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Reassessing the Role of Stocks in Retirement Savings

By Randy Myers

Stocks historically produce the highest long-term returns of any asset class, and conventional wisdom now firmly asserts that stocks deserve a prominent place in almost everybody's retirement portfolio. But David Babbel, professor of insurance and risk management as well as professor of finance at the University of Pennsylvania's Wharton School, is sounding a note of caution.

As Babbel explained at the SVIA's third annual Spring Seminar in April, the average returns posted by the stock market over the past century can be misleading, especially when used in some of the simpler retirement-income calculators that investors often use to figure out how much money they will need to retire. The problem, of course, is that stocks don't generate that steady average return in real life. Some years stocks go up, some years they go down—a lot. And that has a dramatic impact on how someone's retirement account will perform in the real world.

To illustrate the problem, Babbel cited a simple example in which an investor has $1 million to invest at retirement. Assume the investor earns an average 8 percent a year on that portfolio—the average return of the Dow Jones Industrial Average from 1900 through 1999. Also assume that he withdraws 6 percent of the portfolio's value in the first year of retirement and the same percentage, adjusted for an average 3.5 percent rate of inflation, every year thereafter. With those inputs, a simple retirement calculator would conclude that the investor could enjoy this steady, inflation-adjusted income for 32 years. Most 65-year-olds would find that prospect reassuring.

Unfortunately, Babbel noted, that calculation does not take into account how the investor's portfolio might be impacted by real-world fluctuations in stock market returns or, for that matter, inflation rates. To get a truer picture of how this $1 million nest egg might fare in real

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Stable Value Seeks Its Place in a Target-Date World

By Randy Myers

Target-date retirement funds, which have taken the defined contribution plan marketplace by storm over the past half decade, are now the most popular default investment option for large plans, according to a new survey by Callan Associates, a San Francisco-based investment consulting firm. But stable value funds also remain a popular investment option and may have an ongoing role to play as a component of some target-date funds.

Target-date funds hold diversified investment portfolios that automatically grow more conservative—that is, they gradually reduce their exposure to stocks—over time. They were the default investment option for 36 percent of the large defined contribution plans surveyed by Callan early this year. Target-risk funds, which maintain a constant asset allocation mix over time, were the second most popular default option, used by 25 percent of plans. Stable value and money market funds collectively were the third most popular default option, used by 17 percent of plans. In addition, all of the 65 plans surveyed offer some sort of principal-protection product, whether a stable value fund or money market fund, as a voluntary investment option.

Target-date funds got a popularity boost last year when the U.S. Department of Labor issued new regulations granting a fiduciary safe harbor to plan sponsors who use them as their default investment option. However, the Department also provided grandfather protections for assets invested in stable value funds as a default option prior to the new regulations. The Callan survey found that 42 percent of plans that had previously defaulted participant investments into a stable value fund said they were either likely or very likely to take advantage of those grandfather provisions and leave assets in those funds.

While most target-date funds offered today are mutual funds and don't include any stable value assets, Greg DeForrest, senior vice president and director of manager research for Callan, told participants at the SVIA's 2008 Spring Seminar that large plan sponsors are increasingly interested in building their own target-date funds using collective trusts as the underlying investment vehicle. By doing that, he noted, plan sponsors can create funds with significantly lower costs—about 25 to 45 basis points, on

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life, Babbel suggested two small but important changes in the example's assumptions, drawing on earlier research by Jim Otar.[1] First, rather than assuming a steady 8 percent investment return, Babbel proposed using the actual returns of the Dow Jones Industrial Average from 1900 through 2002 to represent an all-equity portfolio. Then, instead of using a steady rate of inflation, he plugged in actual annual inflation rates for that time period. The initial 6 percent withdrawal rate would not change.

