RISK & REWARD
ARE TRAVELING COMPANIONS

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Background

The "Immutable Law of Investing" is: *"Risk and reward are traveling companions"*. Investments promising to double your money rapidly can also erase your money quickly. The promise of a 12% return in a market offering 4% for safe investments is unrealistic and carries a high probability of loss. As the time-worn adage says, "if too good to be true, it usually is". The only "exception" is an investment guaranteed to give you an "opportunity" to earn an above-market return. Yet, **investors constantly search for loopholes in this "Immutable Law of Investing"** and the popular press is full of advertisements promising unrealistic returns for very low risk. You've simply got to resist the temptation because imbibing will most likely be a bitter experience. It is human nature to think that this time you've found the exception and that the absurdly high interest rate or guaranteed return you're being offered is real. The testimonials that come with it are compelling and the individuals touting it are with a good organization, so it must be the "real deal"! It's not.

Forget the hype and stop thinking that money is being given away, the promise of a higher rate is associated with high risk and you're in danger of losing some or all of your money if you think otherwise.

When you see a high rate, you only need remember: *risk and reward are traveling companions*. There are zero exceptions so you can stop looking. Getting a high return without an equal amount of risk is as likely as losing weight without eating less and without exercising. I know: lots of folks fall for that one too. There is no magic bullet, no holy grail of investments, no money growing on trees, no free lunches and no above-average reward without above-average risk.

The General Classifications of Risk

There are numerous "kinds of risk" that you will face as you invest your retirement money or give it to others to invest. Those most commonly faced by the typical American are: (a) interest rate risk and (b) market risk. Of course there is also the risk of insolvency (corporate bonds), liquidity (real estate), currency exchange (off-shore investments), sovereignty (bonds of foreign governments), inflation (purchasing power), legislation (tax law changes) and numerous others ranging from obsolescence of a product to outright fraud by corporate executives or money managers. Many times there is more than one risk involved with an investment. For example, with real estate you have to worry about market prices, taxes, inflation, liquidity and finding tenants. However, let's limit the discussion to the ones you're most likely to encounter: interest rate and market.

Market Risk

Market risk is perhaps the best understood since it is commonly associated with stocks, bonds, mutual funds or other investments whose value vary with market fluctuations. If the price can move up it can also move down, and therein lays the market risk. Don't ever fall into the trap of thinking that investments always go up in value unless they are guaranteed to do so by someone, or some institution, that is financially strong enough to make such guarantees. By the way, if you're relying on such a guarantee, make sure it is in writing and not a promise provided by the salesperson or representative of the guarantor. Parenthetically, brokers are not permitted to make binding commitments, or guarantees, on behalf of the companies they represent – so if your broker make such guarantees or promises, don't walk away, run. You will not find a risk-free investment that pays an above-market rate of return: this animal is extinct, if it ever existed.

Regardless of the "professional recommendation" or past performance, there is no "absolute safety" when purchasing investments whose price can fluctuate. So don't believe anyone who tells you that your investment will only increase in value unless they have guaranteed it in writing, they are authorized by their company to make such warranties, and have the financial strength to stand behind their guarantee. Naturally, fixed-rate investments like bank CDs, government savings bonds, money market accounts and fixed annuities from insurance companies will only increase in value in you hold them to maturity because they have a stated rate of interest that will be credited to your account each year. Notice please: these safe money options are very safe and as a result will also have interest rates that reflect that safety. Again, no risk means relatively low return and high returns are dressed in high risk: always. Or said another way, the promise of a high return involved high risk: always. This truism is universal because if there were some easy way to make above-market returns with below-market risks every money manager in the world would be taking advantage of it. If such a situation developed, the overwhelming demand for the higher return with lower risk would cause demand to swamp supply and the high rates would be bid down to a level commensurate with the risk. So, even if the risk-reward calculus gets out of equilibrium, there are automatic forces to push them back into balance again. Granted, some investors have a knack for finding bargains and may even be able to outperform the market, but this does not mean they are taking zero risks to get the above-market returns. Least you think you can “beat the performance of the market” bear in mind that the vast majority of professional money managers (those that manage pension funds, mutual funds, and the like) do not do as well as the broad market indexes like the S&P 500 or the Dow Jones Industrial Average. Unless you’re willing to devote a great deal of time, study and research to “investments” and can afford to suffer losses, you would be well advised to stick with the safe money options when investing your retirement nest egg. There is simply too much risk of loss and retirees may not have the time to make up for investment mistakes. And, even if the losses can be recovered over time there is the unavoidable reality of inflation that erodes your purchasing power.

