THIRD QUARTER 2013 | PAT QUINN, GOVERNOR

# Insight

A QUARTERLY PERIODICAL DEDICATED TO HELPING YOU PREPARE FOR TOMORROW

## "FEE HOLIDAY" LIFTED

The State of Illinois Deferred Compensation Plan (the "DCP") continues to provide you with a great way to save for retirement. It lets you defer part of your salary before taxes and provides a variety of investment options. There are, however, costs associated with participating in the DCP for services such as plan administration and investment management.

The DCP will reintroduce a per-participant fee beginning January 1, 2014. Since its inception in 1979, the DCP has been subject to a state mandate requiring it to be self-funded with all costs borne by its participants. For the last six years, through the combined efforts of cost efficiencies and surplus reductions in reserves, the Illinois State Board of Investment ("ISBI"), which administers the DCP, has been able to provide all participants with the benefit of a "fee holiday." In recent years, ISBI has introduced institutionally priced products, such as common trust funds and separate accounts, to the DCP, helping to reduce additional administrative and investment management costs for participants. As of the most recent reporting period, the DCP expenses are lower than the industry average.

Due to the surplus reduction in reserves, beginning January 1, 2014, a $7.50 fee will be automatically deducted from participants' accounts on the last business day of each quarter and prorated across all of the investment options held in participants' accounts.[1] In accordance with federal law, the fee will be limited to offsetting the costs of the DCP and will be held in a trust agreement for the exclusive benefit of the DCP participants.

You do not need to take any action regarding this change in fee structure. However, if you have any questions, please call T. Rowe Price at 888-457-5770.

[1]Fees will not be assessed to participants' accounts having a balance of $3,000 or less.

## HOW TO DRAW DOWN YOUR SAVINGS IN RETIREMENT

***It's important to have a plan that will help your nest egg last throughout your retirement years.***

Once you leave the workforce, you will have to make important decisions about how to draw on the money you saved during your working years. Those actions will help determine whether or not the nest egg you've built over your lifetime will sustain you in retirement, which could last to age 95 or longer.

### START WITH THE 4% RULE

One approach is to use the 4% rule, which sets the withdrawal at age 65 (or whatever your first year of retirement is) at no more than 4% of your overall nest egg. Each subsequent year, you can maintain your purchasing power by increasing your withdrawal amount by 3% annually to help offset the rate of inflation.

**A Drawdown Strategy** **Consider this example of the 4% rule.**
**Starting with a $500,000 portfolio:**

| YEAR 1 | YEAR 2 | YEAR 3 |
|---|---|---|
| -4% of portfolio | +3% of previous withdrawal | +3% of previous withdrawal |
| Withdrawal: $20,000 | Withdrawal: $20,600 | Withdrawal: $21,218 |

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## HOW TO DRAW DOWN YOUR SAVINGS IN RETIREMENT *from page 1*

### ADJUST YOUR WITHDRAWALS

Keep in mind that the 4% rule is a guideline. Each year in retirement, you need to revisit the current balance in your portfolio and decide how much you can afford to withdraw. If the market has performed poorly over the prior year or you have had to take additional savings from your portfolio, you may decide to hold off on taking any increases for inflation for a year or more until you are back on track with your long-term withdrawal plan.

### FACTOR IN REQUIRED MINIMUM DISTRIBUTIONS (RMDs)

There are minimum amounts you must withdraw each year from most types of retirement accounts once you reach age 70½, although you can always withdraw more. Key considerations include the following:

- You must pay federal and state taxes on distributions when applicable.
- You are required to take your first RMD from each IRA you own (excluding Roth IRAs) and from each previous employer plan account by April 1 of the year following the year you turn age 70½.* If you are still employed at that time, you are eligible to delay taking RMDs from your current employer's plan account until April 1 of the year following the year in which you retire—an advantage of continuing to work after age 70½.
- If you don't take your RMD, or if you take too little, an IRS penalty equal to 50% of the amount not distributed will apply, and you will owe interest on that amount as well.