With these small changes to the inputs, Babbel looked at how the investor's portfolio would hold up over successive 30-year periods, assuming the investor retired in 1900, in 1901, in 1902, and so on. Of the 70 successive 30-year periods studied, there were only eight in which this more true-to-life stock portfolio beat the standard projections derived from the steady, average inputs used in most retirement calculators. For 62 of the 70 periods, or 89 percent of the time, the real-life portfolio performed worse than the standard retirement calculator projection. In the worst case, Babbel found, the investor would have been broke after six years in retirement. The same general pattern held true, Babbel said, for withdrawal rates between 2 percent and 10 percent. It also held true for a portfolio composed of 60 percent stocks and 40 percent bonds.

One explanation for these disappointing results, Babbel said, is the fact that withdrawing a fixed percentage of assets from an investment portfolio over long periods of time is, in effect, a reverse form of dollar-cost averaging, the oft-lauded strategy of buying stocks on a regular basis so that when prices are low, you are able to buy more, and vice versa. When withdrawing money from a nest egg, this same regular pattern results in the investor selling more shares when prices are low, leaving fewer shares to participate in the market's next upturn.

Many financial services firms employ more sophisticated retirement planning models that employ Monte Carlo analysis to account for market volatility and give investors a more accurate picture of how likely it is that their own investment and drawdown strategies will result in a financially secure retirement. Still, Babbel stressed, the volatile behavior of the stock market and its impact on the ability of investors to make their nest egg last through retirement calls into question the widespread belief that stocks should be the bedrock component of almost all retirement portfolios. And, he said, that same volatile behavior makes stable value investments all the more attractive by comparison. In fact, he said, his research has demonstrated that including stable value funds in an investment portfolio shifts the so-called efficient frontier—that is, those points on a risk-reward graph where, for any given expected return, the investor assumes the lowest amount of risk—upward. In short, it makes it possible to earn higher returns without taking on more risk.

Babbel has used intertemporal optimization methods to show what optimal asset allocation models would have looked like for investors with four different levels of risk tolerance for a period of time ranging from the first quarter of 1989 through the fourth quarter of 2007. For the most aggressive investor, the optimal asset allocation mix occasionally included substantial allocations to small- and large-company stocks but almost always included substantial allocations to stable value as well. For each of the other investors, stable value was the predominant asset class represented, accounting for virtually all of the portfolios of the two least risk-tolerant investors. The conclusion to be drawn, Babbel noted in earlier research on this same topic, is that for even moderately risk-averse investors, stable value should be the fixed income component of an optimal portfolio.

Stocks may belong in many retirement portfolios, and indeed, it could be hard to convince many investors that they have any other options for generating the investment returns they need to build up an adequate retirement nest egg. However, Babbel's illustration shows that models are not the silver bullet for retirement financial security. In fact, he cautions, rather than looking for models to "optimize" retirement savings by looking at how much an investor can make, investors should take a more pessimistic outlook based on

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Editor:

Robert Whiteford — Bank of America (robert.whiteford@bankofamerica.com)

Editorial Board:

Andrew Cohen — New York Life Investment Management Andy_Cohen@nylim.com

Phil Connor — MassMutual Financial Group (pconnor@massmutual.com)

Deborah DuPont — ING (deborah.dupont@us.ing.com)

Rick Garton — Pacific Life Insurance Company (rick.garton@pacificlife.com)

Gina Mitchell — SVIA (gina@stablevalue.org)

Tim Murphy — New York Life Investment Management (tim_murphy@nylim.com)

Victoria Paradis — JPMorgan Asset Management (victoria.m.paradis@jpmorgan.com)

Richard Taube — Pacific Life Insurance Company (richard.taube@pacificlife.com)

Chris Tobe — AEGON Institutional Markets (ctobe@aegonusa.com)

Greg Wilensky — AllianceBernstein (greg.wilensky@alliancebernstein.com)

Across the Pond: The United Kingdom Struggles with Familiar Retirement Issues

By Randy Myers

Like their American counterparts, many Britons face financial uncertainty in retirement. According to a recent survey by Britain's Office for National Statistics, 62 percent of British pensioner couples had less than £10,000 in income from state and private pensions in 2005-06, the last period for which data is available. That's about $19,700 at current exchange rates and is below Britain's official poverty line, according to Joe Harris, general secretary of Britain's National Pensioners Convention.