One of the first rule you learn in investing is that forecasting future movements of the markets is not possible – not by you nor by anyone. Contrary to what you sometimes hear from financial journalists and the talking heads on TV, they don’t know the future nor do they know anyone who does know. Forecasting interest rates, economic levels, stock prices and such is just guesses and most sages are wrong many more times than they are right. There are simply too many imponderables: politics, international complications, economic and financial developments, technological changes and human emotions. American business icons have failed and investments in them made worthless because of fraud, mismanagement, terrorism, class action lawsuits, product liability, government investigations, rapid technological changes, weather, and countless other causes not foreseen by "experts" or anticipated by stockholders. Granted, "blue chip" stocks are not as risky as "penny stock", but there have been spectacular, and unanticipated, failures of "blue chip" companies. If an investment can wax and wane in value, then it has market risk and the saying "*caveat emptor*" (buyer beware) is appropriate. There's an old saying about the stock market that is appropriate to all speculative investments: if you have the courage of a lion and the tenacity of an octopus, you have a ghost of a chance of making money in a speculative investment. Speculative investing is betting and there is no such thing as a "safe bet". Risk and reward are indeed traveling companions and have been since the beginning of financial history.

Your retirement nest eggs in stocks, bonds, mutual funds, variable annuities, real estate and general securities are exposed to market risk and losses can, and may, occur. So if these are the vessels in which you carry your retirement lifestyle and you can't afford the risk, it is time to re-check your retirement safety net. No one is making you a guarantee about the growth of your investments if "markets" determine their value. In fact, the regulatory authorities overseeing the securities industry specifically forbid licensed securities representatives (you generally call them "brokers") from making you guarantees about performance. Specifically, the prospectus that you must acknowledge reading before buying a security says in bold red print: ***past performance is not a reliable indicator of future performance; all (name the security, e.g., mutual funds, have costs that lower your investment returns; you can lose money***

investing in (name the security, e.g., variable annuities). So, when your stock broker or financial advisor tell you that a mutual fund, variable annuity, stock, bond or any other investment (whose value is market determined) is going to only go up in value, you should know that she or he just violated the ethics of their profession and you're on the edge of being duped. The same is true if the broker shows you the past performance charts, or hypothetical rates of return, of an investment and then extrapolates these into future years as a "sure thing" or likely to happen. The sad part about such promises is that the broker making them is oftentimes convinced they are true. In some cases, well-meaning brokers actually think that there is a free lunch and you can have outlandish rewards without taking risks. Even though they make their living as financial advisors, they haven't yet learned that risk and reward are traveling companions. Generally, these type advisors are "salespersons" that have a product which they believe everyone needs. Of course, it is a fact that no one investment is good for everyone because there are differences in risk tolerance, wealth, income, health, obligations, commitments, life expectancy, aspirations, and the other things that make us all different. There is no "one retirement plan" that fits all as if you were buying a shirt or blouse from the rack made plan to exactly suit your retirement needs and aspirations. You, and everyone else, needs a tailor to custom-make their retirement plan and appropriate investments. Likewise, there is no one asset allocation model (solutions in a software box) that will yield suitable portfolios for everyone. As an aside, most "asset allocation" software is provided by brokerage companies and surprisingly the "proper asset allocation" always seems to include – you guessed it – securities they offer and which fluctuate in value as the markets change. Just because a particular investment is not suitable for you doesn't mean it's also unsuitable for your next door neighbor, co-worker or aunt. Due to different capabilities, risk tolerance, aspirations, etc., your needs are unique and you need "your retirement" plan not a one-size-fits-all plan.

