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Retirement Times

NEWS AND UPDATES FOR RETIREMENT PLAN SPONSORS AND FIDUCIARIES

Volume X | Number VI | June 2017

Time to Reset Expectations

We are now in the eighth year of an equity bull market, making this the second-longest upswing in American history.[1] Additionally, the bond market has been in a secular bull market since 1982 as rates on the 10-year treasury fell steadily from above 14 percent to below 2 percent last year.[2] The recent strong returns we have experienced may be difficult to sustain due to equity valuations, near-record corporate profit margins, and low interest rates. This is not to say we are in a bubble or an imminent bear market looms, however now may be a good time to reset long-term investment return expectations for participants. In fact, California's state public pension system, Calpers, recently lowered their expectations for long-term investment returns from 7.5 percent to 7 percent.[3] Even those reduced projections may prove optimistic.

Equity returns are primarily a function of three factors: earnings growth, the multiple paid for earnings, and dividends. Earnings have benefitted from near-record corporate profit margins.[4] Since the Great Recession, corporate profit margins have expanded on the back of cost cutting, low labor costs and low interest rates. This margin expansion has fueled earnings growth and any reversion to the mean would create a headwind for earnings going forward.[5]

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Furthermore, the current price-to-earnings ratio[6] for the S&P 500 is about 18 times forward earnings. That compares to a historical 25-year average of about 16 times earnings.[7] These valuation levels are not extreme yet can provide less opportunity for future multiple expansion to drive returns. Lastly, the current dividend yield on the S&P 500 is less than 2 percent compared to a historical median yield of over 4 percent.[8] For all of the above reasons, U.S. equity returns in the high single digits may be unlikely over the coming years from this starting point.

Returns from fixed-income investments may also be challenged going forward. A significant component of fixed income returns are yields. During this secular bull market in bonds, returns have been bolstered by falling interest rates. The current yield on 10-year treasuries is about 2.5 percent. That compares to an average historical nominal yield of over 6 percent.[9] Additionally, if or when rates eventually rise, bond prices may be pressured since bond prices move inversely to interest rates. With yields near historically low levels, fixed income investments may return less than they have historically.

This is by no means a signal to exit the market and go to cash. Market timing is a fool's game because it is impossible to properly time an exit and entry back into the market. As history has repeatedly shown, investors who try to time the market may be destined for inferior returns over time. However, from the current starting point, it is difficult to envision a balanced portfolio achieving high single digit returns over the next five to 10 years. A low to mid-single-digit return may be a more realistic expectation.

[1] http://money.cnn.com/2016/04/29/investing/stocks-2nd-longest-bull-market-ever/
[2]http://www.cfapubs.org/doi/pdf/10.2469/cp.v27.n2.6
[3]Calpers Cuts Investment Targets, Increasing Strain on Municipalities. The New York Times. December 21, 2016.
[4]A "Generational" Peak In Corporate Profit Margins. ZeroHedge.com. April 2, 2016.
[5]A "Generational" Peak In Corporate Profit Margins. ZeroHedge.com. April 2, 2016.
[6]The ratio for valuing a company that measures its current share price relative to its per-share earnings.
[7]2Q 2017 Guide to the Markets. J.P. Morgan.
[8]S&P 500 Dividend Yield.
[9]2017 Guide to Retirement. J.P. Morgan.

Recruit, Retain, Retire – Reframing Financial Wellness

So much of the financial wellness conversation to date has focused on the potential health care cost mitigation of adopting organizations.

A more effective angle, however, may come in the form of the company's increased ability to recruit, retain, and allow a happier workforce to retire on time.

Wellness Programs Aim to Keep Employees and Employers Happy

T. Rowe Price conducted a plan sponsor survey in April 2016[1] to get their thoughts about financial wellness and other defined contribution trends. When asked what the major objectives of financial wellness initiatives are for your company, plan sponsors responded with:

- Major Objective: Retaining skilled employees – 74%
- Major Objective: Increasing employee satisfaction – 69%
- Major Objective: Improving employee productivity – 67%
- Major Objective: Competing effectively for skilled employees – 64%

These responses are almost identical to the common reasons why employers offer an overall benefits package in the first place—to recruit and retain top talent.

Financial wellness programs, for the most part, are focused on more holistic financial education, such as debt management, budgeting, and saving and spending strategies.

Retirement Success Requires Fiscal Fitness

Over the years, advisors and employers have improved overall retirement plan participation rates and perhaps deferral rates through automatic services; however, overall retirement readiness may not be improving. Why? It may be counterproductive to tell employees to save more, maximize the match, and take advantage of compounding if there are larger financial issues preventing them from doing so.

And even if employees are participating and saving at an adequate rate, that doesn't necessarily mean they have the financial flexibility to cover a financial emergency. Often, retirement savings is the first to suffer when a financial crisis hits.