As in the United States, British employers are caught between the twin goals of wanting a secure retirement for their workers and containing the escalating cost of providing that security. Already, many have closed their existing defined benefit pension plans to new members and new contributions, says Bobby Riddaway, a London-based senior consultant with global human resources consulting and outsourcing firm Hewitt Associates. Defined contribution plans have been introduced to replace defined benefit plans. While still typically funded by the employer, those plans aren't committed to paying out a predetermined or "defined" benefit; instead, the benefit paid to each plan participant is based solely on how much money is placed into each participant's account and the investment performance of the participant's assets.

Speaking at the Stable Value Investment Association's third annual Spring Seminar in Ponte Vedra Beach, Florida, Riddaway noted that about half of the defined contribution plans in the U.K. are trust based, meaning that the employer or a designated set of trustees has ultimate fiduciary responsibility for plan assets. These trust-based funds control about 95 percent of the assets in the U.K. defined contribution plan market.

While equity and cash funds are the most universally offered investment options in U.K. defined contribution plans, Riddaway said, target-date retirement funds that grow more conservative as their investors age have become enormously popular as well—just as in the United States They are now offered by 92 percent of all plans. In fact, he noted, about two-thirds of U.K. defined contribution plans designate such funds as their default investment option. That's significant, he said, because approximately 90 percent of U.K. plan participants opt for the default fund. Equity funds are the second most popular default option, used by about 20 percent of plans.

While most U.S. workers take a lump sum distribution from their 401(k) plan upon retirement or roll their nest egg into an Individual Retirement Account, Riddaway noted that nearly all participants in U.K. plans are required to convert 75 percent of their retirement savings into an annuity when they stop working.

Riddaway reminded seminar participants that the British government has proposed some dramatic changes to its retirement plan market. Beginning in 2012, it plans to mandate that employers who do not provide a retirement plan begin to do so. Most are expected to comply by offering their workers access to so-called personal accounts, part of a new, national private pension system. Where they're offered, workers will be automatically enrolled, and those who opt out will be re-enrolled every three years, Riddaway noted, until all workers are participating in the plan.

Participants in the new system will be required to contribute 4 percent of their salary, while employers will be required to contribute 3 percent, and the government will kick in another 1 percent in the form of a tax credit. Employer and employee contributions will be based on the employee's earnings between £5,000 and £33,500, up to a maximum annual contribution of $5,000 in U.S. dollars. All of the investment options offered in the new personal accounts are expected to be passively managed funds, Riddaway said, utilizing either a target-risk or target-date approach. SVIA

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determining how much he or she needs in retirement and then ensuring that the "floor" target can be met. Babbel urges that investors consider both ends of the spectrum and realize that the behavior of financial markets near and during retirement can challenge the best made financial plans for retirement security. SVIA

[1]Jim Otar's research was published in *CA* magazine, a Canadian accounting publication. Mr. Otar is a professional engineer, market technician and financial writer, and author of the book *High Expectations and False Dreams—One Hundred Years of Stock Market History Applied to Retirement Planning*.

Target-Date World

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average—and also incorporate in them asset classes that aren't readily available in the mutual fund arena, including stable value investments. He noted that Callan already offers its own proprietary target-date funds incorporating stable value investments as an underlying component. Those funds, he said, have a "very meaningful" allocation to stable value as their targeted retirement date nears. "When the equity markets are down 20 percent," he said, "stable value will produce that steady 4 percent to 6 percent return."

DeForrest said Callan continues to favor the use of stable value funds over money market funds as voluntary, stand-alone investment options within defined contribution plans, since stable value funds can invest slightly farther out on the yield curve without incurring additional risk. In helping its clients choose stable value funds, he said, his firm looks first and foremost at a fund's ability to provide principal protection and then its liquidity characteristics. A competitive return, he said, is the third criteria in his firm's analysis. SVIA

Crazy for VEBAs

By Randy Myers

Goodyear Tire & Rubber Co. is planning to set one up at a cost of $1 billion. General Motors, Ford, and Chrysler, the three U.S. automakers, are planning to pump $46 billion into one, too. A host of other big employers are considering following suit. What they're all scrambling to create is a Voluntary Employees' Beneficiary Association, or VEBA.