The rule about market risk is: only if you can "afford the risk" should you "assume the risk". Another way of saying this relative to investments which wax and wane with the markets: if you can't afford to lose money, don't take the risk. And don't put it in mutual funds, variable annuities, your son-in-law's business or any other investment linked to the stock market or general economic activity without guarantees of performance backed by a financial solid guarantor, unless you can shoulder the risk. When your broker indicates that you don't need to read the prospectus before your commit your money, just remember that this is the legal document that governs your relationship with her company and in cases of dispute it is the "final word". There is a very good reason why you are required to acknowledge that you have read and understand the prospectus that goes with investments whose value is determined by "the market". Also, you should also know that you'll be required to agree to settlement by arbitration prior to doing business with a brokerage or stock firm. Any doubt in your mind why all this is necessary? Right again, things that wax and wane in value at the whims of the market are risky.

To finish the discussion on market risk, what about real estate? You've no doubt heard the story that given the growth in population and the limited supply of real estate, the price will only go up.

Therefore, invest in real estate if you want to make money. If you've studied real estate the first principle you learn is that only three things are important: location, location and location. And, the "location" that people are willing to pay for is constantly changing and the "costs of holding real estate" (taxes, insurance, vacancy and maintenance) are high and subject to frequent, and rapid, change. Also, exiting a real estate investment can be slow and expensive because "selling costs" are meaningful and a buyer is sometimes hard to find. While real estate has been, and will continue to be, a great investment for some speculators, it is risky on several fronts. If you can afford the risks associated with real estate, it is an appropriate investment; otherwise, you should proceed cautiously because prices do not automatically, and constantly, rise. Also, if the economy is gasping to breathe due to an economic downturn (or worse recession or depression), buyers can be few and far between: meaning real estate can be very illiquid even at below-market prices.

Interest Rate Risk

Interest rate risk is encountered daily but understood by few. Believe it or not, this risk exposes even gilt-edged securities like U. S. Government bonds to substantial losses. For example, let's say you bought today a 30-year U.S. Treasury bond paying 5% interest at its face value of $1,000. Interest of 5% will be paid every year and at the maturity in 30 years the $1,000 you paid for the bond will be returned. But, what happens if interest rates on similar bonds rise to 10%? Every interest payment on the 5% bond is below market because now it would take only one-half the investment to earn the same amount of money. Or, put another way, if you sold the 5% bond, a buyer would offer you only about one-half what you paid for it.

Even if you hold rather than sell, you have an unrealized loss since you're earning only 5% in a 10% environment. Of course, if you must sell, the market value will reflect the lower interest rate and you'll have to "discount" the bond to the buyer. What's more, the longer you have to go before you get your initial investment back, the worse the loss will be. In our example, the hurt will continue until the end of the thirtieth year and a buyer will take this extended suffering into account when shelling out money to buy your bond. If, on the other hand, you would have chosen a 5-year bond the buyer would suffer a shorter period with the lower interest payment and would not "discount" the price as much. If this concept is giving you a problem, think about your mortgage. If you have a 5% mortgage that is fixed for the next 30 years, you won't think much about refinancing when rates are 10%. Why? Because, the below-market mortgage rate has a value that you're unwilling to give up. But, if the 5% rate is due to increase to 10% in three months, the decision about refinancing would be less important because you don't have long to go before returning to market conditions. Conversely, if you have a 10% 30-year mortgage rate and new loans are priced at 5%, you'll be moving fast to refinance – especially if the lower rate can be locked in for a long time. Just remember, the longer a fixed-rate investment has to go until it matures, a given change in the interest rate will have a larger effect than if the maturity is near at hand. Also, while fixed rate savings vehicles such as saving bonds, bank CDs and government bonds are rock solid safe relative to getting your principal amount returned, they do have interest rate risk that will materialize into losses, either real dollar losses or lower earnings, if you sell before maturity or continue to hold when rates rise.

