FOR INVESTORS

America's lifetime income challenge

Retirement income planning | White paper

EXECUTIVE SUMMARY

America faces a complex challenge: securing incomes that last a lifetime for a rapidly growing population of retirees.

With life spans rising, the U.S. Census Bureau projects that America's over-65 population is on track to double by 2040 – to more than 80 million people.

Over the past generation, America has become a society of investors. Both retirement and employee medical benefits programs are placing more and more reliance on individual savings and wealth management. This shift to individuals is occurring at a particularly challenging time for managing investments. The bear markets from 2000 to 2002 and 2007 to 2009 resulted in the worst 10-year stock market performance ever – even including the Great Depression.[1] The impact to the psychology of retirees and pre-retirees is likely to be long-lasting.

This paper begins by describing the scope of America's retirement income challenge. It discusses the changes in financial thinking that retirees must make as they transition from full-time work and wealth accumulation to retirement and possible wealth drawdown. It lays out five key risks that retirees face in planning for lifetime incomes: longevity risk, inflation risk, poor asset allocation, too-rapid withdrawals, and rising health care costs. It explains the need to consider investment probabilities in retirement planning, rather than relying on historical average returns. And it discusses specific trade-offs and possible solutions to help achieve a secure retirement.

To improve the odds of living comfortably in retirement, Americans must develop realistic retirement income plans and cushion their investment portfolios against unforeseen financial shocks. Lastly, it is extremely important that individuals revisit and update their plans regularly as their circumstances change.

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Fidelity INVESTMENTS

SECTION 1

Aging America and the broken bubble

Over the past generation, a seismic shift has occurred in how retirements are funded in this country – away from companies and the government and onto the shoulders of individuals. A majority of American households became stock market investors – for the first time – directly or through their retirement savings plans. With greater individual responsibility comes greater risk, which was never more apparent than when U.S. equity markets experienced three down years in a row, from 2000 to 2002, or the more recent bear market from October 2007 to March 2009. These severe stock market corrections most sharply impacted people in or close to retirement and resulted in trillions of dollars in wealth being lost.

Many retirees have had to adjust their budgets and downsize expectations for retirement living. Some have had to go back to full-time work. Many people still in the workforce feel compelled to delay retirement, raise their savings, and lower their expectations about post-retirement lifestyles that had, until the market corrections, looked to be very comfortable.

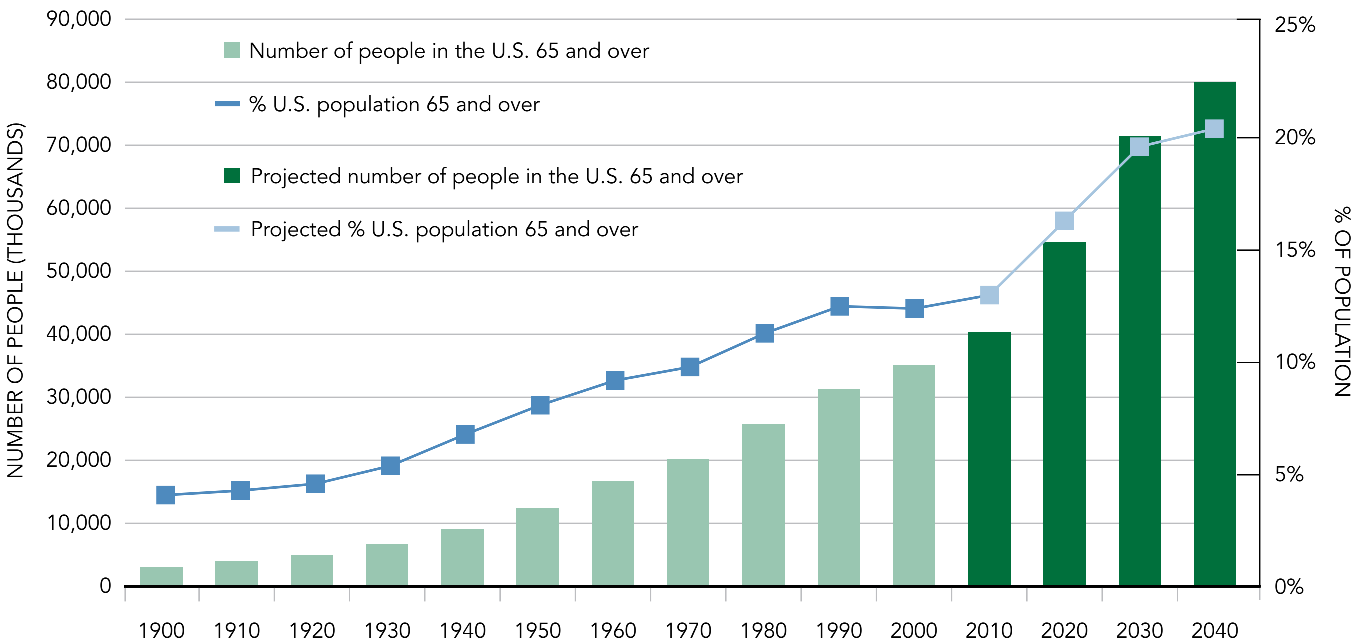
Coming after the heady years of a long bull market – which saw the percentage of American households owning stocks climb from less than 20% in 1982 to a peak of 57% in 2001 (and back down to 48% in 2008) – these corrections have made financing a comfortable retirement seem a more daunting challenge than ever.[2] It also underscores the importance of building a retirement income plan that has the potential to sustain even severe market downturns.

There is no way to dodge it; individually or as a nation, time is running out for many Americans to take the necessary steps to secure their financial futures.

As Exhibit 1 demonstrates, more than 35 million Americans, one in eight, are over age 65 right now. By 2040, more than 80 million Americans will be over 65 – over 20% of the whole population. A major factor that will contribute to this projected spike will be 76 million baby boomers – those born between the years 1946 and 1964, the largest generation in American history.

EXHIBIT 1

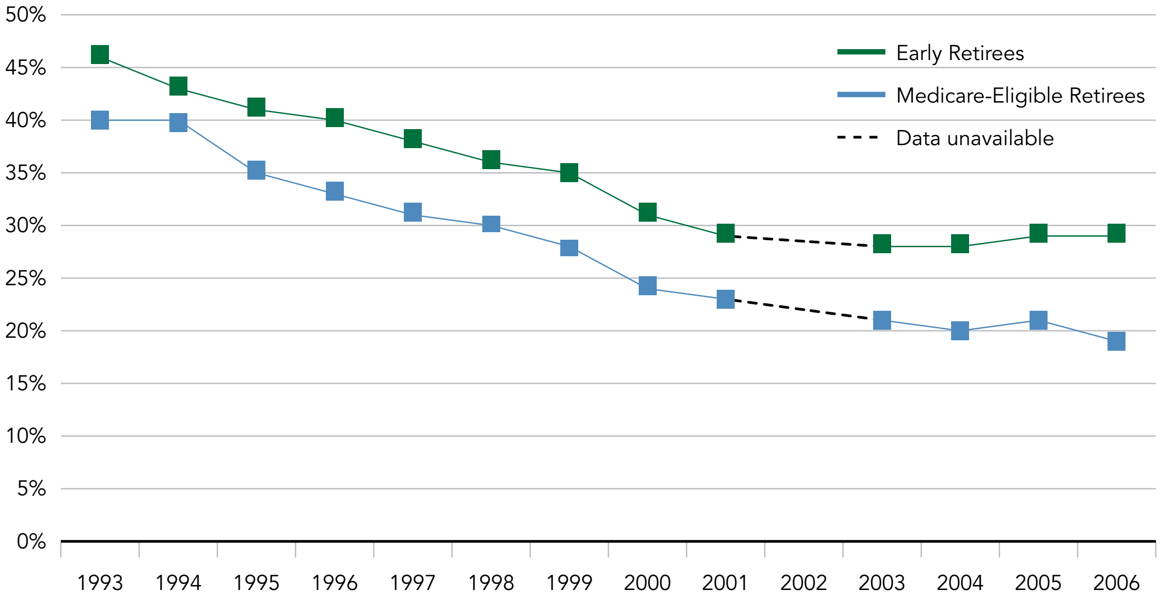
Aging U.S. population



Sources: U.S. Census Bureau: National Estimates by Age, Sex, Race: 1900-1979 (PE-11), Intercensal County Estimates by Age, Sex, Race: 1980-1989, Annual Population Estimates by Age Group and Sex, Selected Years from 1990 to 2000, 2004 "U.S. Interim Projections by Age, Sex, Race, and Hispanic Origin," Consistent with 2000 Census, Internet Release Date: March 18, 2004.

EXHIBIT 2

Employer-sponsored retiree health coverage among organizations with 500+ employees



Source: Mercer Human Resources Consulting, 2006 National Survey of Employer-Sponsored Health Plans and Employee Benefit Research Institute, Issue Brief 279, March 2005. (Data unavailable for 2002.)

Boomers are turning age 60 at the rate of more than 7,900 a day, or 330 people every hour.[3] Finding reliable sources of income that they won't outlive is becoming a more difficult challenge.

Short-term events and long-term trends make financing retirement more uncertain and complex. Stock prices hit 12-year lows (as measured by the S&P 500®) in March of 2009, and savings rates – though significantly higher than a year ago, are still too low. On the job, the shift from defined benefit (DB) pension plans to defined contribution (DC) plans places more responsibility on employees for their retirement security.