A VEBA is a tax-favored trust created specifically to pay for certain benefits provided to a group of retirees who are linked by a common employment-related bond, such as membership in the same union or employment by the same company. Benefits eligible to be covered by a VEBA include life and accident insurance and, most commonly, healthcare. Once an employer creates and funds a VEBA, the VEBA has responsibility from that point forward for managing its assets and paying for the designated benefits. The employer's financial obligation ends. Not surprisingly, setting up a VEBA typically requires the agreement of retirees and their union. Although VEBAs have been around since 1928, they've attracted new interest from big employers looking for a way to escape the increasingly expensive burden of funding retiree medical benefits.

Speaking at the SVIA's third annual Spring Seminar in Florida in April, attorney Charles Kerby, III, a partner in the Washington, D.C., office of McDermott Will & Emery LLP, said VEBAs have features that appeal to both employers and employees. Employers get to shift decision-making responsibility for retiree benefits to a third party and, once their share of the funding is complete, remove their liability for retiree healthcare benefits from their books. Employees, meanwhile, have dedicated funds set aside for their retiree medical benefits. They also enjoy greater control over how their benefits program is managed. A VEBA is controlled by its employee members and by an independent trustee, trustees, or other fiduciaries, at least some of whom are designated by, or on behalf of, employees themselves.

VEBAs are not without risks, though, for either employers or employees. For employers, creating a VEBA typically requires sharing detailed financial data about their retirement obligations with employees and unions. Also, the Securities and Exchange Commission (SEC) has raised concerns about whether some employer commitments to VEBAs should be accounted for as if the employer were still operating a retiree health plan, especially when the VEBA is being funded over time rather than with a lump sum. If the SEC decided that employers in such circumstances should be viewed as still operating a health plan, it would make VEBAs less attractive.

For their part, employees and their unions must worry about whether the funds given to the VEBA will be sufficient to meet their liabilities. They also must prove themselves adept at administering benefits and at managing investment risk and the risk that healthcare costs will continue to rise faster than inflation. "A VEBA is running a health plan," Kerby explained. "Someone has to manage COBRA benefits, provide access to physicians and hospital networks, and adjudicate claims. It needs auditors, actuaries, accountants, and lawyers."

Internal Revenue Service regulations specify that a VEBA can be established for a group of employees who belong to the same union, work for the same employer, or work for multiple employers in the same geographic locale. Membership must be voluntary, Kerby said, but noted that the definition of voluntary is usually finessed to mean anyone who is eligible.

Because they have competing interests, Kerby said, employers and unions can find that negotiating the terms of a VEBA is difficult and complex. If a company is in Chapter 11 bankruptcy proceedings and wishes to implement a VEBA, he noted, it will have to negotiate the VEBA terms with retirees before emerging from bankruptcy court protection.

Assets held by a VEBA are subject to the rules and regulations of the Employee Retirement Income Security Act, meaning, among other things, that they must be held in trust, may not include employer securities that are not qualifying employer securities, and may not include employer securities exceeding 10 percent of the fair market value of the plan's assets. Most VEBAs are structured as pooled accounts, Kerby said, meaning that investment decisions are generally made at the plan level rather than the individual participant level.

While there are plenty of VEBA cynics among employers and labor unions alike, Kerby said they can be a winning proposition for both parties. SVIA

Growing Markets: Health and Education Savings Accounts

By Randy Myers

Over the past decade, state and federal governments have introduced three new types of tax-advantaged savings plans that individuals can use to fund their healthcare and education expenses: Health Savings Accounts, Education Savings Accounts, and 529 Qualified Tuition Plans. Of those three, only 529 plans have attracted a significant level of assets to date. However, all are growing rapidly, reports Randy Hardock, managing partner of the Washington, D.C.-based law firm of Davis and Harman LLP, and all are potential new homes for stable value investment products.