The cautious, but uninformed, investor may try to avoid interest rate risk by (a) buying only short term bonds (or bank CDs) that generally have low interest rates (remember the risk and reward trade-off), (b) buy only when interest rates are at the peak (is this possible?), or (c) buying investments that adjust to market every day, week or month which also have very low rates. Of course, the shorter the term you select the lower the interest rate you get, generally. Why? Because risk of shorter term investments is lower since there is less time for things to go wrong (like rates rising) and the associated return is lower to match the risk. If I borrow money from you and we agree it will be repaid tomorrow, you'll likely take a lower interest rate than if I promise to repay it in 30 years. Why? Many more things can go wrong in 30 years compared to one day. So even with rock solid safe investments, the longer you commit to keep your money invested in a financial instrument, the higher the interest rate you will generally receive. That's why 5-year bank CDs pay more than money market accounts and why 30-year government bonds have higher rates than 3-month Treasury bills. Once in a blue moon, short term interest rates exceed long term rates but this "inverted yield curve" is invariably temporary. The historical structure of interest rates has been long term rates exceed short term rates. This upward sloping rate structure is true whether you're a borrow or a lender.

Nonetheless, while many of you have your retirement money invested in safe places, you have it all in very short maturities. While you're to be applauded for keeping your risk low, you're giving up earning power by keeping all your money in the same, short maturity. And, loss of earning power is a "risk" that you should avoid whenever possible. This safe and short structure is fine if you intend to use the money near term or you are fearful of needing it for an emergency, but if you'll be using it systematically over your entire retirement, varying maturities that match the period of need will serve you better. If you intend to use your money at some distant point in the future, you should seriously consider having your investment mature at about the same time it will be needed. You don't pick fruit all at the same time for obvious reasons, and you shouldn't have all your retirement money coming due at the same time. Separate your retirement money into batches and allocate it in say five-year periods and then choose your investments so that each five years one is coming due that will sustain you until the next one matures. This is called "laddering" your investments since the maturities will resemble the rungs on a ladder. Of course, you've got to keep some of your money liquid for unexpected emergencies. Liquid usually means to the ability to get your money without loss on short notice.

I know that you've heard about this great investment that will pay you 12% when the going CD is paying only 4%. You should immediately sense something that is not quite right. Are you smelling "high rate means high risk"? Good, we're making headway. High risk means high probability that some, or all, of your money may become vapor. But, you say, my sister-in-law made that investment and it turned out great. Remember the law of probability: sometimes the long odds do occur that's why we have lottery winners. But, most of the time long odds don't pay off, and that's when the loss occurs. If you bet on horse races you know that long odds like 100:1 pay well if they win, but seldom do they win. Maybe your sister-in-law is lucky at the horse races too. There are no exceptions to the risk-and-reward calculus, so get the something-for-nothing out of your head. Also, there is no secret that only a few know, or only the rich know, that you can learn by paying $250 and attending a "tell all" seminar. The same is true of "learn the proven techniques of buying income generating real estate without any money down so that you can stop working".

If you can afford the risk and the potential reward is comparable, then you can safely assume the risk. That's why you play the lottery: a $2 bet may reward you with a $1,000,000 payday, but most likely you'll lose the $2 which was a risk you could afford. That's different than betting your $250,000 retirement nest in egg in hopes you'll turn it into $500,000 by this time next year. When you get that genuine promise that you can double your money in just one short year, don't even be tempted because it has never been true and it never will be unless you are willing to risk losing your money. You will occasionally see an ad in the newspaper that offers you a 50% return on a government guaranteed investment, but you now know that this is like a mirage in the desert – it doesn't exist. Do people double their money by investing for just one short year? Yes, but you'll hear a lot more stories about complete losses than you will about doubling. There are lottery winners, but there a millions of losers for every winner. You've probably seen advertisements about how you can make a killing just like the rich folks, or by using a method known only to the rich, or by doing the same as the person advertising the proven method. Ever heard the expression: "a fool and their money are soon separated"? The promise of a high reward with low risk is generally

the starting point of that journey. By the way, if someone invites you to an exclusive seminar, offers you a revealing CD or book to learn how you can get rich without risk, the first question you should ask is: "why don't they follow their own advice rather than collecting money from others for divulging their methods"? You see these schemes a lot with real estate, day trading the stock market and investment in commodities. There are no shortcuts, rainbow stew or free bubble-up without risk. In frontier America there were traveling salesmen that offer cure-all elixirs that cured all ill from headaches to bunions and everything in between. These drummers were called "snake oil salesmen" and the term is now used to characterize someone who is selling something that doesn't perform as promised. The next time you read about, or hear, of a violation of the immutable law of investing, remember the term "snake oil salesman" and you'll be able to avoid the temptation.