### KEEP YOUR PORTFOLIO BALANCED

The final element of your retirement withdrawal strategy is to review your portfolio at least annually to ensure that your allocations to stocks and bonds remain in line with your targets over the course of your retirement. Electing to automatically rebalance each account on a regular basis may be the most effective approach to reduce over- or underexposure to asset classes.

#### Time Can Make Savings Add Up


Figures are rounded to the nearest hundred and assume a 7% average annual return. This chart is for illustrative purposes only and is not meant to represent the performance of any specific investment option.

*You may choose to add up the balances in all your Traditional IRA accounts and take the RMD from just one. However, you will need to make separate withdrawals from each employer plan.

### TELEPHONE NUMBERS

***Deferred Compensation***

Plan Rules/Options Information
800-442-1300/217-782-7006
TDD/TTY: 800-526-0844
Internet: http://www.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: http://rps.troweprice.com

*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.*

Log in to your Plan's website at **rps.troweprice.com**.

# HOW DO I DETERMINE MY RETIREMENT SPENDING NEEDS?

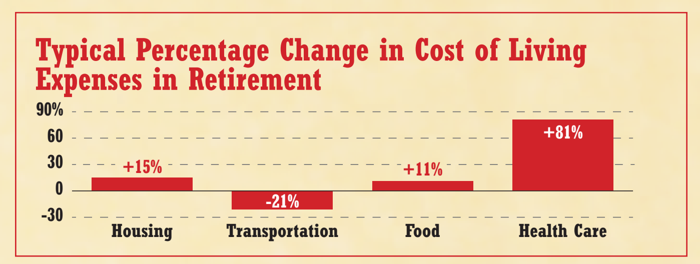
***Stuart Ritter, CFP®, a senior financial planner with T. Rowe Price, explains how investors approaching retirement can prepare for the expenses ahead.***

Think of your spending strategy in retirement as a road map. Consider the lifestyle you want to lead: Will you travel extensively or pursue expensive hobbies? For any expense, you can estimate its future cost by using a simple inflation calculator at an average rate of 3%. Begin by documenting your current expenses. Then add a "projected expenses" column to get a sense of what you may spend in retirement.

Keep in mind that your spending patterns are likely to change as you move through retirement. After you retire, some expenses likely will be lower because of lifestyle changes. Commuting and clothing costs, for example, may decline. Other expenses, such as payroll taxes, may be eliminated altogether. On the other hand, given the trend of rising health care costs, your medical expenses and health insurance premiums likely will increase in retirement—a factor that reinforces the need to have a nest egg large enough to supply the income you'll require at that time.

## SAVE ENOUGH NOW

To build a nest egg sufficient to cover expenses throughout retirement, most investors should save at least 15% of their salary for most of their working years, including an employer match (if any). Creating a spending and savings plan as you approach retirement, and understanding how your expenses are likely to change over time, can set you on a path toward a successful retirement




Source: Consumer Expenditure Survey 2011, U.S. Bureau of Labor Statistics. Data is per household based on the reference person of the household.

# LOW INTEREST RATES AND YOUR RETIREMENT

***What investors can do in the future is focus on maintaining their allocation to stock funds.***

The Federal Reserve's policy-making committee voted in July to keep short-term interest rates unchanged from the current target range of 0% to .25%. The Federal Open Market Committee (FOMC)—a 12-member board whose mission is to keep the U.S. economy, inflation, and employment on track—uses interest rates to help control economic growth. When the economy weakens, Federal Reserve policymakers cut interest rates or keep them low, a way to encourage increased borrowing and spending by consumers and businesses. When the economy grows quickly enough to spur inflation, the Fed typically raises rates or keeps them high so it becomes costlier for people to get loans. The result is less borrowing and spending. Economic activity slows and inflation pressures ease.