Designed to cover most postsecondary education costs, 529 plans debuted in the late 1990s and were made permanent by the Pension Protection Act of 2006. By last year, they had captured $105 billion in assets, up 36 percent from 2006. By contrast, Education Savings Accounts, or ESAs, had $6 billion in assets, up 20 percent from the prior year, and Health Savings Accounts, or HSAs, had $2.3 billion in assets, reflecting a year-over-year gain of 53 percent.

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Speaking at the SVIA's third annual Spring Seminar in April, Hardock said 529 plans are attracting the most money in part because they offer several attractive features for investors. First, they have a generous contribution ceiling of $350,000 per beneficiary over the life of the account. That's sufficient to cover four years of postsecondary education at an expensive private institution. In addition, 529 plans can accept contributions from many different donors, including the beneficiary's grandparents. A special federal tax exemption lets donors kick in up to $60,000, or $120,000 per married couple, in a single year with no gift-tax implications. That's five times the normal limit. Finally, the plans are available to everyone, regardless of income. By contrast, the IRS phases out the ability to fund an ESA for high-income earners; the limits range from $95,000 to $110,000 per year for individuals and from $190,000 to $220,000 per year for married couples.

Despite their charms, Hardock said, 529 plans have not gained traction in the employer market. In part, that's because many states have established state income tax advantages for their own plans that benefit only residents of their states. That means a large, multi-state employer that offered just one plan to its workers might be accused of steering workers into an inappropriate investment, since choosing it might mean foregoing the tax advantages offered by their in-state plan. That's a liability risk few employers have been willing to take on.

ESAs were first created under the name "Education IRAs" in 1998, then renamed Coverdell ESAs in 2001 as part of a package of tax cuts pushed through by the Bush Administration. Originally subject to the 2011 sunset provisions of those tax cuts, ESAs were also made permanent by the Pension Protection Act of 2006.

Like 529 accounts, ESAs are funded with after-tax contributions and impose no tax consequences on withdrawals. However, contribution limits are much lower: $2,000 a year. Another drawback: Once money is put into an ESA for a child, it cannot be reclaimed by the parents. By contrast, if parents or grandparents decide not to use the money in a 529 plan for the original beneficiary, they can use it for another child or even reclaim the money after paying a tax penalty.

Created in 2003, HSAs offer greater tax benefits than either type of education account. Not only do HSA account balances grow tax-free, with no taxes due upon withdrawal, but contributions are made on a pre-tax basis as well. Put more simply, no taxes are ever due on money paid into or taken out of HSA accounts, provided, of course, that those monies ultimately are used to pay for qualified medical expenses.

HSAs can be funded with both employee and employer contributions. To be eligible to use an HSA, individuals must participate in a high-deductible health plan that makes them responsible for more of their first-dollar healthcare costs than a typical health insurance plan. For 2008, the maximum HSA contribution allowed for an eligible individual is $2,900; for a family, it is $5,650.

Hardock said the tax benefits offered by HSAs and the growing support of them by employers eager to shift more responsibility for healthcare onto their employees suggests that the plans will continue to grow in popularity. While there were only about 1 million HSAs in 2005, he predicted there could be six million by the end of this year.

Since mutual funds dominate 529, ESA, or HSA account investment offerings, stable value funds are not commonly found. Hardock said many investors in those accounts could benefit from stable value's unique investment proposition of low volatility and guaranteed principal. An investor saving for a child's college education, for example, might appreciate stable value's principal-protection guarantee, especially as that child grows older and the first tuition payment comes into sight. The U.S. Department of Labor, Hardock noted, has already issued advice stating that employers could duplicate in an HSA the same investment lineup used in their 401(k) plans without making the HSA subject to the rules and regulations of the Employee Retirement Income Security Act, or ERISA. Many 401(k) plan investment lineups, of course, include a stable value option.