The Risk of Inflation

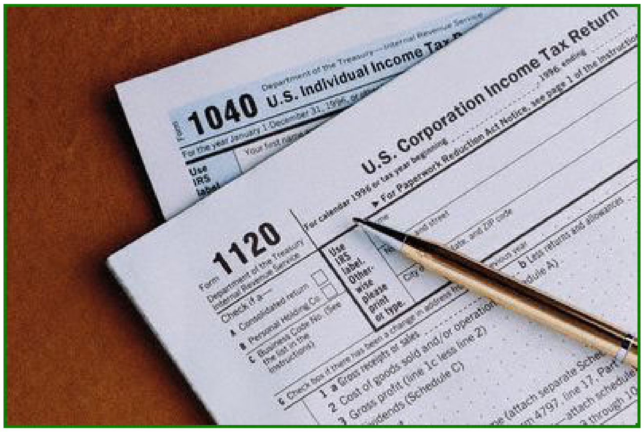
All the other risks are important but not as important, usually, as market and interest rate risks. However, one risk you now face, and will continue to face in retirement, is the change in prices of the things you use in your daily life – from automobiles to zucchinis and everything in between. You know this risk as "inflation" and it is especially important to those living on a fixed-dollar income, like retirees. It has often been said that "inflation is the cruelest tax of all" because it affects the people who can least afford it, like the poor and those on fixed incomes. Fixed incomes fit most retirees to a tee! By fixed income is meant that you're not working for wages and can't expect a "pay raise" every time price rise. Of course, some benefits like Social Security may be indexed to inflation and automatic cost of living increases are given, but mostly retirees use their fixed lifetime savings to support retirement. The earnings on this nest egg are not linked to the cost of living and the principal that earns the interest is constantly shrinking in purchasing power because of the falling value of the dollar. Inflation has a lot in common with gravity: it is constantly tugging and over time diminishes substantially what your money will purchase. Adding to the eroding effects of inflation is the fact that health care, a necessity that increases with age, is rising dramatically in price in response to better medical improvements, increased litigation against health care providers and longer life expectancy combined with a surging number of Americans reaching retirement age. The future looks like more of the same as the 76 million baby boomers are poised to join the retirement ranks over the next two decades. This "aging of the population" is true not only of Americans but also for most of the other affluent countries.

Rather than think about how much money you have, think about how much your money will buy, or its purchasing power. If you earn 4% on your bank CD but prices go up by 6%, you're going backwards at the rate of 2% a year. Add to inflation the leakage of taxes on that 4% of interest, and you have an even greater erosion of purchasing power. Of course, you can't always look at the Consumer Price Index (CPI) and use that as a measure of how much "your prices" are rising. You know that medical costs are accelerating at an alarmingly fast rate, and if you happen to be on medication or under the care of a doctor, then your cost of living is rising faster than prices in general. If purchasing power is not important to you, why not convert all your investments to cash and put it in a safety deposit box? Since you don't go that route, at some economic level you must be thinking that growing your money is important, probably because you know that a dollar tomorrow won't purchase as much as it will today.

When you're thinking about tomorrow and the money you'll have, always think in terms of what it will buy rather than the absolute amount of money you'll have. If prices increase just 7% annually, prices will double in ten short years and quadruple in twenty years. A visit to the dentist that cost $150 today will cost $600 in twenty years if prices rise 7% annually. Remember the bond example! The $1,000 in principal you'll be repaid in 30 years is not worth a lot today and that's another reason why *how much you earn on your money over long periods of time* is generally the most important aspect of an investment.

