FIRST QUARTER 2011 | PAT QUINN, GOVERNOR

Insight

A QUARTERLY PERIODICAL DEDICATED TO HELPING YOU PREPARE FOR TOMORROW

FINANCIAL PLANNING FOR LIFE

While you can't control or predict the performance of the market, you can take steps so that you're on strong financial footing when you leave the workforce. Each stage of life has its own set of rewards and challenges—and a few simple actions throughout your career can give you the opportunity to enjoy a more comfortable retirement.

Your 20s and 30s

With retirement at least 35 to 45 years away, you may be tempted to wait before starting to save. But beginning now is a good idea and can make a huge difference in the size of the nest egg you build.

- Create an emergency fund equal to three to six months of expenses to help you weather unexpected events—the loss of a job or a long illness—without having to dip into your retirement savings.
- Invest most of your savings in stocks. Let's say you're 25 years old and start contributing $300 per month to your Plan. By age 65, you would have $1.05 million, assuming an average annual 8% return. But if you wait 10 years to start saving, your total drops by more than half to $450,000.[1]
- You should aim for an overall savings rate of 15% of your income to your employer's retirement and increase your contribution by 1% to 2% each year until you reach your target.

Your 40s and 50s

In mid-career, you may be earning more than you were 20 years ago, but your expenses might be higher too. Continue to save—try to ramp up your rate if you've been below the 15% target.

- Adjust your asset allocation strategy and rebalance at least once a year. As you approach retirement, you should consider reducing the percentage of your allocation to stocks and add more bonds.
- Pay off those credit card debts starting with the card that has the highest interest rate first. Pay new bills in full when they arrive to avoid new debts.

Your 60s

By now, diligent saving over the decades should have paid off. Though this is the final stretch before retirement, there are still effective actions you can take to increase your income potential.

- Consider staying on the job a few extra years. Instead of drawing on your savings, you'll be able to keep contributing to your workplace Plan, allow more time for your investments to potentially grow, and decrease the number of years you'll rely on those savings. You'll also maintain other benefits your employer offers.
- Delay taking Social Security benefits. Although you're eligible to start collecting at age 62, you can increase your benefit amount by 7% to 8% each year you delay until age 70.

[1] *This example is for illustrative purposes only and not meant to represent the performance of any specific investment option.*

HOW CAN I GET THE MOST FROM MY SOCIAL SECURITY BENEFITS?

While it's tempting to start collecting benefits as soon as you become eligible at age 62, Christine Fahlund, CFP© and senior financial planner with T. Rowe Price, explains why waiting a few years before collecting could help you maximize your income in retirement.

Should I start taking benefits as soon as I'm eligible?

You can potentially collect much more if you wait. If you don't begin collecting at age 62, you'll increase your monthly benefit 7% to 8% for each year you wait. If you wait until age 70, your monthly benefit will be approximately twice the amount you would have received at age 62.

If I delay my benefits, how should I make up for that income?

Consider extending your career for a few more years. You'll have income to live on, your savings can keep growing, and you can stay on your employer's health Plan, if offered. At this point, you could scale back your Plan contributions. Use the extra money to begin enjoying some of the activities you plan to pursue in retirement.

What other choices can I make to maximize my benefits?

If you're single, you'll need to decide when to collect. Married couples, however, have some added flexibility, as they may choose to have one spouse begin collecting early for income. It generally makes sense for the spouse with the lower income to begin collecting first, while allowing the benefits of the higher-income spouse to build as much as possible until reaching age 70. That's because, regardless of which spouse dies first, the survivor receives the higher of the monthly benefits for the rest of his or her life.

To learn more about your benefits, visit the Social Security Administration's website at www.ssa.gov.

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

GET A JUMP ON MONEY MATTERS

Taking control of your financial life can help you save more, establish who will receive your assets in the event of your death, and stay ahead of debt.

Establish and stick to a budget

Write down your goals and how much you'll need to save to meet them. Next, write down your monthly income and "outflow" to savings plans, expenses (such as mortgage payments and groceries), and discretionary spending on entertainment or dining out. If cutting is required, trim your purchases rather than your Plan contributions.

Check beneficiary designations

Have you named beneficiaries for assets such as IRAs, employer sponsored retirement plans, and life insurance contracts? Doing so is the best way to ensure that your assets go to the people or institutions you desire in the event of your death. If you already have your designations in place, be sure they're up to date. A change in marital status, a death, or the birth of a child may require you to redesignate.

Check your credit

Your credit score affects the rates you'll pay when you seek a loan for a major purchase, such as a home or car. Your score also can have an influence on your ability to get certain jobs. Scores above 720 on the most commonly used credit scale (300-850) usually get the best rates on loans. If your credit score needs improvement, be sure to make at least the minimum payment on time each month and refrain from applying for more credit cards or credit lines.

