State of Illinois Deferred Compensation Plan

Insight

Second Quarter 2015

Bruce Rauner, Governor

Balancing Act

Make retirement savings a priority, even as you juggle other financial considerations.

Your kids need braces, the car is on its last legs, and the driveway is crumbling. Tack on the cost of saving for your children's college education and other everyday living expenses, and you might be tempted to push retirement savings to the back burner. Don't. While this may seem like a good short-term solution, delaying or decreasing your retirement savings now could have serious future consequences, including running out of money when you need it the most.

Of course, prioritizing your retirement savings can be challenging with so many financial obligations competing for your paycheck, but saving for your retirement should always come first. Staying invested and contributing regularly to your State of Illinois Deferred Compensation Plan (DCP) throughout your working years can significantly increase your assets over time, thanks to the power of compounding, the snowball effect that occurs as your earnings potentially generate more earnings. Here are some tips for keeping your retirement front and center.

How much to save

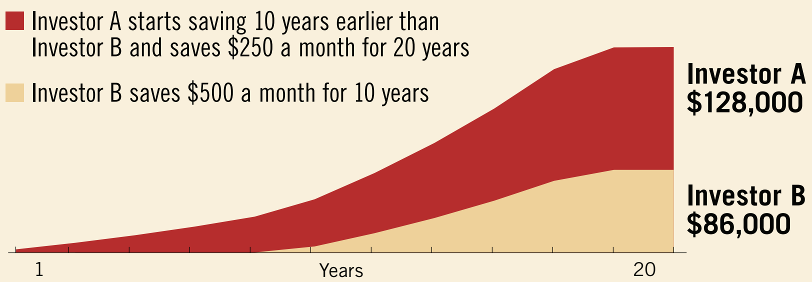
T. Rowe Price suggests that by age 65, investors have about 12 times their annual salary in savings in order to be able to live comfortably in retirement. If the suggested 15% savings rate is not immediately possible, begin by setting aside 6%, and increase that amount 2% a year until you reach 15%. See the chart below to see how your savings can add up over time.

Consider all your college options

T. Rowe Price's "2015 Family Financial Trade-offs Survey" shows that parents are putting their own retirement at risk to support their kids' education. This could be a mistake. When it comes to college, your children have a wide variety of choices, such as going to a less expensive school or working part time while going to college. "But outside of Social Security and a pension, the way to fund your retirement is through personal savings in a tax-advantaged retirement account," says Judith Ward, CFP®, a Senior Financial Planner at T. Rowe Price.

The compounding effect

Consistent investing over a long period of time can help you effectively build your retirement nest egg. Even small deposits can add up over time, thanks to the power of compounding. Consider the two hypothetical investors in this chart. In these cases, the total contribution amount is the same, but Investor A ends up with more savings because the earnings were able to compound over a longer period of time.



Note: Assumes a starting savings balance of $1,000 and a 7% rate of return, compounded monthly.
Source: T. Rowe Price

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After your retirement savings are on track, develop a plan to save for your kids' college, aiming for enough to cover at least half the cost of a four-year education. Our research shows that saving now instead of borrowing later can cut college costs in half.

Even small amounts you contribute to a tax-advantaged college savings plan, such as a 529 plan, will add up over time, and you can encourage relatives to contribute to the plan in lieu of more traditional birthday, holiday, or graduation presents.

Make a plan

Create a budget that allows you to put as close to the 15% suggested savings rate as possible into your DCP. Look for ways to trim your spending so that any extra money can be redirected toward retirement. If you are in debt, try to pare other expenses to the minimum and set a timetable—one to three years—to pay down what you owe. Target high-interest debt such as credit cards first and accelerate payments as you are able. Continue making regular payments on other kinds of debt, such as student loans and your mortgage.

Of course, there will always be unforeseen expenses, but don't let them sidetrack your retirement savings. Funding an emergency reserve can help ensure that you don't have to tap your retirement nest egg or stop contributing to your DCP when the unexpected occurs. Your reserve should have enough cash to cover three to six months of expenses.

Juggling the financial demands of everyday life requires focus and balance. Staying on track with your retirement savings goals is the first step.

Understanding two approaches to investment management

The DCP offers a variety of options in its investment lineup to ensure you have access to investments with a proven track record of consistent investment management, performance history, and appropriateness for long-term retirement investors. If you're an investor who likes choice, through the DCP you have the option of creating an investment strategy using (1) actively managed investment options, (2) passively managed investment options, or (3) a combination of actively and passively managed investment options. Read on for a better understanding of these two approaches to investment management.