Over the period 1976 – 2006, consumer prices rose by an average of 3.52% annually. At this rate, every 20.04 years price will double. By the way, a general rule of thumb is that if you divide the annual interest rate, or price increase, into 72, the result will equal the number of years it takes for your money, or prices, to double. For example, 72 divided by 3.52 (average inflation rate over last 30 years) is equal to 20.45 years – very close to the actual 20.04 years. If you earn 5% (net of taxes) on your investment, then it will double in amount in about 14.4 years (72/5 = 14.4). Inflation over time works just like compound interest – it just works against you rather than for you.

Let's take a side trip. When talking about prices doubling and re-doubling we must also consider that our investments can do the same. Albert Einstein, everyone's favorite genius, said that compound interest is the most powerful force in the universe. Most of you take little time to think about this powerful force, but it can have a profound impact on your life – positive or negative. If you invest $1,000 today and leave it for 20 years, then it will be worth about $4,000 if you earn about 7% annually and don't pay taxes. If you pay taxes of 30% on our earning annually, it will take closer to 30 years for your money to grow to $4,000. Taxes slowed the growth of your money by ten years. The point: not paying taxes can be very important over the longer term because of the compound interest on the money not paid in taxes. That is why tax-deferral works so well and that is why it is smart to max out your 401(k), IRA and any other retirement contribution you can: you don't pay taxes on the earnings and more growth results from the powerful impact of compound interest. Tax deferral yields triple compounding: interest on the principal you invest, interest on the interest you earn and interest on the money you would ordinarily pay in taxes. Remember what Einstein said about compound interest? Well think about the effect of tripling that force! You'll find that triple compounding from tax deferrals can make a huge positive difference over longer period of time. That's exactly why you should lock up your retirement nest egg in safe, tax deferred savings options that mature near the time the money will be used to support your



retirement needs. Longer is better for two reasons: your tax deferral has longer to work and generally a commitment of longer term means higher rewards at the same level of risk.

The other side of compound interest, inflation, will also be a major factor during your retirement. Since your retirement is likely to last 30 years or longer, even annual inflation as low as 2.34% means that prices will double during your retirement years. To make your money last for the duration of your retirement, you can't afford to spend more that 4% or 5% of your retirement nest egg each year, adjusted annually for inflation. For example, let's say you have $500,000 in your retirement account and are age 65. To be reasonably sure your money will last for 30 years, you'll want to limit your withdrawal to an inflation-adjusted amount of about $25,000 annually. What is meant by "inflation-adjusted"? You adjust next year's withdrawals to account for this year's rate of inflation. For example, in year one you withdraw $25,000 but prices also rise by 4%; thus, next year you'd withdraw $26,000 (4% of $25,000 is $1,000 which would need to be added). The extra $1,000 only keeps your purchasing power even because last year's 3% inflation means it now takes $26,000 to buy what $25,000 would buy last year. Here are some price increases during the past 20 years:

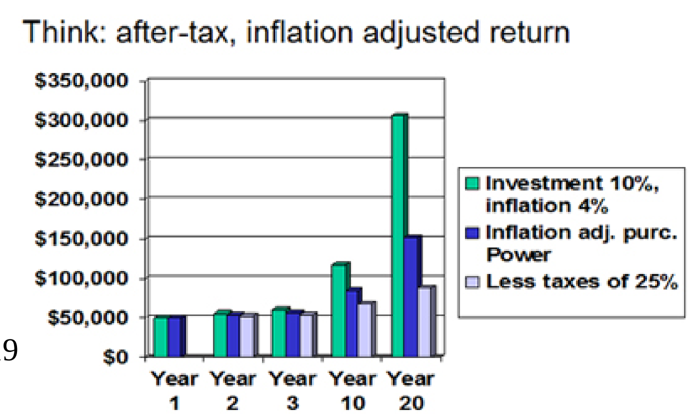
Ground beef prices up 79%
One dozen eggs cost 82% more
One pound of fresh tomatoes has increased 162% in price
One gallon of milk now costs 184% more

Notice we've not spent time talking about deflation (price decreases): over the past several decades price shrinkage has been limited to a few select categories like color televisions, computers and other items whose manufacture has benefited from new technology or mass production. In your lifetime, general deflation has not been a factor.