Of particular concern for future retirees, as Exhibit 2 demonstrates, is the movement by companies to drop extended medical care coverage for retired employees. By the end of 2006, only 19% of companies with over 500 employees still offered their retirees health care coverage.

As recently as 1993, 40% of such companies offered retirees this benefit. The trend is clearly down. Yet total medical care spending continues to grow faster than inflation, rising 6.1% in 2008 alone.[4]

As people live longer, they will need to stretch their retirement finances over more years than they imagined.

Fortunately many Americans do have the means to help create retirement income solutions that fit their lifestyles – if they take inventory of their resources, plan intelligently, and act. Americans over age 65 are healthier and wealthier than previous generations of retirees. The U.S. Census Bureau reports that the poverty rate among Americans over age 65 has been cut by more than two-thirds, from 35% in 1960 to just 9.7% in 2007 – significantly more progress than the decline from 22% to 12.5% for the population as a whole.[5]

Americans aged 50 to 60 are among the fastest-growing age groups and are entering their peak earning years. Many are inheriting their parents' wealth and finishing payments on such big-ticket expenses as mortgages and college tuitions. The result may be net gains in wealth for this cohort over the decade. For many retirees and pre-retirees, the key variable for a comfortable retirement will be the ability to plan well and make their resources last.

The bottom line: More of the responsibility for meeting income needs and health care expenses in retirement is shifting to individuals, and we all need to make retirement income plans to meet that responsibility. By planning wisely, we increase the potential of enjoying our retirement years.

SECTION 2

The challenge: from wealth-building to lifetime incomes

Millions of Americans a year are entering into a dramatically different phase of their financial lives. As they transition from full-time work into retirement, they are moving from "accumulation" – building wealth through savings in their working years – to "distribution," drawing on those savings for income they can rely on for the rest of their lives. Those life savings will also be the source for any legacies they may choose to leave.

This transition is more than just a move from work to retirement – it requires a major change in the way people manage their money. This new "post-retirement" phase of people's financial lives poses new challenges that require a new mindset. Of course, many of the investment principles and strategies that people rely on while accumulating wealth remain valid in retirement. But there are significant differences in how they may be applied tactically.

The consequences of not making prudent investment decisions can be painful. For example, an October 2008 report by the Society of Actuaries, "Managing Post-Retirement Risks," states that the poverty rate among elderly widows was as high as 15% – nearly four times greater than poverty levels among elderly married couples. A significant factor was that the fall in income caused by the death of a spouse can often be greater than any reduction in expenses. To sustain their lifestyles, the study suggests, surviving spouses need income to cover as much as 75% of their previous expenses, not just half.

The core principles for building lifetime wealth through financial assets are quite straightforward. Consider investing as early in life as possible; keep investing regularly; build a well-diversified portfolio strongly weighted toward equities in one's early years; then add an increasing share of less volatile, but also historically less rewarding, fixed-income assets as retirement age approaches.

This basic strategy of age-appropriate asset allocation is based on the past performance of stocks, bonds, and short-term investments and the knowledge gained from previous generations of investors. It aims to avoid the twin risks of excessive caution early in life and excessive risk-taking close to and in retirement. It enables an individual to use time itself to overcome adverse short-term moves in the equity markets and so capture the long-term growth potential of stocks.

Looking back as far as we have records, equities as a class have significantly outperformed bonds or cash for long investment horizons, e.g., 20+ years. But stock markets can also decline rapidly and substantially during the short term or deliver low returns for several years at a time, and past performance is no guarantee of future results.

Age-appropriate asset allocation strategies are designed to optimize a person's chances of benefiting from those long-term patterns. In the retirement savings arena, these strategies aim to accumulate wealth by a date that individuals generally do have significant control over – their chosen time for retirement.

America's financial services industry has done a fairly good job of educating the public about this accumulation phase of lifetime financial management. Millions of Americans broadly follow these principles in their 401(k) and IRA savings plans.

But at the point where individuals transition from building assets to drawing down their life savings, their situation becomes more complex – and the stakes of making correct choices rise. Retirees have, after all, moved from a situation in which they could count on long-term averages to correct mistakes into a less forgiving world in which they must depend on current, real returns from their portfolios – and plan based on probabilities, not averages. (See the following pages: "The Flaw of Averages.")

The financial services industry has not done a very good job in preparing its customers for this distribution phase of their financial lives.

A 2005 study by LIMRA International, Inc., a life insurance marketing research organization, found that only about one in three retirees or one in five pre-retirees has any formal, written plan for managing income, assets, and expenses during retirement.* Many who do have plans base them on incorrect assumptions. And most retirees are simply "playing it by ear" – at serious risk to their long-term financial health.

Of course, many basic investment principles – diversification, finding an appropriate risk-reward asset allocation, keeping a long-term perspective – carry over to helping secure lifetime income in retirement. It may make sense, for example, for young savers to begin acquiring equities as the first core elements of their retirement assets to maximize lifetime appreciation potential. By the same token, it also may make sense for most retirees to allocate some portion of their post-retirement portfolios to equity investments.

Based on historical measures, equities held early in retirement may have time to deliver truly long-term returns, because they can – and should – be held to finance income needs in later stages of retirement, which may be twenty, thirty, or even more years away.

But some savings and investment tactics change when moving from accumulation to drawdown. For example, younger workers typically benefit most by saving the maximum allowed in tax-sheltered savings vehicles like IRAs and 401(k)s first before they set aside any other savings. By contrast, most retirees benefit by drawing on their taxable assets first, saving their tax-sheltered savings for last – drawing on them only after other, non-sheltered savings are exhausted. The differences between drawing taxable and tax-sheltered assets wisely or unwisely can add or subtract years of income.

Another example is guaranteed income. Accumulators generally don't need guaranteed income, whereas retirees often need guaranteed income for life to help pay for essential expenses.

There are several other key differences between the accumulation and distribution or drawdown phases. While young savers can monitor their accumulation progress using long-term average annual returns as a benchmark for progress, retirees have to meet their expenses from real, current returns on their assets. These returns can fluctuate substantially and unpredictably each year.

While younger savers can aim at a fairly predictable and controllable retirement date, retirees simply don't know how long they themselves or their spouses will live. They can't, then, forecast with much certainty how long their financial resources need to last.

The five key risks that everyone should address as they plan for retirement include: longevity risk, or the likelihood of living well beyond their theoretical life expectancy; withdrawal risk, or the potential of drawing down their savings too rapidly; inflation risk, or the potential decrease in the purchasing power of retirement income; asset allocation risk, specifically being too conservative or too aggressive; and the risk of not having set aside enough money to cover future health care expenses.

Some of these risks are more complex than the types of financial hazards that people have faced in building up their retirement nest eggs. And mistakes in managing post-retirement risks are more difficult, sometimes even impossible, to correct. Yet all of these retirement income risks can be met, and potentially overcome, provided people understand them and take action by creating sound retirement income plans, either on their own or with guidance from financial professionals.

The bottom line: Entering retirement and beginning the distribution phase of one's financial life involves a major change in financial tactics and mind-set to successfully manage a series of high-stake risks.

* LIMRA International. Based on a 2005 survey of over 2,000 individuals aged 55 to 70 with at least $50,000 in household investable assets.

The Flaw of Averages

One of the most common and potentially disastrous mistakes in planning for income after retirement is to base those plans on historical average returns – and then project those averages out in a linear manner for 20 years or more. This approach to planning is somewhat like deciding to wade across a river based on the average depth: the average may be four feet, but that won't help you when you're in the middle of a section that's 12 feet to the bottom.

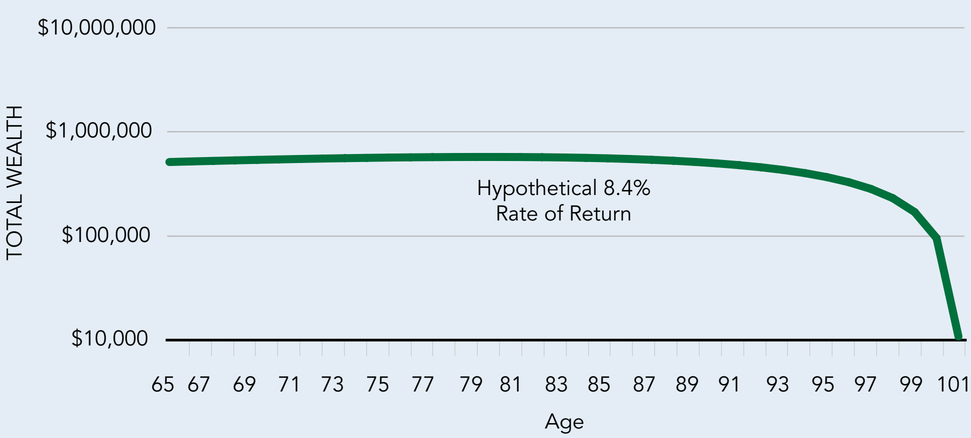
Referring to long-term averages does have some utility in the accumulation phase. It can encourage younger savers to look past short-term volatility, particularly in equities, and continue steadily building up their assets.

Post-retirement, though, the options for correcting errors are more constrained. Planning retirement income streams on a linear projection of average returns can very easily create a misleading sense of security or certainty about a portfolio's chances of success. The real world of markets and investments is much more variable and unpredictable.

