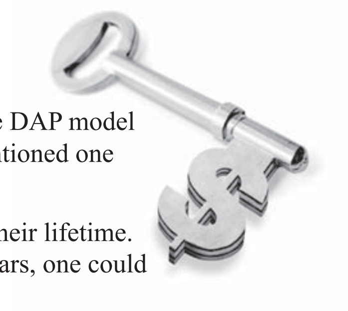
Heads Up

The Directed Account Plan Quarterly Review July 2007

Determining Your Distribution Rate



Last quarter in the Heads Up issue, we featured an article on the Distribution Phase of Retirement and why the DAP model portfolios have worked so well for so many participants during this phase of their lives. In that article we mentioned one key to successfully managing your retirement assets is to take modest distributions (4%-6% of your balance).

This modest distribution rate is suggested by many in the financial community to insure a retiree's assets last their lifetime. But since all of the DAP's Model Portfolios have annualized performance greater than 6% for the past 13.5 years, one could expect to receive the following question.

Q. Why the 4% rule on distributions, if my assets are achieving a rate of return greater than 4%? Won't my asset balance actually grow at this low distribution rate? Is the possible shortfall (earning less than 4%) in some years the reason for this seemingly low recommended withdrawal rate?

A. That's only part of the answer. The main reasons for a modest withdrawal rate are inflation and the dangers of the "sequence of investment returns", a term commonly used in retirement planning.

Inflations Impact on Your Nest Egg

The often-quoted and just as often misquoted rule of thumb is the 4 % rule - withdraw 4% annually to avoid running out of money in retirement. But such a simplistic statement is misleading because the 4 percent applies to the first year of retirement only. A retirement typically lasts 30 years so inflation will impact this withdrawal rate over the years.

Using this rule, if you have $500,000 saved, you would withdraw no more than $20,000 the first year. In subsequent years, to keep up with inflation, you would need to withdraw more than $20,000. Assuming inflation runs at 3 percent a year, you would withdraw $20,600 the second year, $21,218 the third, and so on. On year 30, your withdrawal would balloon to $48,545. That is 10% of the original $500,000 balance.

Therefore, even if the annual return on your assets matches the initial rate of withdrawal, you could eventually run out of money because you're taking out bigger amounts each year. Of course, the counter to not withdrawing more to keep up with inflation is to change one's standard of living as inflation eats away at ones buying power.

Sequence of Investment Returns in the Distribution Phase

If you leave your money alone, the sequence of annual investment returns does not matter. However, the sequence in which investment returns occur can make a huge difference in your distribution phase account balance. This factor is of extreme importance and is often misunderstood.

In the distribution phase, early positive returns may mean a lifetime of sufficient income, while early losses can mean running out of money in the midst of retirement. In one example from a well know insurance company, two 65-year-olds retiring with $549,000, making annual withdrawals and achieving an average compounded 8 percent annual rate of return can end up with either $1.8 million at age 90 if above-average gains occur in the early years and losses later on, or less than $1.4 million if the 8 percent return is constant each year. But if losses occur early, the money could run out at age 79. The key here is that 8 percent is an average and the volatility of the yearly returns will determine whether one's money lasts a lifetime.

excerpt from The Post Dispatch Business Section column "The 4% Rule" 6/10/07

The volatility of returns is one reason all the DAP Models have an asset allocation to the Stable Value Option. This allocation reduces the volatility (the large swings) in equity returns and helps you get to an average without large gains and losses in returns.

For those currently adding to your investments, the accumulation phase, you actually benefit from early losses because you're "buying low" while prices are down (of course, this assumes prices eventually recover). Therefore, rather than panic and quit contributing, young workers, if anything, should step up contributions during market declines. (Good advice for your children and grandchildren).

Planning Tools for the Distribution Phase

To get a better feel of what your chances really are for achieving a particular financial goal, planners are turning to computer modeling techniques called Monte Carlo simulation. This model helps determine how much you can realistically withdraw from your retirement portfolio without running out of money. The planner plugs in the desired withdrawal rate, the "expected" return of the investments, the portfolio's standard deviation (how much the returns vary each year), an expected inflation rate, life expectancy, and so on. The program then generates hundreds, even thousands of variations of these numbers, each generation slightly altering a particular variable such as the sequence of investment returns, the average rate of return or a different life expectancy, while keeping the target withdrawal rate the same.

The result shows you the probability, given the assumptions used, that a particular withdrawal rate will achieve the results you want. For example, you might find that you have a 90 percent chance of

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Performance

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Fund Performance

as of June 30, 2007 (in percentages)

