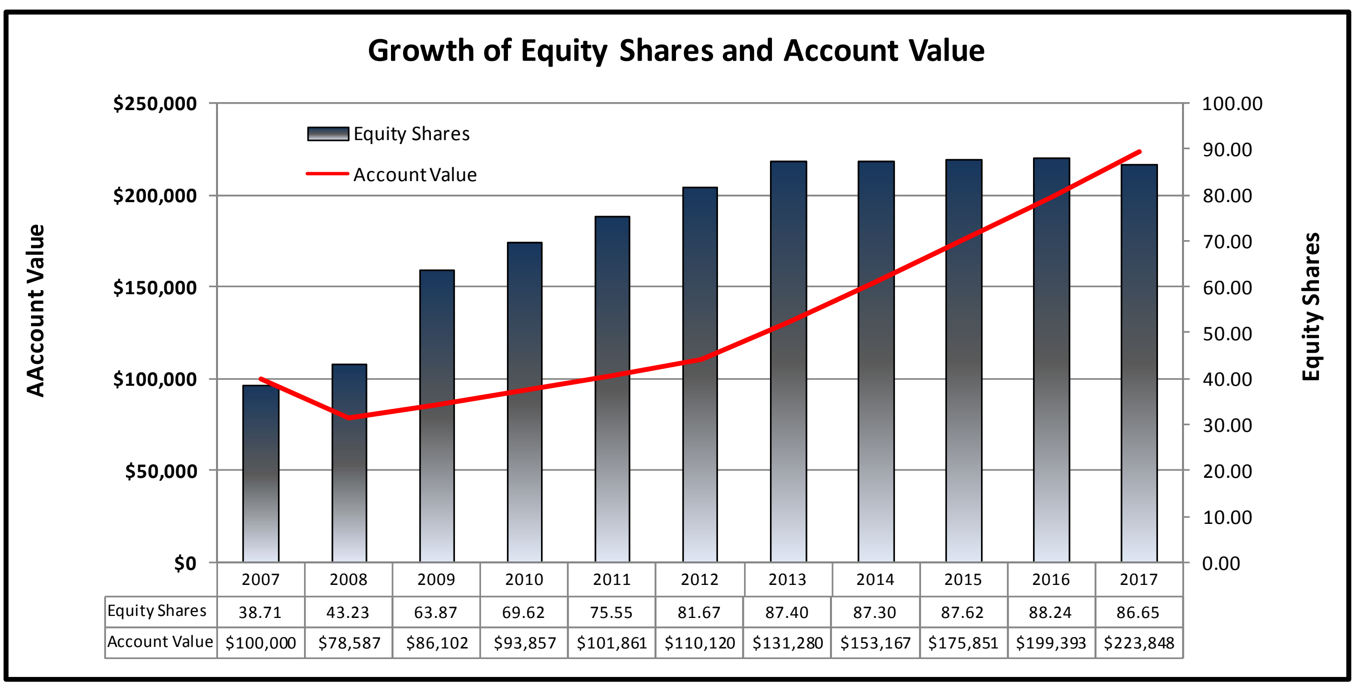


The greatest number of equity shares was accumulated by the participant that makes ongoing contributions and rebalances back to the original 60% equity target each year. The fewest number of equity shares are held by participants that do not rebalance and do not make additional contributions. This is because as market prices fall the rebalancing and new contributions effect far more share purchases than they did earlier. Many more shares are purchased at the S&P 500 price of 800, versus the S&P 500 price of 1,550.