This is how "Monte Carlo" simulations – probability pattern generators that show the full range of possible results from a given portfolio of assets – can be very useful. Instead of a single answer based on historical average returns, such as "you can draw down 6% of your portfolio a year," a Monte Carlo simulation will examine hundreds of possible future outcomes for a portfolio – based on past market actions or even on hypothetical events that range beyond past experience and show probabilities of reaching a specific goal.

EXHIBIT 3

Retirement income plans built only around average returns may provide a false sense of security



Planning based on averages may not provide an accurate picture because market volatility isn't considered.

Source: Fidelity Investments. Hypothetical value of assets held in an untaxed account of $500,000 invested in a portfolio of 70% stocks, 25% bonds, and 5% short-term investments. Average rates of return for stocks, bonds, short-term investments, and inflation are based on the risk premium approach. Actual rates of return may be more or less. The chart is for illustrative purposes only and is not indicative of any investment. These illustrations assume a 6.5% inflation-adjusted withdrawal rate.

Past performance is no guarantee of future results.

See "Methodology and Information" in the back for further details about indexes and methodology used to produce the chart.

These two ways of assessing a portfolio produce dramatically different images of the likelihood of success. For example, in Exhibit 3 we see a hypothetical illustration of a portfolio's assets over more than 30 years based on a 6.5% inflation-adjusted withdrawal rate, but assuming that historical average returns of 8.4% occur smoothly. The implication is that this portfolio may deliver a reliable income stream over that period.

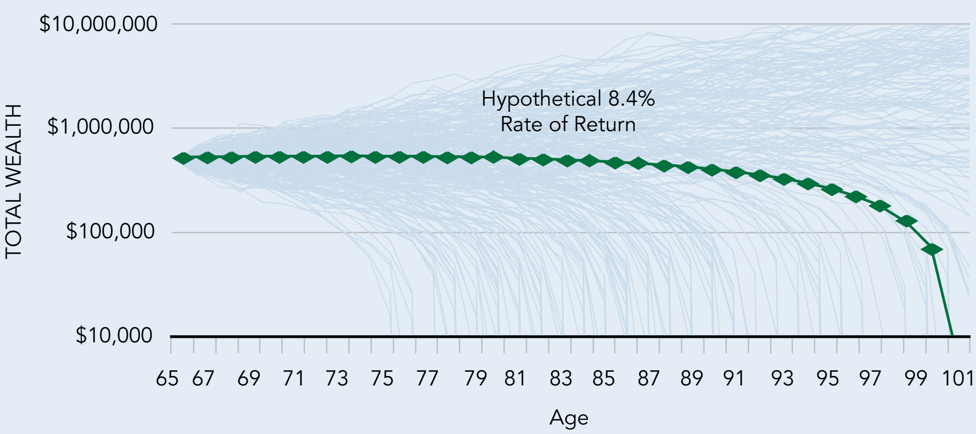
And it might. In fact, it might even return more. But running the same portfolio with the same withdrawal rate through a Monte Carlo simulation model tells a dramatically different story (Exhibit 4), because the simulation uses hundreds of possible hypothetical returns for the portfolio and it shows a very wide range of possible outcomes.

More importantly, the analysis reveals that in real market conditions, this portfolio – which looked rock-solid based on projecting past averages into the future – actually has only a 62% chance of delivering income for 25 years through age 90 and drops to 53% if the person lives to age 95. Perhaps more troubling, it also has a significant chance of failing in less than 20 years – a possibility that a projection based on averages thoroughly, and misleadingly, masks.

One simple lesson for those seeking lifetime income security: use one of the many online Monte Carlo simulation tools to test your retirement income plan. Taking account of the full range of possible return scenarios can enable you to plan much more reliably for the type of retirement you want than relying on a potentially misleading long-term average.

EXHIBIT 4

A sound retirement income plan should be built around multiple return scenarios



Planning based on multiple return scenarios provides a more accurate picture because market volatility is considered.

Source: Fidelity Investments. Hypothetical value of assets held in an untaxed account of $500,000 invested in a portfolio of 70% stocks, 25% bonds, and 5% short-term investments. Average rates of return for stocks, bonds, short-term investments, and inflation are based on the risk premium approach. Please refer to the Methodology and Information page at the back of this paper for important information about the methodology used in this chart and index information. Actual rates of return may be more or less. The chart is for illustrative purposes only and is not indicative of any investment. These illustrations assume a 6.5% inflation-adjusted withdrawal rate.

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SECTION 3

Five key risks to lifetime income

Financial security in retirement depends on understanding a series of risks that can erode even significant life savings – unless people understand these risks and plan to manage them. Here are the five biggest challenges to creating secure lifetime incomes.

1. Longevity "Risk"

One of the most astounding success stories of the 20th century was arguably the sheer extension of human life spans. Advances in science and medical research have driven this success by increasing the likelihood that more infants will survive into adulthood and the probability that 65-year-olds will have a greater chance of living into their 80s and even 90s.

But when it comes to retirement income planning, life expectancy figures can be seriously misleading. Half of the people born at any given time will outlive their own life expectancies.

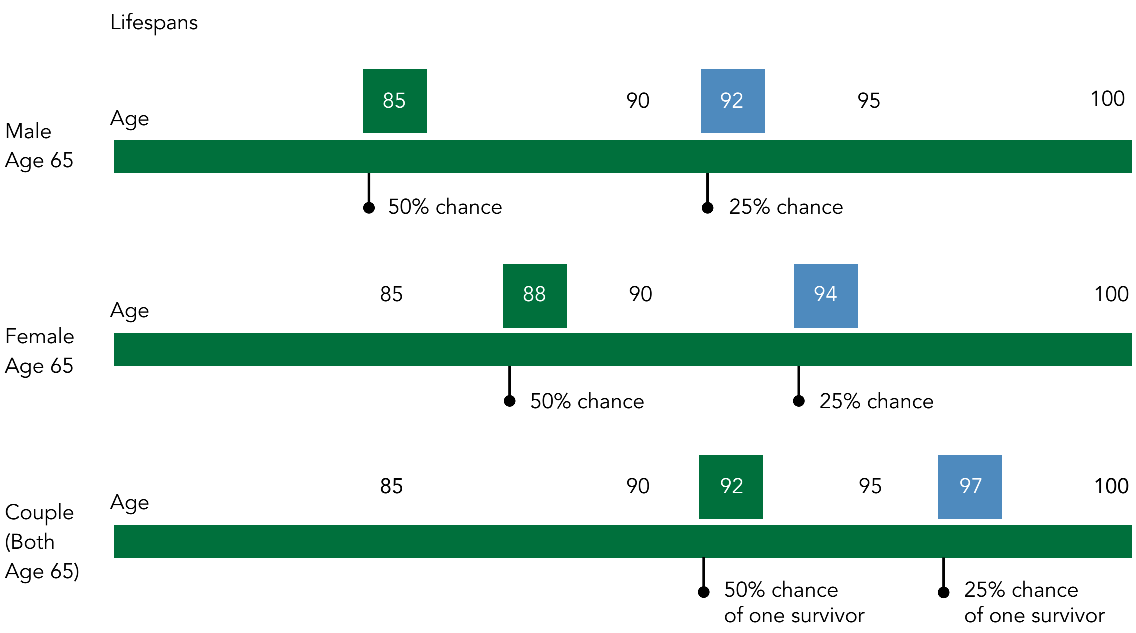
This means that most people ought to think hard about longevity risk – the real possibility of living 20, 30, or even 40 years past retirement age. Without planning, a longer-than-expected life could easily lead to a person, or couple, outliving their savings.

Though it really boils down to a simple sentence, "You need to plan for the possibility that you will live longer than you think," longevity risk is probably the least-understood variable in retirement income planning. Very few people have any clear sense of the distinctions between the life expectancy of their own age group and the probability that they will live many years beyond their life expectancy once they reach age 65. Fewer still realize that if they are in good health, even people who have reached age 80 or 85 still have quite high probabilities of living 10 or 15 more years.

As a result, most people underestimate the length of time they need to plan for living in retirement. Let's look at the facts. As Exhibit 5 shows, an American man who has reached age 65 in good health, for example, has a 50% chance of living twenty years to age 85, and one chance in four of living to 92. For a 65-year-old woman, those odds rise to a 50% chance

EXHIBIT 5

Retirees should plan for longer life expectancies due to increasing longevity



Source: Annuity 2000 Mortality Table; Society of Actuaries. Figures assume a person is in good health.

of making it to age 88 and one chance in four of living to 94. The odds that at least one member of a 65-year-old couple will live to 92 are 50%. And there is one chance in four that one member of that couple will live to 97.

As medical research and technology continue to push that life span envelope, more and more healthy individuals just entering retirement will have to make plans for the very real possibility of needing 30 to 40 years of post-retirement income.

2. Inflation Risk

Inflation, the long-term tendency of money to lose purchasing power, impacts retirement income planning in two ways: by increasing the future costs of goods and services and by potentially eroding the value of assets set aside to meet those costs.