Hardock predicted that state and federal legislators will continue to refine the rules for HSAs, ESAs, and 529 plans in the years ahead. The challenge for the stable value industry, he said, will be deciding where among these and other opportunities it wants to devote its energies. SVIA

Meeting Retirement Income Needs in a Defined Contribution World

By Randy Myers

Unlike many of their parents, a high percentage of the 76 million Baby Boomers born in the United States between 1946 and 1964 will not receive traditional pension benefits from their employers. That's too bad; research by Aon Consulting concludes that Boomers have greater income needs than their parents. Not only do they spend more freely, they're also living healthier and longer lives. Compounding the income problem, employer-paid retiree medical benefits are disappearing along with pension plans, leaving Boomers responsible for a greater percentage of their healthcare expenses.

"Planning for retirement has never been more important or more difficult than it is now, as the Baby Boomer generation enters their retirement years," said Scott Fiedler, assistant vice president and senior fiduciary and defined contribution consultant for Aon. At the SVIA's third annual Spring Seminar in April, he said the problem won't go away anytime soon, as, on average, another Boomer is turning 55 every eight seconds.

Replacing pension plans with defined contribution retirement savings plans has been popular among employers for at least two decades, but the practice gained real traction in the 1990s. During that decade, Fiedler told his SVIA audience, many people were comfortable with this shift as the stock market was booming, income tax rates were low, and

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it was easy to envision scenarios under which defined contribution plans might prove capable of meeting their participants' retirement needs. The new millennium brought with it a new dose of reality, though. First, the technology stocks bubble burst in 2000, triggering a widespread sell-off in the stock market. A bull market ensued, and last year the subprime mortgage lending crisis erupted, sparking a widespread credit crunch and another swoon in stock prices. "Over the past eight years," Fiedler said, "the number of poor investment years has equaled the number of good investment years."

Amid this volatile backdrop, Boomers are having a tougher time than ever trying to figure out how much money they need to retire. One bit of good news, Fiedler said, is that most will require less in retirement than they did while working, thanks to the elimination of both work-related expenses and the need to save for retirement. In addition, he said, most people will have the luxury of knowing that at least one component of their retirement income, Social Security benefits, will be either fully or partially tax free.

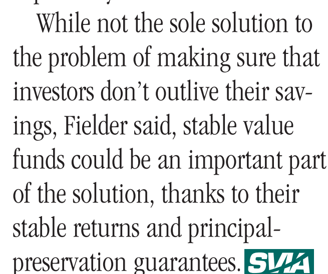
Given all those factors, Fiedler said, a one-earner Boomer couple bringing in $60,000 a year might reasonably expect to need, on average, only about 75 percent of their pre-retirement income in retirement. The replacement ratio will be higher for couples that had very low or very high incomes.

What those numbers don't take into account, Fiedler warned, is the ongoing disappearance of employer-sponsored retiree medical insurance plans, which means that many Boomers will be spending a greater percentage of their income on healthcare once they stop working. In a worst-case scenario, he said, the couple earning $60,000 per year might need 79 percent of their pre-retirement income rather than 75 percent, and a couple earning just $20,000 might need 101 percent rather than 89 percent.

Even if they can figure out with some confidence how much income they will need in retirement, Fiedler said Baby Boomers must still calculate how much money they need to amass to throw off that level of income—and how to guarantee that all their carefully laid plans won't be dashed by volatile financial market returns, unforeseen healthcare costs, or longer-than-expected life spans.

Aon has some answers, at least for the question of how much Boomers need to save. It calculates that a male Boomer leaving the work force at age 65 would need to have $16,850 for every $100 of monthly income needed in retirement, assuming a steady 5 percent return on his investment from that point forward. If he could assure himself a 7 percent return, he would need only $14,167, while a 9 percent return would lower the figure to $12,143. A woman of the same age would need more under each scenario—$19,655 assuming a 5 percent investment return—because women have a longer life expectancy.

While not the sole solution to the problem of making sure that investors don't outlive their savings, Fielder said, stable value funds could be an important part of the solution, thanks to their stable returns and principal-preservation guarantees.



NYSE Economist Sees United States in Recession but Poised to Recover

By Randy Myers

The U.S. economy is in bad shape, a veteran Wall Street economist says, but it is hardly on its deathbed.