Least you think that you'll spend less on the basics as you age, government data show that people over age 65 spend roughly the same percentage of their yearly income on housing, transportation, food and entertainment as do all Americans. People older than 65, however, spend more than twice as much on medical care as the average American, even though they're insured by Medicare. In 1985 retirees 65 or older spend on average $880 on medical care and in 2005 they spend $5,150 – an incredible increase of 485%. Compare this price increase to those above! The compound interest emanating from inflation constantly erodes the purchasing power of your money and over long periods of time, like the expected length of your retirement, the effects are drastic. If both your earnings and inflation are 4%, you're losing ground because (a) there is always a share you've got to pay in taxes, and (b) as you age the percentage of your income going to health care will rise, and (c) unless the unexpected happens the inflation associated with health care will exceed by a wide margin the general inflation level.

Taxes

A closely allied topic to inflation is taxes. This is true because taxes, like inflation, erodes purchasing power. If you add up all the types of taxes that you pay – income, sales, property, excise, gasoline, *ad nauseam* – you discover an alarming fact: you're paying close



to half your annual income in taxes. But, you're getting law and order (sometimes), regulations that prevent unscrupulous businesses from ripping you off (oh, you haven't noticed), and an educational system that is head and shoulders above those of some third world countries. The upshot of inflation and taxes is that you've got to take them into consideration when you invest your money. Always ask: "what is the after tax, inflation-adjusted return I'm getting?" That means a bank CD that is paying you 2% is not really paying you 2% because inflation is 3% and you're paying taxes equal to 0.6% (30% income tax bracket). Your "real" rate of return, adjusted for inflation and taxes, on your bank CD in our example, is -1.6%. In other words, you're going backward and paying taxes on real losses in purchasing power. How does that make you feel? Don't expect your banker to tell you because (a) she probably hasn't figured it out or (b) if she has it is not in her best interest to let you in on the secret.

You should always take advantage of the legal tax breaks and always do the arithmetic so you know your after-tax return. You can boost your investment returns, without sacrificing safety and without the help of your CPA, just by taking advantage of the breaks that Congress has included in the tax laws. It's not wise to cheat on your taxes and pay less than your fair share, but taking advantage of the legal tax breaks is something you should not only do but you should take pride in exercising the rights Congress has provided you. Taking advantage of the legal tax breaks is just investing smart. It has been said that capitalism breathes through the loop holes in the tax laws: you should also look at the same loop holes for some fresh air. But, a word of caution: some of the razzle-dazzle tax schemes that supposedly take advantage of loop holes in the tax laws should be viewed with a jaundiced eye and you need to really look before you leap. I know you're also tired of paying income taxes of up to 85% on your Social Security income, but that is not a topic we'll discuss here. You didn't know you were paying taxes on your Social Security? We're making real progress!

The Solution to Risks & Inflation

So what's a typical retirement-minded, conservative saver to do to minimize risk, maximize safety and preserve a chance of getting a market return? How about putting your retirement money into something that is guaranteed to only go up in value if held until maturity – not dramatically but modestly, will benefit from market gains if they occur and not suffer from market declines if they happen, will avoid current income taxes on earnings, has no up-front brokerage fees or other charges, has liquidity for emergencies, and is backed by global companies with decades of operational stability and integrity?

Could this rare breed really be alive? Yes it is, but is does not violate the Immutable Law of Investing regarding risk and reward? It does offer the advantage of tax deferral conferred by Congress – just your IRA, 401(k) and other pension accounts. It allows you the "opportunity" to earn a better rate of return by computing your interest rate on changes in market indices. You have an opportunity to improve the odds of doing better without increasing the odds of doing worse. The "risk" you have is not knowing exactly how much interest you'll earn each year; however, you know if will always be positive because you're guaranteed some minimum interest rate unless you withdraw your money early. Is this savings vehicle appropriate for everyone? No: and neither is any other investment option. Will you get rich if you use exclusively this investment? Remember, it is rock solid safe and that tells you that the reward is not going to be outlandish. Is it available only to the rich? No, it is used by people at all income levels and in virtually every profession. It is used more by the senior-set than the young, but how many young people do you know that even save? There are IRS penalties for most withdrawals prior to age 59½ and penalties may be imposed by the issuing insurance company if you withdrawal all or more than your penalty free amount in any given year before maturity. It is offered by your bank, your broker and your financial advisor. It comes in very modest sizes or you can put mega-dollars into it. It comes in very short maturities or you can choose long ones. It is an ideal place to put your five to fifteen year retirement money – remember to match the maturity of your retirement money to the time when you intend to use it to maximize your reward.