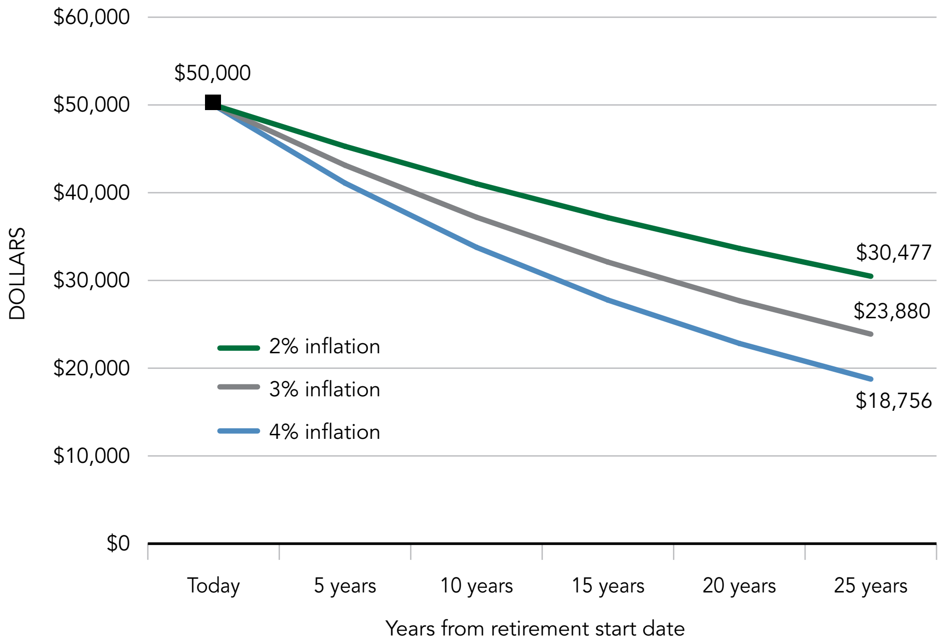
During the late 1990s through the turn of the 21st century, Americans experienced what felt like a period of relatively low inflation. But like the asset bubble of the 1990s itself, recent experience is more likely to be an exception than a reliable indicator of the future.

In fact, even in the 1990s, a decade in which inflation was relatively low by recent standards, overall costs, as measured by the Consumer Price Index, rose more than 30%. Looking over the course of the 20th century as a whole, inflation eroded ordinary Americans' purchasing power by about 95% – reducing a 1900 dollar to a 2000 nickel.[6]

EXHIBIT 6

The effect of inflation on purchasing power

Even at a low inflation rate of 2%, in 25 years $50,000 will buy as much as $30,477 buys today.



All numbers were calculated based on hypothetical rates of inflation of 2%, 3%, and 4% (historical average from 1926 to 2009 was 3%) to show the effects of inflation over time; actual inflation rates may be more or less and will vary.

Inflation, in other words, is more norm than exception.

The high likelihood of continued inflation makes investments that have the potential to beat inflation imperative – especially over the longer retirements that today's retirees can anticipate.

As Exhibit 6 indicates, even a relatively low inflation rate of 2% can have a significant impact on a retiree's purchasing power. For instance, $50,000 of income today would only be worth $30,477 in 25 years.

What's more, general inflation may not capture the impact of rising medical expenses on retirees. Between 2001 and 2004, for example, a study by Families USA found that "prices for the 30 drugs most commonly prescribed for older Americans rose 22% … 3.6 times overall inflation rate for the same 3-year period." In the five years since that study, drug costs have continued to significantly outpace the general rate of inflation. Numerous studies also show that the majority of lifetime medical costs are incurred in the last few years of life, posing additional high costs in the very last stage of retirement.

3. Asset Allocation Risk

Long-time-horizon investors aiming to build wealth may be able to wait out the inevitable ups and downs of the stock market. But retirees and those close to retirement age generally have less time to recover from downturns. Pre-retirees' accumulation plans can be sharply set back – and their retirements possibly delayed – if their lifetime savings portfolios are over-concentrated in stocks when a serious bear market strikes. Retirees who rely on fixed incomes and are uncertain of their time horizon must, by necessity, care more about current returns year by year than about long-term returns.

However, fear of being caught in a bear market causes some retirees to err on the side of what they might perceive as caution – and they end up liquidating their stock holdings. But retirees should recognize that they, too, may have sufficient time to benefit from wise asset allocation strategies and carefully sequenced plans for asset drawdowns to maximize the long-term income potential of any given pool of wealth. There is a real danger that many anxious retirees may overreact to a down cycle by selling most or all of their equity holdings and aiming to meet lifetime income needs solely with cash and fixed-income instruments. What can greatly help retirees is having the right set of income products. Retirees who have a high level of certainty they can pay their essential expenses (for life) no matter what happens in the financial markets are much less likely to overreact to a bear market.

Unless retirees have huge cash resources relative to their needs, adopting such an ultraconservative strategy can actually be quite dangerous to their financial health. It can, in fact, seriously increase the risk that they will outlive their assets. Why? Because it eliminates the long-term upside potential and inflation hedge that diversified stock investments offer. Such a strategy may, for many, prove to be the mirror image of another typical investment error: the failure of some young investors to acquire diversified stock holdings in their early working years.

Even in retirement, as we'll see, the key to long-term success can lie in a Balanced (50% stocks, 40% bonds, 10% short-term) to Growth (70% stocks, 25% bonds, 5% short-term) portfolio – neither all stock, which makes a person too exposed to bear market risk, nor all bonds and cash with scant potential for upside appreciation.

Exhibit 7 illustrates how long different asset allocation portfolios are likely to last, at a 6% inflation-adjusted annual withdrawal rate, given different asset allocation strategies. Using Monte Carlo simulations, this illustration shows the length of time different portfolios might survive under both extended down market conditions and average market conditions. A 6% withdrawal rate is only used to illustrate the relationship between risk and return – it is not a specific recommendation for withdrawing assets in retirement.

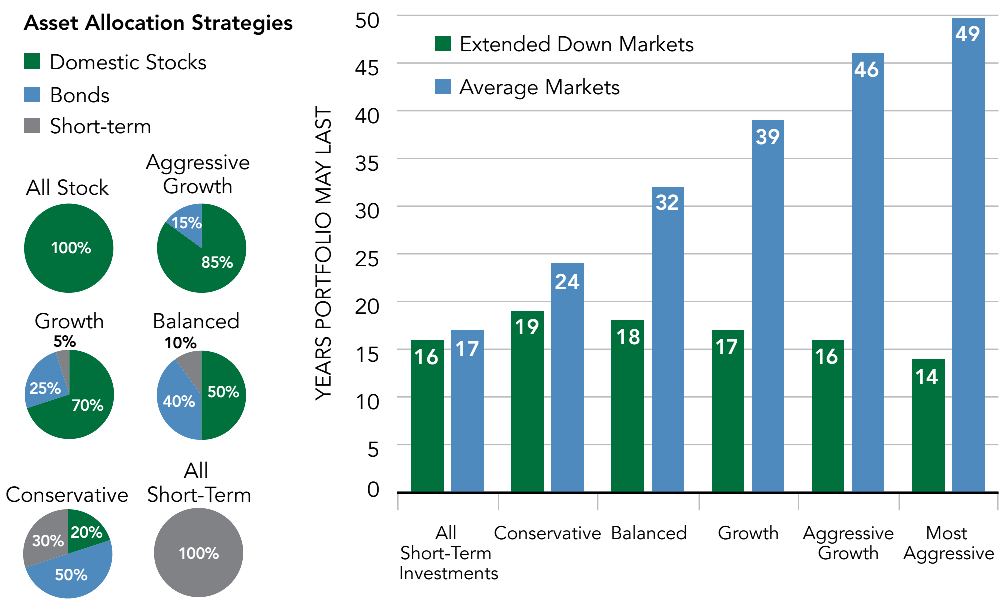
The bottom line: Longer retirement income planning horizons – reflecting greater awareness of longevity risk – make stock holdings vital for portfolios intended to provide income throughout retirement.

Not surprisingly, as a portfolio's potential for volatility increases, the length of time it might survive in a down market decreases. A more aggressive portfolio composed of

EXHIBIT 7

Stocks should be part of a retirement portfolio

How long your money may last depends on your asset allocation and the long-term performance of the market. Consider, for example, a 6% withdrawal rate strategy.



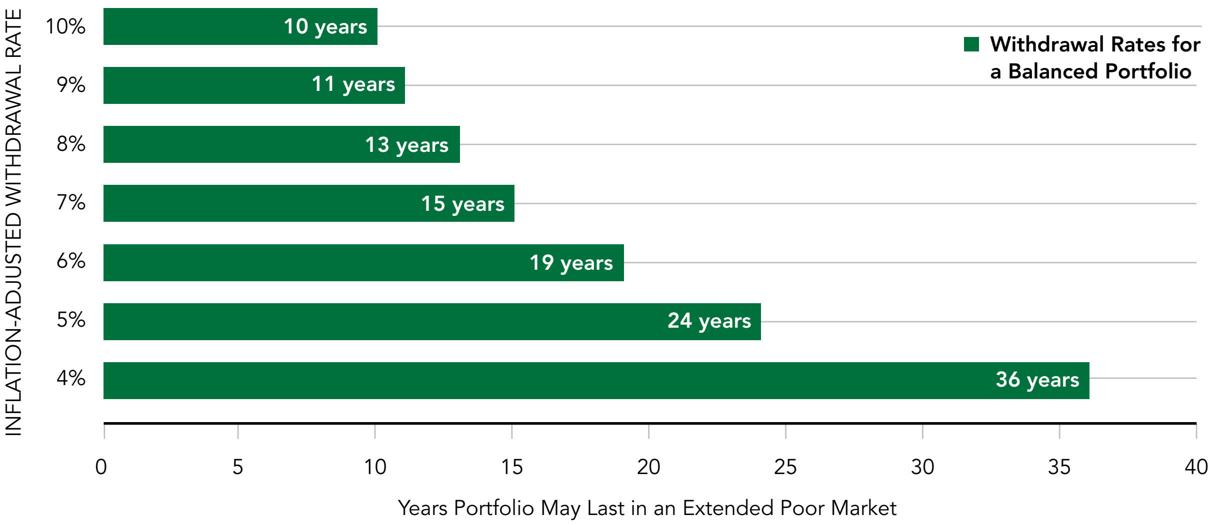
Source: Fidelity Investments. Average rates of return for stocks, bonds, short-term investments, and inflation are based on the risk premium approach. Actual rates of return may be more or less. The chart is for illustrative purposes only and is not indicative of any investment. Past performance is no guarantee of future results.