Although the economy has yet to meet the formal definition of a recession—two successive quarters of declining gross domestic product—it surely is in one, William Freund, chief economist emeritus of the New York Stock Exchange, told participants at the SVIA's third annual Spring Seminar in April. But, he said, by the time data is available to confirm the recession, it may be nearing its end.

"My best guess is that the recession will last all of this year," Freund told his audience. "GDP in the first half may decline as much as 4 percent and in the second half will begin to level out, maybe reaching 0 percent to 1 percent growth, although it will still feel like a recession. And I think we'll see a resumption of modest growth, say 2 percent, next year." (On April 30, the Commerce Department announced that the economy grew at a tepid, seasonally adjusted rate of 0.6 percent in the first quarter of 2008, the same rate posted for the fourth quarter of 2007.)

Freund attributed the economy's slump to a variety of factors, many of them relating to the collapse of the sub-prime mortgage lending market last year. These include, he said, a now broad-based credit crunch, plummeting real estate values, and mounting real estate foreclosures. High gas prices, escalating food prices, and rising unemployment also are weighing on the economy. On the latter score, he noted that over the past 50 years, whenever the United States has experienced declining job growth for three months, it has always slipped into a recession. Job growth so far this year has been negative. According to the Federal Bureau of Labor Statistics, the monthly rate of growth in non-farm jobs began falling in November 2007, and in the first three months of this year, the number of non-farm jobs actually declined by 160,000.

Freund said the overuse of leverage in the financial services industry has contributed to the turmoil. He seemed to have little sympathy for those institutions that overextended themselves indiscriminately. Citing a firm that made its living trading credit derivatives but recently went out of business, he observed that it had leveraged its bets by 25 to 1. "They were concerned with getting a return on their money, not a return of their money," he quipped. "They did not have an adequate reserve cushion."

As a consequence of the leverage abuse and sub-prime mortgage crisis, Freund predicted that the federal government will heighten its oversight of the financial services industry. Already, the Federal Reserve has intervened to help save investment bank Bear Stearns & Co. from failure by helping to arrange the bank's takeover by a larger

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Editor's Corner
Stability in Uncertain Times

By Robert Whiteford, Bank of America

"Tomorrow belongs to the people who prepare for it today."
African proverb

This issue of *Stable Times* reviews several of the presentations at the SVIA's third annual Spring Seminar in April. I am very encouraged by the selection of conference speakers and by the topics that they covered. It is clear that the stable value sector is preparing for tomorrow. Those of you who have read this column when I have been the guest editor know that I believe that stable value can serve the community of investors that exists beyond the defined contribution pension sector. I am sure that some people who read the articles that follow will search for reasons to suggest that there are unbridgeable obstacles to opening up new stable value applications, but—with minor reservations—I have to disagree.

As the emphasis on savings for non-pension needs such as education and healthcare increases, we have to find new ways to accommodate risk-averse investors who need a good, steady return. Stable value meets that need. As Voluntary Employees' Beneficiary Associations (VEBAs) continue their rapid growth, and as employers come to realize that they can no longer bear all of the risk of providing these benefits, we will see the existing trend toward individual defined contribution–type accounts accelerating. Many, or most, people who suffer when these accounts drop in value can not withstand a sizable loss. Stable value gives them the protection that they need. Target-date funds are growing in popularity, but as many pension plan participants in the United States and abroad have found, target-date funds may contain more risk than they can stomach. When a stable value fund serves as the fixed income component of these funds, the risk drops appreciably. Overseas plan participants, particularly those in the well developed U.K. defined contribution market, have been seeking investment opportunities beyond those currently available to them. There may come a day when stable value will fit the bill there as well.

Why are new opportunities opening up now? There is a pronounced movement toward benefit programs that require individuals to make decisions that affect the amount of money they will have available to meet their pension, medical, and educational needs. Employers have been transferring risk to plan participants at the same time that the government is offering savings incentives. We have seen this with 529 college savings plans that are now offered throughout the country and in an increasing number of VEBAs and other providers of postretirement medical, insurance, and dental benefits. In many cases, the number of investment options open to individuals is limited. As the time horizon until the disinvestment period in many of these plans is often shorter than for retirement plans, there is always a need for a safe investment that will grow steadily. We have already seen a number of states add a stable value option to their 529 plans. I believe that stable value will be increasingly used by other benefit programs as well. Defined contribution pension plans have also been growing steadily overseas. A repeated complaint is that there are not enough investment options open to plan participants. Stable value would be an alternative to the government bond or money market funds that are often the sole conservative investment offered.