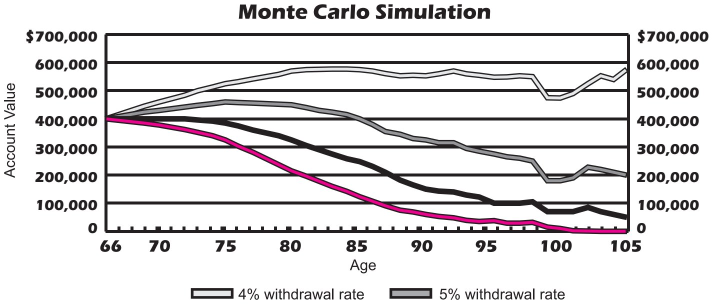
Funds & Portfolios	2006	Ytd 2007	3 yr. avg.	5 yr. avg.	10 yr. avg.
Stable Value Fund	**5.21**	**2.58**	**5.24**	**5.08**	**5.75**
Lehman Br. 1-3 yr. Govt./Treas.	4.12	2.14	3.04	2.89	4.72
Value Stock Fund	**16.93**	**10.60**	**15.01**	**13.89**	**10.20**
Russell 1000 Value Index	22.25	6.23	15.93	13.31	9.87
Equity Index Fund	**15.50**	**7.08**	**12.39**	**11.46**	**7.37**
Russell 3000 Index	15.72	7.11	12.44	11.53	7.62
Growth Stock Fund	**5.79**	**9.45**	**11.59**	**11.90**	**5.94**
Russell 1000 Growth Index	9.07	8.13	8.70	9.28	4.39
International Stock Fund	**27.41**	**14.36**	**24.91**	**19.67**	**10.03**
MSCI EAFE Net Dividend	26.34	10.74	22.24	17.73	7.66
Div. Small Co. Stock Fund	**14.54**	**9.63**	**12.69**	**13.07**	**11.23**
Russell 2000 Index	18.37	6.45	13.45	13.88	9.06
Conservative Portfolio	**9.72**	**5.12**	**8.67**	**8.29**	**7.20**
Conservative Composite Index	10.07	3.95	7.50	6.70	6.33
Moderate Portfolio	**11.97**	**7.36**	**11.57**	**10.93**	**8.28**
Moderate Composite Index	12.97	5.69	10.19	9.29	6.60
Aggressive Portfolio	**13.99**	**8.60**	**13.27**	**12.39**	**9.00**
Aggressive Composite Index	15.50	6.55	12.19	11.13	7.19

not running out of money with a 4% withdrawal rate but only a 75% chance if you consistently withdraw 5%. Keep in mind that Monte Carlo calculations are very useful in assessing risk and the calculations are based upon historical relationships which may or may not hold true in the future.

A great planning tool (and it is free) available to DAP participants is the Retirement Planning Tool. It is found at www.netbenefits.com under Tools and Learning. Click on the "Retirement Planning Tools" link and then the "Retirement Income Calculator" link. The calculator automatically uses the balances in your DAP accounts as well as any other accounts you have aggregated to NetBenefits when doing retirement planning simulations.

Expected annualized return, inflation, and sequence of returns are all factors in determining your appropriate distribution rate. Making use of the retirement planning tools available to you at www.netbenefits.com will help simplify this important decision. **HU**

Effects of Different Withdrawal Rates using Monte Carlo Simulation



Source of chart data: Retirement Income Manager, Oppenheimer Funds, 2007. This hypothetical example is not intended to show the performance of any DAP fund for any period of time or fluctuations in principal value or investment return.

Graph based on the following assumptions:

- $400,000 in investable assets
- inflation-adjusted withdrawal rates that ranged from 4% to 7%
- Portfolio begins with a 75:25% equity to fixed income ratio
- Portfolio becomes more conservative when the client reaches age 75
- At age 80, portfolio undergoes further conservative shift, to a 35:65% equity to fixed income ratio

Plan News

- Royce International Value was added to the International Stock Option in June.
- The new ***Summary Plan Description*** will be arriving in your mailbox this month.

Fund Component Weighting

These tables represent component weightings for individual investment funds as of June 30, 2007.

	Weightings	Net Value of Funds ($MM)
Stable Value Fund		**$308.5**
Cash/BGI Money Market	15%	
PRIMCO GIC	45%	
Wellington Core Bond	40%	
Value Stock Fund		**64.6**
BGI Value Index	20%	
Neuberger Berman Partners	20%	
Morgan Value Strategy	20%	
Goldman Sachs Mid Cap Value Instl.	15%	
T. Rowe Price Value	15%	
CGM Focus	10%	
Equity Index Fund		**24.1**
BGI US Equity Index	100%	
Growth Stock Fund		**25.9**
BGI Growth Index	20%	
Wellington Mid Cap Opp.	15%	
Turner Mid Cap Growth	15%	
Marsico Focus	20%	
T. Rowe Price Growth Stock	15%	
Primecap Odyssey Growth	15%	
International Stock Fund		**56.5**
BGI EAFE Index	14%	
Am Century International Discovery	10%	
Am Century International Growth	10%	
Templeton Instl. Foreign Equity	12%	
First Eagle Overseas	12%	
Oppenheimer Intl. Sm. Co. A	10%	
Thornburg International Value	12%	
Marsico International Opportunities	8%	
Dimensional Emerging Markets Value	8%	
Royce International Value	4%	
Diversified Small Co. Stock Fund		**45.3**
BGI Small Co. Index	20%	
Dimensional US Micro Cap Portfolio	15%	
Royce Opportunity	15%	
Legg Mason Opportunity	10%	
Century Small Cap Select Instl.	15%	
Third Avenue Small Cap Value	15%	
Morgan Stanley US Sm. Cap Value Instl.	10%	
Conservative Portfolio		**55.0**
Moderate Portfolio		**317.8**
Aggressive Portfolio		**26.2**
Fidelity Funds Window		**95.2**
Total		**1,019.1**

The intent of this communication is to provide useful information, not investment advice. Each participant in The Directed Account Plan is ultimately responsible to make his or her own investment decisions.

More Information and Plan Contacts

To get daily NAVs, account balance information, or to make transfers, you may call the DAP Service Center telephone voice response system, available 24 hours a day. Customer service representatives are available 8:30 am to midnight, Eastern time Monday through Friday. Call 1-877-4TWADAP (1-877-489-2327) **or** dial the AT&T direct country code and 877-833-9900 (call collect) outside the U.S. Use Social Security number and PIN to access your account.

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