See "Methodology and Information" in the back for further details about indexes and methodology used to produce the chart, including definitions of "Extended Down" and "Average" Markets.

EXHIBIT 8

Higher withdrawal rates can derail your plan no matter what your asset mix

Consider the following:



Withdrawal Rates for a Growth Portfolio

10%	9 years
9%	10 years
8%	12 years
7%	14 years
6%	17 years
5%	22 years
4%	32 years

Source: Fidelity Investments. Hypothetical value of assets held in an untaxed Balanced portfolio (50% stocks, 40% bonds, and 10% short-term) and Growth portfolio (70% stocks, 25% bonds, and 5% short-term investments) and inflation-adjusted withdrawal rates as specified. Returns for stocks, bonds, short-term investments, and inflation are based on the risk premium approach. Please refer to the Methodology and Information page at the back of this paper for important information about the methodology used in this chart and index information. Actual rates of return may be more or less. The chart is for illustrative purposes only and is not indicative of any investment. Past performance is no guarantee of future results.

See "Methodology and Information" in the back for further details about indexes and methodology used to produce the chart.

85% equity, for example, might only last 16 years in a down market scenario, versus 19 years for a conservative portfolio. However, being too conservative may not allow a portfolio to grow enough to last for a lifetime. Under average market conditions, a conservative portfolio might only last 24 years, versus a projected 46 years for an aggressive portfolio. It appears that a moderate to growth-oriented portfolio may be able to strike a balance between preserving capital during down markets and providing potential for continued growth during retirement. Even if it seems counterintuitive, especially after the downturns (2000 to 2002, and 2007 to 2009), historical asset-class returns suggest retirees do need stocks for the long haul.

4. Withdrawal Risk

Until recently, many people were misled into overly optimistic withdrawal rates in their early retirement years because their expectations of the future were conditioned by the high equity returns realized from 1982 to 2000. Many retirees simply assumed that they could look forward to drawing out 7%, 8%, or even more per year – then count on rising stock prices to keep the total value of their portfolios virtually unchanged, or even growing.

The severity of the most recent market corrections (2000 to 2002, and 2007 to 2009) has exposed this fallacy. After the market downturn, many financial advisors reported that they had to downsize retirees' budgets and lifestyle expectations. Some were even seeing customers forced to go back to full-time jobs – precisely because of overly generous withdrawals in their early retirement years.

Exhibits 8 and 9 look at withdrawal risk in an extended poor market. Exhibit 8 shows how long a balanced portfolio of 50% stocks, 40% bonds, and 10% short-term instruments might last if its owner withdrew between 4% and 10% a year, adjusted upwards annually for inflation. The scenario was run at a 90% confidence level.

Exhibit 8 shows that at a 10% withdrawal rate, a retiree could only count on a Growth investment portfolio lasting nine years and a Balanced portfolio lasting 10 years. However, at a 4% withdrawal rate, the investment portfolio might last for 32 years with a Growth portfolio and 36 years with a Balanced portfolio – long enough to provide a 65-year-old with an income stream lasting into their 90s. Moving that rate up to just 6% might risk exhausting those assets by age 84 – an age which a majority of current 65-year-olds are expected to live to see. (People who have advanced far along the age curve, and whose portfolios have held up well, may decide that it is very reasonable to increase their withdrawal rate.)

Exhibit 9 looks at the impact that a range of inflation-adjusted withdrawal rates would have had on a $500,000 portfolio of 70% stocks, 25% bonds and 5% short-term investments over the period from 1972 to 2008. This period includes the great bull market of the late 20th century – roughly 1982 to 2000. But it also encompasses three of the worst bear markets in Wall Street history, six recessions, and the rabid inflation and painfully tight monetary policy of the late 1970s – one of the worst inflationary outbreaks in U.S. history. This exhibit uses the actual, historical returns over this period.

As you can see, it shows that the initial pool of $500,000 would have been exhausted by the late 1980s if funds were drawn down at a 6% rate. It also shows, along the bottom axis, that a 65-year-old couple who retired in 1972 with this portfolio would face more than a 90% probability of having one member survive to see those assets completely drained away. If the assets are needed to pay for essential expenses, most retirees would consider such a high probability to be unacceptable. If the assets are to be used to fund discretionary expenses only, then somewhat more risk may be taken (though not necessarily a 6% withdrawal rate). A more modest 5% withdrawal rate could have extended income from the portfolio for nearly 25 years, but it still would have run out at a time when there would still be a 63% chance of one member of our retiree couple being alive.

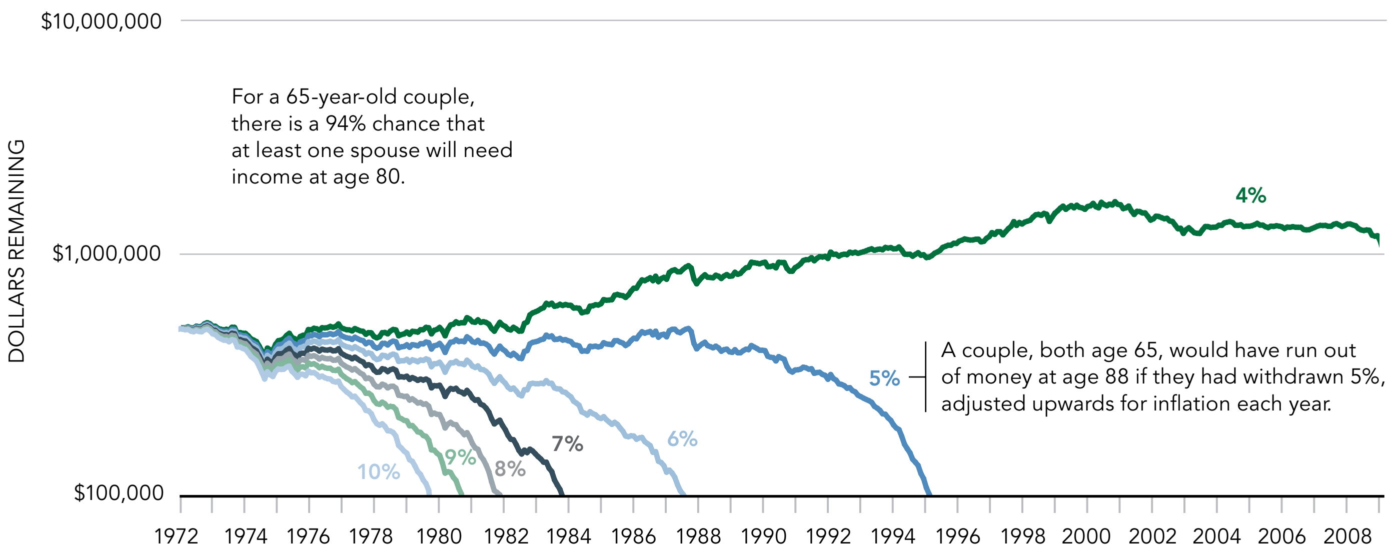
In this extreme case, only a 4% withdrawal rate could have been supported. It would have left enough total assets intact to catch the full tailwind of the long bull market that began in 1982. Indeed, this portfolio with a 4% withdrawal rate would actually have risen to $1.7 million at the market crest in 2000 before falling back to just about $1.3 million by 2008.

Exhibit 9 illustrates how the combined risks of inflation, market volatility, and withdrawal rates run parallel with the risk of longevity itself, which is so easy to underestimate. It also illustrates the power of potential stock returns – given enough time – and the critical importance of withdrawal rates.

EXHIBIT 9

Sustainable withdrawal rates can extend the life of a portfolio

How a 65-year-old couple retiring in 1972 with $500,000 is affected.



Hypothetical Couple (Both Age 65)*	100% at age 65	99% at age 70	98% at age 75	94% at age 80	83% at age 85	63% at age 90	35% at age 95

Source: Fidelity Investments. Hypothetical value of assets held in an untaxed account of $500,000 invested in a portfolio of 50% stocks, 40% bonds, and 10% short-term investments with inflation-adjusted withdrawal rates as specified. Please refer to the Methodology and Information page at the back of this paper for important information about methodology and index information. This chart's hypothetical illustration uses historical monthly performance from January 1972 through December 2008 from Ibbotson Associates: stocks, bonds, and short-term investments are represented by S&P 500, U.S. Intermediate-Term Government Bonds, and U.S. 30-day T-bills, respectively. This chart is for illustrative purposes only and is not indicative of any investment. Past performance is no guarantee of future results. *Probability of a couple surviving to various ages is based on Annuity 2000 Mortality Table; Society of Actuaries. Figures assume a person is in good health.