That's about as close as we can get to financial utopia without boosting risk beyond acceptable limits for conservative savers. I'll not keep you in suspense any longer – the savings vehicle I've been describing has been around since ancient times and is used by lawyers when settling personal injury cases, by state when awarding lottery winning and in numerous other ways to provide guaranteed payments over time. We're talking about fixed annuities which are offered by the same insurance companies who insure your house, car, life, health, children, business and about everything else you value. Even though fixed annuities – notice the word "fixed" because some annuities are "variable" and carry more risk than the average retirement-minded saver needs to bear – has been around since ancient history, it has only gotten traction in the last few decades. You need to check it out if you haven't already – you'll find it available at your bank, at brokerage firms or from your financial advisor. As is always the case, take the time to know what you're putting your money into and once there watch it like a hawk. My prediction: you'll learn that your intermediate term retirement money will do very nicely in fixed annuities because they were designed specifically for retirement-minded conservative savers who need fair returns, some liquidity and safety.

Summary

There are no exceptions to the immutable law of investing: risk and reward are traveling companion. If you assume risk you have the potential of making above average returns, but there is no guarantee that you will. When you take risk by putting your retirement money in investments whose value is determined by "the market", you may experience losses or you may experience gains. There are no guarantees except with the safest of options like bank CDs, money market accounts, government savings bonds, and fixed annuities – and then only if leave you money until maturity. If you are offered above market interest rates or earnings, you should immediately remember that high risk goes with the promise of high reward. If you can afford to shoulder the risk, then proceed on the journey with caution, but if risking your retirement nest egg cannot be tolerated, don't make the trip. If your investment nest egg is in investments whose value is determined by "the market", then you have exposed them to market and/or interest rate risks. By taking risks with your retirement moneys, you are risking your retirement life style unless you have much more than needed after adjustments for inflation and taxes.

If you take risk with your retirement nest egg you must realize that you may not have time to earn back a loss. And, if you do recover your loss you must take into account the effects of inflation and taxes on the purchasing power. A dollar today is worth more that a dollar in the future because inflation is constantly undermining purchasing power. Taxes add insult to injury because often times you suffer a real loss but have a taxable gain. For example, if your bank CD is paying 4% when inflation is 3.5% (the historical average over the last 30 years) and you are in a 25% tax bracket, your real earnings are a negative 0.5% because you're paying 25% in taxes and inflation is taking 3.5% of the 4% you earned (4% - 1% - 3.5% = -0.5%). You should always think about the future value of your retirement money in terms of inflation-adjusted, after-tax value, i.e., purchasing power. One of the scary aspects of an expected 30-year retirement is the current exploding cost of health care that will likely be further fueled by the 76 million baby boomers entering retirement over the next two decades.

Compound interest, the most powerful force in the universe according to Albert Einstein, which comes in triple strength with tax deferral, can make a substantial difference in the earnings on your retirement money. Accordingly, you may be able to put your money to work harder and smarter by using tax deferred savings vehicles like fixed annuities to build a maturity “ladder” that provides funds when they are needed for use in retirement. Placing all your retirement money in short term maturities for rock solid safety and instant liquidity can be very inefficient because you’re giving up the higher earning power of longer term commitments.

The other important point to remember in retirement other than “risk and reward” is: everyone is unique and no one investment, or collection of investments, is good for everyone. Conversely, no one investment is bad for everyone. The make sure you avoid risks you can’t afford, consider all the options that are appropriate for you, and get the hardest and smartest work from your money. To realize these objectives it is recommended that you do the same thing you do in all other aspects of your life when you need expert advice or assistance: consult a professional. In the case of retirement, a professional financial advisor that can steer you clear of investment hazards that can threaten your retirement life style.