Actively managed investment options

Actively managed investment options are managed by a team of professionals who use research, financial analysis, and personal expertise to determine which securities to buy and sell. Unlike index (passive) investments, actively managed investments seek to outperform the **market index**. The *potential* to outperform the market is one advantage that actively managed investment options have over passively managed investment options.

There is, however, no guarantee that the investment manager will be able to beat market returns, and investment management fees can be higher than the fees charged by index (passive) options.

Each actively managed investment has a specific *investment style* and strategy included in its prospectus. *Investment style* refers to the way a portfolio manager chooses and manages the portfolio. While not a comprehensive list, the following includes the most common investment styles used:

- **Growth:** Emphasizes stocks that have the potential to outperform the market over time. These stocks tend to be more volatile and, therefore, more risky.
- **Value:** Emphasizes stocks that are considered undervalued but which have the potential to increase in value over time. However, not all value stocks realize an increase in price.
- **Blend:** Utilizes a combination of both growth and value investment styles.

Index (Passively managed) investment options

What is a market index?

A market index is an imaginary portfolio of securities that represents a particular market or section of the market. Although you cannot invest directly in a market index, you can invest in an "index" mutual fund that is designed to mirror a particular index by investing in the securities that compose the index. For example, in a stock index, all the stocks generally have at least one trait in common—they might trade on the same stock market exchange, relate to the same industry, or have similar market capitalizations. Among the more widely known stock indexes are the S&P 500, the Nasdaq Composite, the Dow, the Wilshire 5000, and the Russell 2000.

Index investment options, which are passively managed, buy some or all of the stocks or bonds that make up a widely used market index (such as the S&P 500) with the goal of matching the index's market performance. An index investment option does not attempt to outperform the index in good times or bad times—it simply seeks to mirror the performance.

There are typically lower operating expenses associated with passively managed investment options than actively managed investment options. Since the index fund manager simply invests in the securities that make up the selected market index, the investment requires little management. And with the index holdings remaining fairly constant over time, turnover of securities in an index investment is low—resulting in lower fund costs. Passively managed investment options, however, may be more volatile than an investment that can shift its asset allocation based on market conditions or in response to trends in market sectors.

See which investments in the DCP are active versus passive

Stocks	Style	Active vs. Passive
LSV Value Equity Separate Account	Large-Cap Value	Active
Vanguard Institutional Index Fund (VINIX)	Large-Cap Core	Passive
Wellington Diversified Growth Portfolio	Large-Cap Growth	Active
Ariel Fund Separate Account	Mid-Cap Value	Active
Northern Trust Collective S&P 400 Index Fund	Mid-Cap Core	Passive
Northern Trust Russell 2000 Index Fund	Small-Cap Core	Passive
Franklin Small Cap Growth Fund (FSMLX)	Small-Cap Growth	Active
Northern Trust ACWI ex-US Fund	Non-U.S. Large-Cap Core	Passive
INVESCO International Growth Equity Trust	Non-U.S. Large-Cap Growth	Active
William Blair International Small Cap Growth Fund (WISIX)	Non-U.S. Small-Cap Growth	Active
Blended Assets	Blended Assets	
Fidelity® Puritan® Fund (FPURX)	U.S. Balanced	Active
T. Rowe Price Retirement Balanced Active Trust	Balanced	Active
Bonds	Bonds	
T. Rowe Price Bond Trust I	Core Fixed Income	Active
Vanguard Total Bond Market Index Fund (VBTIX)	Core Fixed Income	Passive
Stable Value/Money Market	Stable Value/Money Market	
INVESCO Stable Return Fund	Stable Value	Active
Vanguard Prime Money Market Fund (VMRXX)	Money Market	Active
Target Date	Target Date	
T. Rowe Price Retirement Active Trusts	Target Date	Active

For all investments in the lineup, participants can check daily valuations online at **rps.troweprice.com**.

An investment in a money market fund is not insured or guaranteed by the FDIC or any other government agency. Although the fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the fund.

Call 888-457-5770 to request a prospectus, which includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.

Questions

For instant access to investment information and interactive financial planning tools, visit the website at **rps.troweprice.com** > **Investments**, where you can view or download fact sheets for each investment in the DCP's lineup. You may also request fact sheets by phone at **888-457-5770**.