See "Methodology and Information" in the back for further details about indexes and methodology used to produce the chart.

This isn't to say that a 4% to 5% withdrawal rate offers magical security or assures infinite asset sustainability. Those outcomes depend on market performance. But it is clear that rates much above 5% begin – fairly quickly – to increase depletion risk of a retirement income plan.

The bottom line: The risk of being put on a path to depletion rises steeply at withdrawal rates over 5%. This risk can be magnified even further if a sustained market correction – similar to the 2007–2009 correction – occurs early in retirement. For this reason, Fidelity believes that retirees should consider using conservative withdrawal rates – particularly for assets needed to support essential expenses. Retirees may feel comfortable taking a higher withdrawal percentage (with greater chances of depleting assets) when running out of money has no severe consequences. That is, when funding discretionary expenses, more risk may be taken than when funding essential expenses.

5. Health Care Expense Risk

However their portfolios perform, retirees' finances can be dramatically affected by the state of their health.

Indeed, health care costs pose very real risks of throwing lifetime income plans off track if they are not provided for – and the core trend in this area is not good. For a time in the mid- to late 1990s, managed care programs and other health care cost containment measures had wrung some expenses out of the system. More recently, though, health care costs have resumed growing well beyond the rate of general inflation – climbing 6.1% in 2007 to reach an all-time high of over 16.2% of America's gross domestic product, the broadest measure of all goods and services produced in the United States.[7]

EXHIBIT 10

Saving for retiree health care costs

Age at Retirement	Total Savings Required (Life Expectancy 82 male, 85 female)	Total Savings Required (Life Expectancy 92 male, 94 female)
55	$420,000	$595,000
60	$330,000	$505,000
65	$240,000	$415,000

Source: Fidelity Employer Services Company, Benefits Consulting; based on a hypothetical couple retiring in 2009 with both average (82 male, 85 female) and longer life expectancies (92 male, 94 female).

See "Methodology and Information" in the back for further details about the methodology used to produce this table.

Longer life spans, retiree medical costs rising faster than general inflation, declining retiree medical coverage by private employers, and possible shortfalls ahead for Medicare and Medicaid all add up to make health care costs a critical challenge for retirees and pre-retirees alike.

A 2009 study by the Fidelity Employer Services Company estimates that a couple retiring today at age 65 will need current savings of at least $240,000 to supplement Medicare and cover their out-of-pocket health care costs in retirement, unless they have an employer-funded retirement health plan (see Exhibit 10). A couple retiring at age 60 would need to plan on spending substantially more on health care costs – an estimated $330,000 over the course of their retirement. But these savings only cover expected costs through ages 82 and 85 respectively. When planning to ages 92 for a male and 94 for a female, a couple retiring today at age 65 will need current savings of $415,000.

Unfortunately, retiree health care benefits are clearly and dramatically on the decline as more and more companies try to shed that burden. As shown previously in Exhibit 2, just in the years from 1993 to 2006, among companies employing more than 500 workers, the percentage offering retiree health benefits fell from 40% to just 19%.

Inadequate health care coverage – for medical costs not covered by Medicare or Medicaid or for unexpected nursing home and rehabilitation costs – can have a devastating impact on a retiree's lifetime income plan. That vulnerability is most acute for early retirees, especially in the years before age 65 when Medicare coverage is not yet available.

The bottom line: So substantial is the risk posed by health care expenses that most retirement experts now believe that health insurance itself has become one of the core elements of current retirement security along with pensions, personal savings, and Social Security. Funding such insurance, then, should be considered an essential expense in the lifetime income planning process.

None of these estimates include possible long-term care (LTC) expenses. Yet roughly 44% of males and 72% of females in America reaching age 65 are expected to need LTC services at some point in their lives.[8] Formal custodial care services can be provided in a variety of settings including at home, adult day care, assisted living facilities, and traditional nursing homes. Nursing homes are generally both the most expensive care option and the one that, according to one study, individuals are most eager to avoid.[9] Nonetheless, the costs for a one-year stay in a nursing home may range from $45,589 to over $157,113. The costs of home health aides, adult day care, and assisted living facilities are generally lower than those for nursing homes but can still threaten retirement plan security.

That makes maximizing resources specifically intended to meet health care costs an urgent challenge. People in or close to retirement should, therefore, give serious consideration to long-term care insurance. This insurance is costly at any age. But it is significantly less expensive the earlier in life that a policy is purchased.

SECTION 4

Retirement trade-offs and potential investment solutions

One way to define financial success in retirement is the ability to successfully manage available resources to navigate around the risks we've discussed, while being able to provide reliable income to sustain a particular lifestyle. This broad definition, however, needs to be customized to each person's situation. That's because total life savings, real risk levels and risk tolerance, family health, and the costs of desired lifestyles vary so widely.

In this section, we examine a number of key factors that everyone needs to take into account while seeking retirement income security. This is not a comprehensive review of all aspects of retirement planning. We don't, for example, cover estate planning and trust services that many retirees will want to consider for their heirs. Instead, we focus on a retiree's own desired lifestyle. We then discuss some key trade-offs that people should understand before they make the critical financial and investment decisions needed to achieve their vision.

Getting Started: Visualize Your Retirement

The very first step in planning for lifetime retirement income is for people to envision what they would like their retirement to look like. What will they do when all of their weekdays could now be weekends? Where do they want to live?

What is most important to them – passing on a large legacy to heirs or taking a first-class vacation cruise every year? Do they want a life of full-time leisure, or are they interested in pursuing a new career or working part-time? How concerned are they about their own health or that of their spouse?

Once people have carefully considered what shape their retirement may take, they can make a more accurate estimate of what it will cost to fund that lifestyle. To that end we recommend retirees (and pre-retirees) estimate both essential expenses, such as food, housing, and health care, and discretionary expenses such as vacations and entertainment.

Clearly, visualizing retirement involves unique, deeply personal choices that each person or couple must make for themselves. But the exercise does get people on the road to matching resources and investment strategies with their desires. It also illuminates the fact that for most people, achieving their desires and reaching contentment in retirement depends primarily on planning, saving, and successfully balancing a series of trade-offs.

Three Keys to Contentment in Retirement: Save, Plan, Diversify

A 2002 study of American retirees by gerontologist Ken Dychtwald underscores the importance of these factors.[10] In Dychtwald's analysis, retirees divide into four broad categories, ranked in terms of their sense of contentment: "Ageless Explorers," who are financially affluent, feel fully in control of their lives and eager to launch new ventures; "Comfortably Contents," who are also financially solid but prefer a more leisurely lifestyle; "Live for Todays," who do see retirement as a new life, yet are anxious about their finances; and "Sick-and-Tireds," people who failed to plan adequately and now feel unfulfilled in retirement.

Interestingly, the study found the single biggest driver of satisfaction was not total assets per se, but financial preparedness – the sense that retirees' resources and plans for drawing on them would sustain their chosen lifestyles for many years to come. The two key determinants of preparedness were the number of years spent saving for retirement and the degree of diversification of retirees' assets across several investment classes and vehicles – ranging from IRAs and 401(k)s to real estate, annuities, and mutual funds.

Regardless of their absolute wealth, the most satisfied retirees were those who had been saving for 24 years or more using a variety of these vehicles.

The decision to save for retirement is itself a trade-off between consuming now and consuming later. Retirement saving also provides a less tangible benefit for individuals – the knowledge that their assets are growing to meet future needs at a time when they are likely to be less able to work and earn. This pattern of having to weigh and choose among trade-offs – sacrificing something now to acquire something later – begins, then, well before retirement. And it continues as a person structures an income plan for the rest of his or her life.

The First Trade-Off: Timing Retirement Itself

One of the most basic trade-offs revolves around the timing of retirement itself – precisely, when to stop working or downshift to part-time work. This is something that most retirees have substantial control over. And there is growing evidence that more people are now deciding to postpone full retirement. This may reverse a long-running trend to early retirement that ran for much of the last half of the past century. In 1976, for example, the percentage of men between ages 62 and 64 still in the workforce was over 56%. Twenty years later, in 1996, that had fallen to just over 45%. But by 2008, the percentage of men aged 60–64 still working had ticked back up to nearly 60%.[11]

This evidence isn't enough to declare a trend away from early retirement. But changing attitudes toward work and leisure do seem to be raising Americans' typical retirement age. A service-based economy with fewer physically demanding jobs may be both increasing demand for seniors' experience and increasing their willingness to work. Some sociologists look forward to seeing millions of seniors use their mid-60s – following their "first retirement" – to go back to school and retool before pursuing a second or third career, full- or part-time.

Yet few people realize how much a decision to delay retirement can contribute to income security later in life. It can, for example, help make any later decision to return to work a voluntary choice – not a sheer necessity.

Consider the multiple advantages of delaying retirement from beyond the minimum threshold for collecting Social Security benefits – age 62 – to age 65, 66, or 67, when full retirement benefits are available.

Assuming a person's job provides medical benefits, remaining at work through this period brings a person to full eligibility for Medicare coverage by the time he or she retires. That alone eliminates the need for just over three years of expensive medical insurance costs. Staying on the job past age 65 also provides a bit more than three full years of additional income – and potential savings.