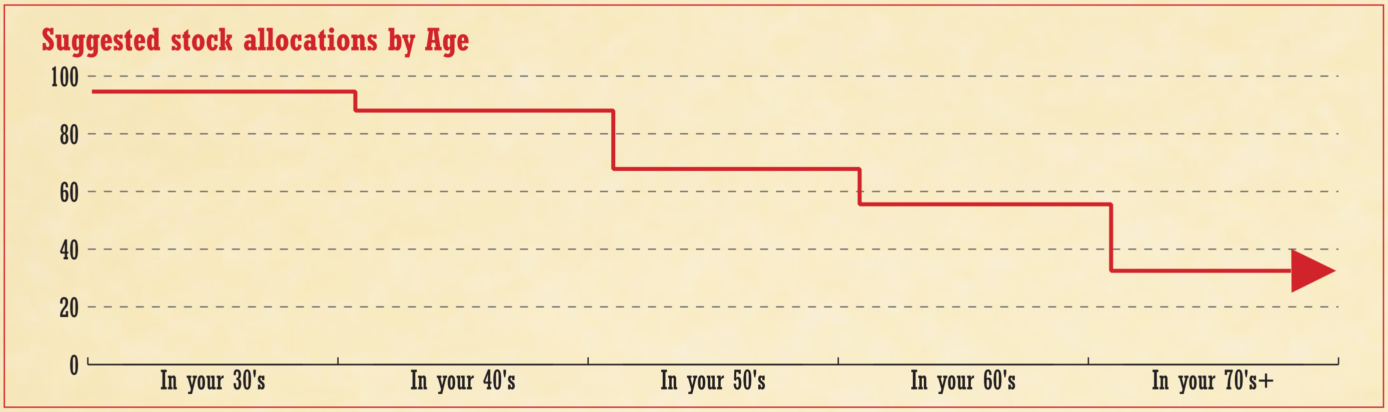
Millions of investors saving for retirement directed large portions of their portfolios into bonds when the stock market fell precipitously in late 2008 into 2009. Investors also expected the Federal Reserve to keep interest rates low to help encourage lending and economic growth. These factors, among others, drove bond returns higher.

Now, with the Federal Reserve signaling a possible increase in interest rates, some see a period of diminished performance in the asset class.

What should investors do? Abandoning bonds altogether isn't a good idea. Instead, the most important action is to maintain an asset allocation to stocks and bonds that's appropriate for your age and time horizon to retirement. Inflation is a key concern for retirement investors because a portfolio that doesn't grow beyond the rate of inflation will not be able to supply the income to match rising prices. A nest egg with an average return of 2%, for example, will be negative in terms of its real return if inflation rises at its historical average of 3%.

Since 1926, the average annual return of stocks through 2012 is 9.8%. The average return for bonds is significantly lower, at 5.4%.[†] Holding stocks at levels below the suggested allocations can dampen your return potential over the long term and can result in a nest egg that is too small to generate the income you'll need in retirement to cover expenses. (See the top of page 4 for a chart showing Suggested Stock Allocation by Age.)

[†]Ibbotson® SBBI® Classic 2013 Yearbook.




## 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 457 Plan.

### 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.

## WATCH LIST—THE STATE OF ILLINOIS DEFERRED COMPENSATION PLAN

### Current Watch List Summary

#### The following fund is on the watch list as of 9/30/13

The **Janus Overseas Fund ("Overseas Fund")**—The Overseas Fund was placed on watch list status due to underperformance of the benchmark and peer group. The Overseas Fund's investment strategy is a high conviction approach whose performance tends to come in cycles. Performance in 2013 has lagged the benchmark and peer group largely due to a greater weighting in emerging markets as the region has lagged the broad international markets. This underperformance has affected the Overseas Fund's longer term record, which is now under the benchmark over the three- and five-year trailing periods. In addition to underperformance, Janus has also experienced planned changes in senior leadership. Janus made a change in their Chief Investment Officer that oversees the investment strategies managed by the firm. However the lead portfolio manager responsible for directly managing the assets of the Overseas Fund has not changed. Participants seeking a similar investment strategy have access to the Invesco International Growth Equity Trust which also invests in large-cap international stocks.



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