Rebalance

Prices of stocks and bonds change constantly, so their value as a percentage of your portfolio is also in flux. Selling a portion of appreciated fund holdings and buying more in asset classes that have declined will put your portfolio back in balance.

*Get a free credit report at **www.annualcreditreport.com**.*

*For more information on your credit score, visit **www.myfico.com**.*

FINANCIAL UPDATE QUIZ

Test your knowledge of deflation

Should a period of declining prices change the way you save for retirement? Take this quiz to see how much you know.

1. Compared with inflation, deflation occurs:

- **A.** More frequently.
- **B.** Less frequently
- **C.** About as often

2. If deflation is a concern, the best approach is to:

- **A.** Sell your investments before they decline
- **B.** Stop investing until the economy improves
- **C.** Keep investing according to your plan

3. To protect against inflation, the best investments are:

- **A.** Stocks
- **B.** Bonds
- **C.** Money market/stable value investments

Answers

1. B. Deflation is relatively rare and usually short-lived. When the Consumer Price Index (CPI) dropped by .4% in 2009 during the height of the economic crisis, it was the first year since 1955 that prices dropped. In every other year after that, inflation occurred.[1]

2. C. Not even experts can say for sure where prices are headed. Trying to guess could result in selling at a loss, and then paying more to reinvest when prices rise. The best approach is a steady, well-planned strategy based on your personal goals rather than market predictions.

3. A. From 1926 through 2010, the S&P 500 Stock Index rose an average of 9.9%, easily beating the 3% average inflation rate during the same period.[2] Note that this inflation rate will cut your purchasing power in half over 23 years, so staying ahead of rising prices is a crucial investment goal.

[1] *Bureau of Labor Statistics.*

[2] *Morningstar, Inc., Ibbotson® SBBI® 2010 Classic Yearbook.*

THE NEW TAX LAW: AN OPPORTUNITY TO INCREASE YOUR RETIREMENT SAVINGS

You may have noticed a positive change in your paycheck. In addition to keeping current income tax rates in place for the next two years and providing for changes in estate tax rates, the 2010 Tax Relief Act likely will mean an increase in your after-tax pay.

- **A one-time break on Social Security.** If you pay into Social Security and make over $20,000 a year, you should see an increase in your take-home pay. For 2011, the Social Security tax rate individuals pay drops to 4.2% from 6.2% of the first $106,800 in salary. But the benefit will not affect some industry, state, and municipal workers who are not subject to the Social Security tax.
- **No hike in dividends and capital gains tax rates.** Capital gains and dividend income tax rates, both of which had been scheduled to increase in 2011, will remain at the 2010 level. This rate will remain capped at 15%, with those in the 10% or 15% income tax brackets paying nothing.
- **A revised estate and gift tax picture.** After dropping to zero in 2010, estate taxes had been scheduled to return in 2011 at a rate of up to 55% for estates over $1 million. The new law sets estate taxes at a more modest 35% and lifts the exemption to $5 million. The lifetime exemption on gifts rises to $5 million from $1 million. While the new tax laws will affect each taxpayer differently depending on individual income and investments, the Social Security tax cut is an excellent opportunity to raise the amount you direct to your retirement Plan. Over time, the added 2% can result in more savings—and a more comfortable retirement.

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 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 funds are on the watch list as of 3/31/2011:

Ariel Fund: The fund completed 2010 with strong performance for the year with a total gain of 26% and ranking in the 23rd percentile of its peer group. Against the backdrop of a volatile 2010 stock market, approximately half of the fund's gains were generated by an impressive fourth-quarter return. The fund's holdings in the media sector specifically added value, such as the fund's top holding, Cbs (+21%), which is believed by the fund's management to have done well due to their strong content. Consumer luxury names continued to be top contributors as well. The fund's longer-term performance as measured by the 5-year annualized return, however, continues to lag its benchmark and its peer group, coupled with higher risk as measured by standard deviation and beta. This fund will remain on the watch list due to longer-term underperformance but the recent outperformance is noteworthy. Participants also have access to the Northern Small-Cap Value Fund that invests in a small-cap value equity style.

Columbia Acorn Fund: The fund was recently placed on watch list status due to a significant short-term change in the lead portfolio management of the fund option. Columbia Acorn announced the lead portfolio manager, Chuck McQuaid, is taking a three-month sabbatical that began on January 14, 2011. He has served as Columbia Acorn's portfolio manager for over thirty years and has publically communicated that he will resume all investment management responsibilities on April 1, 2011. Upon his departure, the fund's current co-portfolio manager Rob Mohn, who also serves as the firm's director of research, has assumed lead portfolio manager responsibilities. He has served as co-portfolio manager for seven years. Due to the significant change in investment management over the short term, the fund will be closely monitored over the next few months. An on-site meeting with the manager is scheduled for April 2011. An alternative fund for participants to choose is the Northern Small-Cap Value Fund because it also invests in small-cap stocks.

250901_nlt_csm_0311
105115