Meanwhile, the pre-retiree's retirement nest egg remains untapped and may benefit from further compounding. This delay also raises the full Social Security benefits the person will be eligible to claim – significantly. And going forward, future inflation adjustments to that later retiree's Social Security income will be calculated from a higher initial base.

According to the Social Security Administration Benefit Calculator (at www.ssa.gov), a 55-year-old baby boomer born in 1954 and now earning $50,000 could expect a monthly benefit (in 2009 dollars) of $1,114 on retiring at age 62; $1,544 on retiring at age 66; and $2,115 if he or she delayed retirement until age 70.

This is a classic trade-off, pitting immediate leisure against continued work and greater future income. Here's how it can play out over time. Social Security is designed to deliver roughly equal total incomes to its recipients up to typical life expectancies. By about age 82, then, a male who retires at 62 will have received virtually the same total income as a man who waited to age 65½ to collect. At that "crossover" point, though, the patient retiree, whose monthly benefits are higher, begins to pull ahead. Should he live to age 92, he will collect tens of thousands of dollars more from the system than the early retiree. And that doesn't count the additional income he could draw during retirement from his extra years of savings, the appreciation of untapped assets, and the savings on medical insurance costs he made by working longer.

Converting Assets for Lifetime Income

Another trade-off, again a very personal one, is the choice that retirees must make about how much they can afford to spend in retirement. This depends on the full array of income sources they can draw on. Unless retirees have sufficient guaranteed pension and Social Security to cover all of their retirement expenses for life, they will have to consider strategies for structuring and drawing down their life savings to provide income to cover those expenses not met by guaranteed income sources. This, in turn, will require trade-offs – sacrificing liquidity and flexibility, for example – to secure guaranteed income streams for life.*

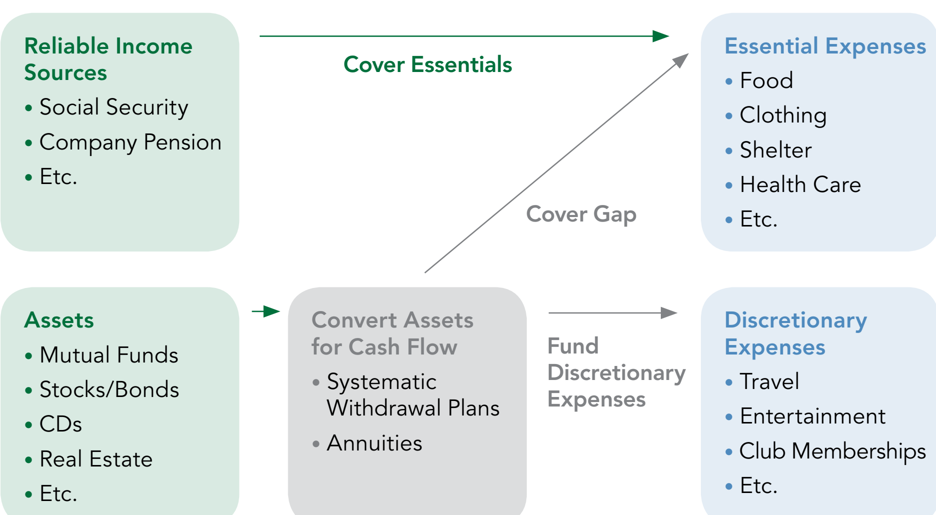
Exhibit 11 illustrates a basic template for approaching retirement income planning. It suggests using the most predictable income sources to meet essential expenses and converting financial assets to cover any income gaps. Then, after there is a reasonable certainty that essentials are covered, financial assets can be directed to fund more discretionary expenses such as travel, entertainment, and club memberships.

Meeting essential expense needs first can give retirees a sense of assurance that their most critical costs may be covered for life. As the name suggests, discretionary expenses are "nice to haves," which can be adjusted up or down depending on lifestyle changes or the performance of financial assets earmarked to cover these expenses. And the assurance of knowing essential expenses are covered may better position retirees to ride out periods of volatility in the financial markets.

Two possible options for converting financial assets into sources of lifetime income include systematic withdrawal plans (SWPs) and annuities. Retirees who have sufficient financial assets relative to their income needs – and who want to retain flexibility – may prefer to rely solely on these assets to fund retirement expenses, living off the dividends these assets may generate or setting up a SWP to liquidate a portion of their holdings at periodic intervals.

EXHIBIT 11

Match the reliability of cash flow to the importance of the expense



* Guarantees are subject to the claims-paying ability of the issuing organization or company.

While a SWP strategy can create a long-term income stream by regularly liquidating a portion of a diversified investment portfolio, the value of such an asset pool can vary with market conditions.

People who wish to buttress their retirement investments with more predictable sources of income may want to consider income annuities. They can provide a specific amount of income for a lifetime or, if so desired, shorter, fixed periods of time, e.g., for 5 years or 10 years. The trade-off is that they do not offer as much flexibility as a SWP strategy because assets must be converted at the beginning of the annuity period to fund the income payments. That commitment of assets has the potential to reduce bequests to heirs if an annuitant dies in the early years of an annuity contract.

The impact of inflation should also be weighed when deciding which type of annuity to purchase. A variable income annuity, which adjusts annuity payments to an underlying portfolio of investments, may provide some protection against the loss of purchasing power brought on by inflation, while most fixed annuities pay a set level of income that will not adjust for inflation. Recently, insurance companies have started to offer Consumer Price Index-linked annuities, which automatically increase their payments along with the general level of inflation. These annuities may be especially attractive to individuals seeking to maintain their standard of living throughout their retirement. Another option is a simple cost of living-adjusted (COLA) income annuity for life. Income payments increase at a set percentage each year, say 2% or 3%, to account for expected inflation.

Like other types of insurance, there is a cost element to an annuity, which helps to fund the income guarantee. However, for many people this additional cost may be worth the certainty of knowing that they are adding another predictable source of income to help cover essential expenses throughout their retirement years.

The following is a list, but by no means a complete list, of potential building blocks for retirement income security – and some of the trade-offs they embody in terms of certainty, possibility for growth, and flexibility.

Social Security provides guaranteed income for life. It is also adjusted automatically for inflation, though the Consumer Price Index used as its inflation measure may understate the rise in health care costs for retirees. Once a retiree has formally signed on, there is no flexibility. The choice of timing on formal retirement locks the person into a set pattern of payouts for life.

Pension plans refer to traditional defined benefit programs, which also provide predictable lifetime income. A few pensions (about 5%) also offer the possibility of increased future payments to compensate for inflation. Like Social Security, there is little or no flexibility once a pension plan withdrawal is initiated and benefits will, in most cases, be reduced on the death of a spouse.

Systematic Withdrawal Plans (SWPs), as mentioned previously, are strategies for drawing income from a given pool of investments, such as stocks, bonds, and mutual funds. SWPs can be designed to last for specific time periods or a lifetime, if recipients adjust their payments each year for market fluctuations or life expectancies. Calculations on how much income might be safely drawn from a given asset pool may be made using Monte Carlo simulations of that pool's range of likely results (see Sidebar: "The Flaw of Averages").

While there are many ways to structure a portfolio to support a SWP, all retirement portfolios should include investments that have the potential to protect against the deleterious effects of inflation, which in many cases means having some exposure to equity investments. Looking at the S&P 500 as a proxy for the stock market, historical experience shows that returns on equities have outpaced other major financial asset classes.[12]

But equities have also been subject to sharp drops, including a record 68% fall in a single year during the Great Depression of the 1930s and more recently the decline of more than 50% experienced from October 2007 to March 2009. Yet stocks have also produced positive returns for every 20-year period since 1926. They have averaged returns of 930% for every twenty-year period since then. Equity performance over these longer periods has ranged widely from a low of just over 45% to a remarkable high of over 2,700%. While past performance is no guarantee of future results, this record strongly supports equities' utility as a long-term hedge against inflation. The operative word, of course, is "long-term." Mutual funds and stocks are also highly liquid. Generally they can be sold at any time, which offers great flexibility.

Bond funds^ can also play multiple roles in a retirement portfolio.

^ Unlike most FDIC-insured bank products, such as CDs, a bond fund's yield, share price, and return will vary and you may have a gain or loss when you sell shares. In general, the bond market is volatile, and bond funds entail interest rate risk. They also entail the risk of issuer or counterparty default, issuer credit risk, and inflation risk.

Bond funds pay monthly dividends, which retirees can receive in the form of cash or have reinvested for additional compounding; or they can act as an important diversifier for a portfolio that is too heavily weighted to more aggressive stock investments. And because bond funds own a large number of individual securities with varying maturities and coupons, investors aren't overly reliant on any one bond. Certain bond funds can even be diversified across various sectors of the bond market including corporate, government, mortgage-backed, and government agency securities. Unlike individual fixed-income securities, bond funds do not have set maturity dates, and their principal value will fluctuate inversely with interest rate movements. Conservative investors can look to mitigate this risk to a degree by investing in bond funds with shorter maturity dates or by investing in inflation- protected bond funds, which invest in U.S. Treasury securities and whose principal value will adjust to inflation as measured by the Consumer Price Index.