Delaying Retirement

Waiting can have a meaningful impact on your finances.

If you're in your late 50s or early 60s, you're probably spending a lot of time thinking about retirement and trying to figure out the right time to make the jump. It's a big decision that involves a number of variables, including your health, your life expectancy, any additional income, and the size of your nest egg.

As tempting as it may be to dream of an early retirement, working longer—even part time—could pay big dividends over the span of your retirement. Working longer offers the dual benefits of boosting your retirement savings while shortening the length of time your savings will have to support you. An even bigger benefit? Waiting until age 70 to take Social Security can significantly increase your monthly benefits check for your entire retirement, and potentially your spouse's retirement if he or she outlives you.

That's because you lose between 7% and 8% of your Social Security income, before inflation, each year you take your benefit before age 70. A few things to note: You won't get additional credits after age 70, so it doesn't make sense to delay taking your Social Security benefits after that. Also, if you wait until age 70 to take benefits, you should still sign up for Medicare at age 65 to potentially avoid paying a higher premium later. If you are married, you will have some additional considerations in taking your benefits.

There are many factors that go into deciding when to retire, and it's a very personal decision. While delaying retirement doesn't work for everyone, it's worth considering for the meaningful impact it can have on your finances.

Visit **troweprice.com/socialsecurity** to estimate your retirement benefits.

What does being on the "watch list" mean?

It is important that you understand what it means to be on the watch list and, perhaps more importantly, what it does not mean. Being on the watch list, as the name would imply, simply means we believe there is good reason to watch this fund more closely. Being on the watch list does not mean you should immediately sell your fund shares. It is not unusual for a fund to appear on the list from time to time. It does not mean the fund is necessarily a bad investment. If we believe the fund no longer represents a suitable investment option, we will remove the fund from the DCP.

Why are funds placed on the watch list?

Funds can be placed on the watch list for several reasons. Why a fund is on the watch list is more important than the mere fact that it is on the watch list. The most typical reasons are as follows:

1. **Performance**—The most common reason a fund is placed on the watch list is poor performance relative to its appropriate market benchmark and/or peer group. When signs of relative underperformance appear, we place a fund on the watch list.
2. **Risk**—Less obvious to many participants is the risk that a fund manager incurs. If a fund becomes too volatile, we will place it on the watch list.
3. **Risk-Adjusted Returns**—What returns has the fund manager been able to deliver relative to the risk the fund has incurred? If the manager is unable to deliver adequate returns for the risk taken, we will place the fund on the watch list.
4. **Portfolio Construction/Style Drift**—Is the fund manager investing the money in the way he or she said? If you invest part of your assets in an aggressive fund that is supposed to be investing in the stocks of small, growth-oriented companies, then you want the manager to do just that. We monitor the manager's portfolio, and if the security holdings do not reflect what has been communicated, we place the fund on the watch list.
5. **Operations**—There are many operational reasons for placing a fund on the watch list. For example, the manager of the fund could leave. Remember, when you purchase shares of a mutual fund, what you are really doing is hiring a professional portfolio manager to invest your money. If that manager leaves, you should watch the fund closely. There could also be firm-level issues. These can include issues such as regulatory violations, turnover in senior management, or a merger or acquisition. Any of these operational issues will automatically place a fund on the watch list.

Current Watch List as of June 30, 2015

Wellington Diversified Growth Fund

The Wellington Diversified Growth Fund ("the Fund") has lagged its respective benchmark, the Russell 1000 Growth, over the three- and five-year annualized periods and ranked in the bottom quartile of its peer group universe. Over the past four calendar years, 2011 posted the greatest underperformance versus the benchmark. The Fund did not have as much exposure to higher priced defensive stocks that performed best. Additionally, the Fund's technology holdings did not keep pace with the benchmark over recent periods. Participants seeking a similar investment strategy have access to the Vanguard Institutional Index Fund, which also invests in domestic large-cap stocks.

TELEPHONE NUMBERS

DEFERRED COMPENSATION
Plan Rules/Options Information
800-442-1300/217-782-7006

TDD/TTY: 800-526-0844

Internet: state.il.us/cms/employee/defcom

RECORDKEEPER
T. Rowe Price Retirement Plan Services, Inc.
Account Value Information and Investment Changes:
888-457-5770 or TDD/TTY: 800-521-0325
Internet Access: 800-541-3022
Internet: **rps.troweprice.com**

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