The articles in this issue discuss Health Savings Accounts, Education Savings Accounts, 529 Qualified Tuition Plans, stable value's role in target-date funds, VEBAs, and the U.K. pension market. I encourage you to take a look and to think today about how to prepare for the tomorrow of stable value.

Robert Whiteford is a managing director at Bank of America. The views and opinions expressed in this column are his own and not necessarily the views and opinions of Bank of America.

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competitor, JPMorgan Chase & Co. Freund said the Fed's action in that case was inevitable. "Bear Stearns had trading contracts with counterparties around the world having an outstanding value of $2.5 trillion," he said. "The possibility of a chaotic unwinding of these positions, and the resulting global run on the banks, was just too much for the Federal Reserve to contemplate."

Freund argued that Federal Reserve Chairman Ben Bernanke has been acting decisively to stem the fallout from the credit crunch, and he predicted that the Federal Reserve would cut the key Fed Funds rate by another 1/4 percent to 1/2 percent before discontinuing the latest round of interest-rate easing. (On April 30, the Fed cut the Fed Funds rate by 25 basis points to 2 percent.) In contrast to his support of Bernanke, Freund said former Fed Chairman Alan Greenspan deserved some of the blame for the real estate crisis, arguing that Greenspan did not warn about "irrational lending" for real estate. He called Greenspan, who has recently disputed such arguments, a libertarian who "essentially doesn't like regulation."

Freund said he doesn't foresee the presidential election having much short-term impact on the economy since the next president won't take office until January of next year. Even then, he noted, policies proposed by the new administration will have to battle their way through Congress. He said that if a Democrat wins the

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White House, "there will surely be a tax increase for families with income over $250,000 but lower taxes for lower-income families." Whether that winning candidate was Sen. Hillary Clinton or Sen. Barack Obama, he added, wouldn't have much of an impact on the federal budget since, he said, neither has announced policy proposals that would effectively tackle the deficit.

Unwilling to predict how the stock market will perform the rest of this year, Freund did note that it historically anticipates recessions and recoveries alike by about six to nine months and "never" misses turning points in the market. If his outlook for the economy is right, then, the stock market could take a turn for the better fairly soon. "We've already seen a 15 percent to 20 percent decline in stock prices," he said, "which is pretty much par for the course." He added that the market's recent volatility should remind investors of the appeal of holding a diversified investment portfolio.

Longer term, Freund predicted that stocks will continue to rise, albeit somewhat slower than they have in recent decades. As for the economy, he said, its long-term prospects will depend on the country's ability to continue to improve productivity. Over the past several decades, U.S. productivity growth has averaged about 3 percent a year, despite some years in which it didn't improve at all. "I'm optimistic that productivity growth in the 2 percent to 3 percent range will continue over the longer term," Freund said. "The dot.com era may be over, but the age of the Internet is just beginning. We are witness to the beginning of a revolution in computers, communications, and science generally, and this will continue to drive economic growth. Computers, biotechnology, and telecommunications will be as important in the 21st century as autos were in the 20th century and railroads were in the 19th century."

While acknowledging that the country is going through "tough times" right now, Freund cautioned that the world is not coming to an end. "Long term," he said, "the American economy is resilient and flexible. It has shown an ability to respond to all kinds of challenges." He noted, for example, that over the past decade alone, the country has survived global terrorism, military action in Iraq and Afghanistan, domestic scandals like Enron and WorldCom, devastating hurricanes, and rising oil prices.

"It will take some time to overcome the collapse in housing and the credit crunch," Freund said, "but the current financial crisis is an episode in our history, not a historical event of long-lasting duration." SVIA

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