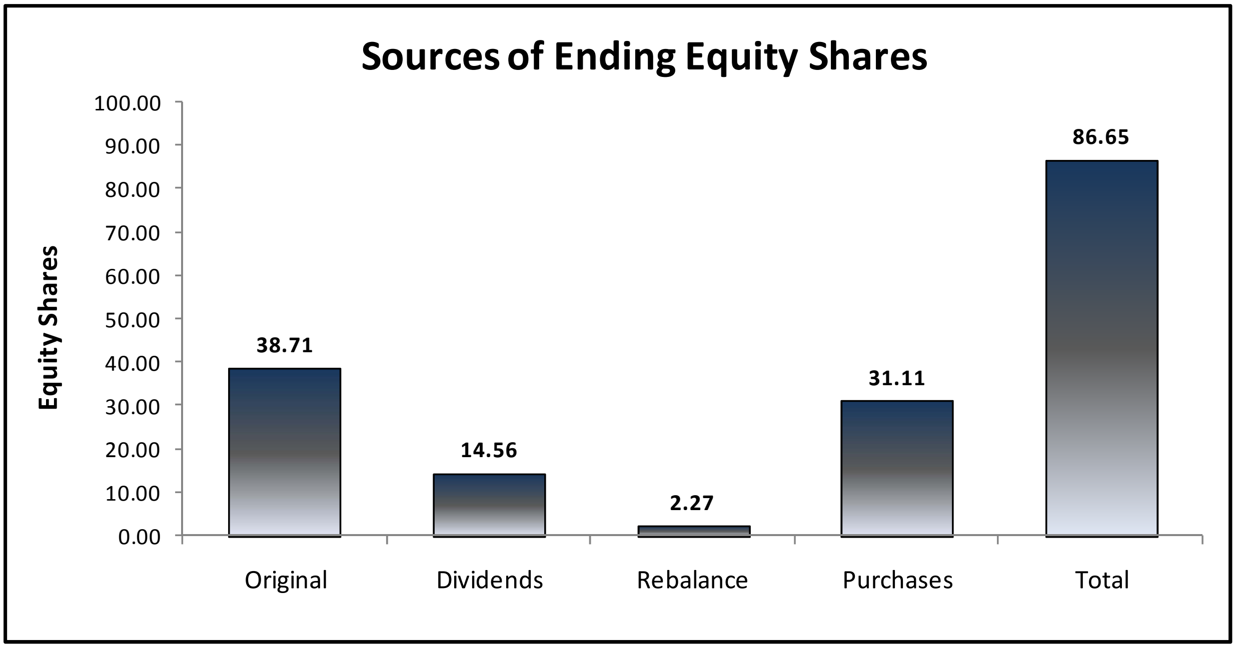
The sources of additional total equity shares include the original amount, reinvested dividends, (this study assumed no capital gain distributions) rebalancing and new purchases from contributions. Rebalancing accounted for a significant amount of net additional equity share purchases in the early years when share prices were the cheapest. However rebalancing reduced equity share holdings during times when the equity market outperformed fixed income.



Over time during conditions of the assumed market recovery the pace of equity share purchases tapers off. But early on in a down market the effect of rebalancing, dividends and new contributions is very powerful. In the delayed recovery scenario, the number of equity shares from 2007 to 2011 in the account nearly doubles (from 38.71 to 75.55) while the account balance barely grows from $100,000 to $101,861.



	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Equity Shares	38.71	43.23	63.87	69.62	75.55	81.67	87.40	87.30	87.62	88.24	86.65
Account Value	$100,000	$78,587	$86,102	$93,857	$101,861	$110,120	$131,280	$153,167	$175,851	$199,393	$223,848



Conclusion

Our conclusion is that a plan participant in the accumulation phase should maintain a balanced asset allocation, in conjunction with continuing contributions, reinvested dividends and continuing rebalancing. The largest ending account balance occurred in both the delayed and steady equity recovery scenarios using rebalancing, reinvesting all dividends and continuing contributions.

Only the most pessimistic scenario of zero equity price appreciation over the next decade enables the plan participant moving to fixed income now to have a higher ending account balance. However the dollar gain, even if correctly anticipated, is minimal under this approach.

About Unified Trust Company, NA

Unified Trust Company is a national bank trust company regulated by the Office of the Comptroller of the Currency. Unified Trust has over $1.3 billion in discretionary assets and a total of $1.6 billion in fiduciary advised assets. We utilize fiduciary "Best Practices" and were the first trustee certified by CEFEX in the United States for fiduciary excellence--the "Prudent Expert" Standard.

As a nationally recognized expert in the management of fiduciary risk, Unified Trust is one of a select few institutional trustees nationwide that accepts responsibility as an active, discretionary trustee and named fiduciary, shouldering a large portion of the fiduciary liability burden.

Unified Trust will bring the UnifiedPlan℠ to market in the summer of 2009. Many studies show most 401(k) plan participants will not receive an adequate benefit when they retire. A traditional defined benefit pension plan often produces better results for most employees. The UnifiedPlan℠ effectively manages each 401(k) plan participant as if it was their personal retirement plan. All investment and actuarial decisions are handled by the discretionary trustee.

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