Unlike implementing services like reenrollment, where sponsors can see the immediate effects in the form of increased participation, the benefits reaped from implementing a financial wellness program will be realized over time. Depending on the level of debt employees may carry, it may take a few years to make a significant impact on increased retirement savings.

And it's important to understand that financial wellness programs are not a participant-sold idea or service. They can be a very effective value add for the employer in the forms of increased retention, higher morale, longer tenure, and potential cost mitigation—that also can have an extremely positive impact on the financial and emotional state of the workforce.

Recruit, Retain, Retire: A Fresh Take on Employee Benefits

The old mantra of offering a competitive benefits package to "recruit, retain, and reward" needs updating. With an emphasis on retirement savings and financial wellness, the "three Rs" should now shift to "recruit, retain, and retire."

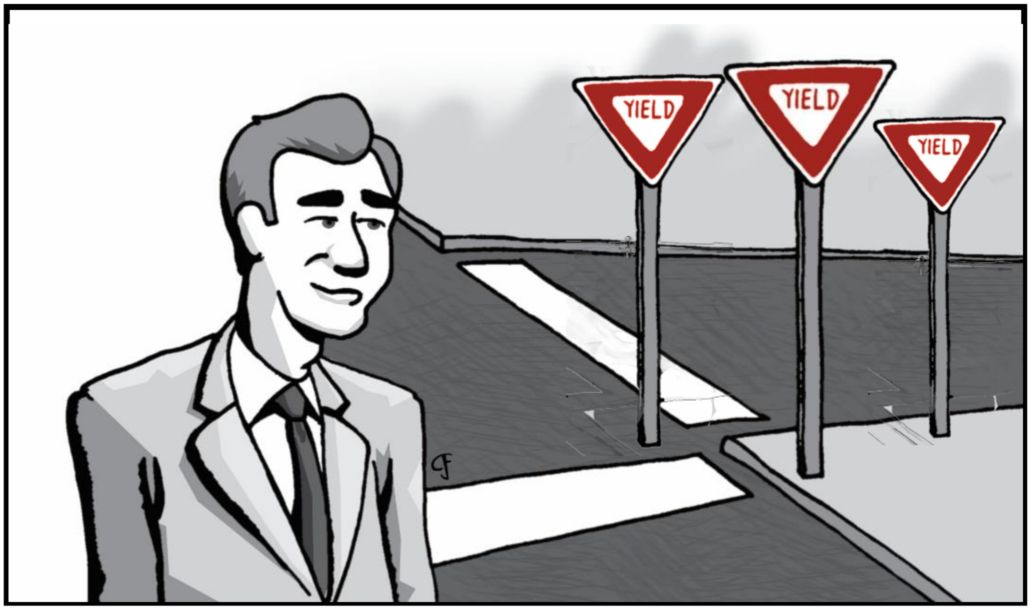
[1]T. Rowe Price/Brightworks Partners, LLC, Plan Sponsor Pulse Survey, April 2016. Survey of 155 401(k) plan sponsors with assets of $100 million or more conducted online, March 22-April 1, 2016.

Company Stock and Fiduciary Considerations

In recent years, there has been a substantial increase in litigation involving retirement plans that have invested in the stock of their sponsoring company. The only definitive way for plan fiduciaries to avoid liability with respect to plan investments in employer stock is to avoid such investments altogether. Nevertheless, many employers, believing that employer stock is beneficial to their plans, continue to maintain it as an investment.

If company stock is available in your retirement plan, you may wish to consider hiring an independent fiduciary. Best practices dictate that the independent fiduciary should have no actual or perceived relationship with the company or its directors and should have exclusive control over the investment-related decisions for the plan, at least with respect to investment in company stock. This eliminates the concern regarding potential insider information and also helps to shift the fiduciary exposure to the independent fiduciary. That said, until this has been accomplished, your company's retirement committee likely doesn't have a choice but to monitor, and make decisions in regard to, company stock (unless the plan document expressly states that the plan must offer company stock). Absent a plan provision requiring company stock, the fiduciaries remain tasked with taking prudent action in the interests of participants in mind, which includes actions taken with respect to the company stock. For more information, contact your retirement plan advisor.

401(k)omic: Why Did the Bond Manager Cross the Road?



COMMUNICATION CORNER: The 10% Savings Goal

This month's employee memo shows how increasing deferral rates each year by just a small amount can equate to big savings in the long run.

Call or email Nate Moody at nmoody@lebelharriman.com or 207-773-5390 if you have questions or need assistance.

Past Performance does not guarantee future results.

Please note that all investments are subject to market and other risk factors, which could result in loss of principal. Fixed income securities carry interest rate risk. As interest rates rise, bond prices usually fall, and vice versa.

S&P 500 Index is an unmanaged group of securities considered to be representative of the stock market in general. You cannot directly invest in the index.

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ACR# 244910 06/17