Bond or CD "ladders." Investors who want a fixed schedule of income payments, or who want their principal returned on a specific date (depending on the credit-worthiness of the issuer of the bond), may wish to investigate investing in individual bonds. A common investment strategy for doing so is a bond ladder. This entails investing in multiple bonds, which provide regular income streams for specific periods of time, typically five or ten years into the future. The maturity dates for the bonds can be staggered (for instance, a set number of the bonds may mature annually) to lessen the impact interest rate movements can have on the principal value of the bonds that are purchased.

By assembling a portfolio of bonds, retirees may be able to receive a relatively predictable income stream for a targeted period of time (at least until maturing bonds in the ladder need to be reinvested) and then reassess their income needs at the end of the period. Because a bond ladder can be constructed to provide a known amount of income for a number of years forward (similar to a period-certain annuity), using this strategy may also enable retirees to segregate another pool of assets for investment in growth-oriented mutual funds or equity pools. This strategy trades off any prospect for significant asset growth in exchange for a time-certain income stream. It does, however, offer some flexibility because the individual bonds underlying ladders are generally quite liquid.

More conservative investors can create ladders using FDIC-insured Certificates of Deposit (CDs), which are bank deposits meant to be held for specific periods of time. CDs generally pay higher interest than regular bank savings accounts, but offer less flexibility since most impose some sort of penalty if they are cashed in before maturity.

Bond or CD ladders still expose the investor to interest rate/reinvestment risk and inflation risk (especially for long-term bond ladders). Bond/CD ladders offer absolutely no growth potential (unless the interest rate environment is favorable). It should also be remembered that "guaranteed" income is only guaranteed to the extent that the issuing entity can meet its obligations.

Real estate. Real estate assets such as primary or vacation homes and investment properties can be used in a variety of ways to provide retirement income – through rental income, from investment of the proceeds of property sales, or through the use of a "reverse mortgage" (a loan that allows an owner to convert the equity value of a home into a source of income). Each of these methods for converting real estate into a source of funds for retirement has certain advantages, risks, and costs associated with it, which should be reviewed carefully with the help of a trusted advisor.

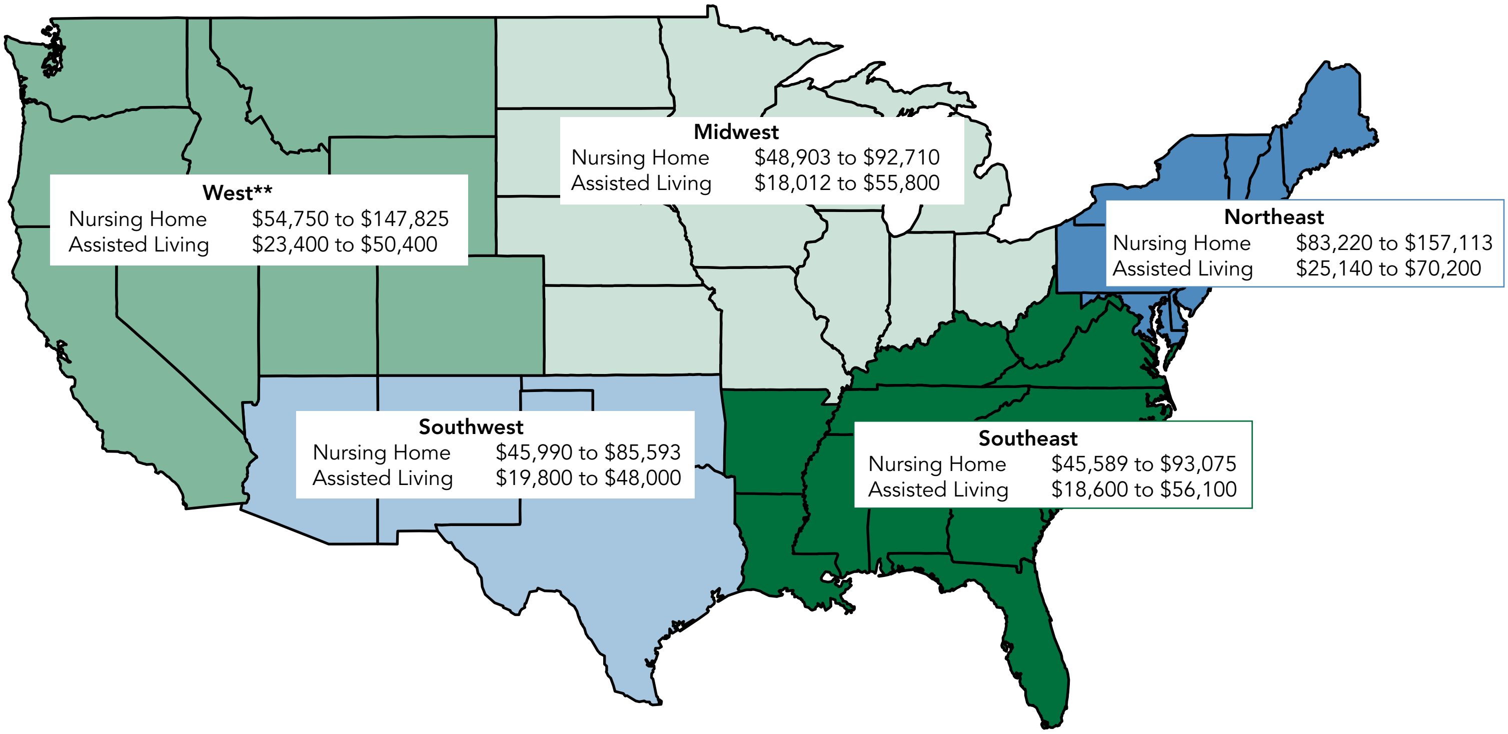
Fixed and variable income annuities offer lifetime incomes in exchange for a nonrefundable initial investment. They can be valuable components of a plan to assure guaranteed* coverage of essential expenses. Income annuities come in two basic forms. Fixed annuities promise to make regular equal payments of income either for a specific period of time or for as long as a person lives, but most do not adjust for inflation. Variable income annuities† also offer period specific or lifetime incomes, but as the term indicates, that income may vary up or down depending on the performance of the annuity's underlying investments. As with stocks and equity mutual funds, a variable annuity could provide a partial hedge against inflation – but the payments are not guaranteed or fixed.

The bottom line: Solving for predictable lifetime incomes involves a complex series of trade-offs. These touch on retirees' core values and preferences – ranging from their desired lifestyles to their wish to leave substantial estates to heirs, to their willingness to endure some uncertainty or pay more for income guarantees. There is no one-size-fits-all solution. The only absolute is the need to plan wisely to help increase the likelihood of a secure retirement.

* Guarantees are subject to the claims-paying ability of the issuing insurance company.
† Taxable amounts withdrawn prior to age 59½ may be subject to a 10% early-withdrawal penalty tax.

EXHIBIT 12

Annual nursing home and assisted living costs by region



Annual Cost for Long-Term Care Coverage[1]

Age 45	Age 50	Age 55	Age 60	Age 65	Age 70	Age 75
$3,810	$4,206	$4,797	$5,955	$8,302	$12,179	$18,239

Source: Genworth Financial, 2007 Cost of Care Survey, March 2007, pp. 26–29.

1. Premiums shown are for coverage with 5% compound benefit increase option and assume the couple qualifies for standard risk classification. Policy has a 5-year benefit period covering an initial maximum of $200 per day in qualifying long-term care expenses per person. (A 5-year plan is illustrated because it strikes a balance between cost and adequate benefits. According to Genworth Life Insurance Company, for all long-term care claims ever paid which lasted or are projected to last longer than one year, only 25% extended beyond 5 years. Thus, a 5-year benefit period can be thought of as a plan with a 75% confidence level of not being exhausted due to aggregate costs of care.) A 90-day elimination (waiting) period applies before expenses would be paid. Coverage is comprehensive – it pays benefits for formal care in multiple settings including in the home. Source: Genworth Life Insurance Company, November 2007.

** Excludes HI and AK.

Trade-Off: Long-Term Care Insurance

The government's Medicare does not pay for most nursing home or assisted living costs if retirees are no longer able to care for themselves. Consequently, another trade-off retirees need to weigh is the one between the costs for long-term care (LTC) insurance and the risks that lack of such coverage may inflict serious damage on their assets if they do face prolonged nursing home stays. Exhibit 12 illustrates the costs of annual nursing home and assisted living care in various regions of the United States and the annual costs of LTC insurance for couples who qualify for standard health rates.

A long-term care insurance policy may pay most of the costs for nursing home care, and many policies may also pay for care at home or other community settings.

Since policies vary in coverage, it's important that people who are considering LTC insurance understand the terms of what the policy covers, by either carefully reading the contract or consulting with an advisor. The financial strength of the insurance company issuing the policy is also another major consideration, given that an LTC policy can be in force for a long period of time.

LTC coverage is increasingly expensive as people age. But nursing home costs can be devastating if they run for long periods. Retirees must calculate this trade-off with a clear sense of their personal health and history as well as a sense of the statistical likelihood of needing an extended stay in a nursing home facility. For example, while half of people over 65 will spend some time in a nursing home, the average stay is less than three years. Three years of living in a nursing home, with costs ranging between $45,589, and $157,113 per year depending on region and quality level of care, is a significant amount of money. But it is a sum that might be self-insured in some cases. (For instance, some homeowners may plan to sell their home and use the equity to pay for long-term care.) However, in some cases, especially in people with Alzheimer's disease, stays of eight years and longer routinely occur. Spending assets at these rates will obviously deplete even very substantial retirement accounts over stays of that length.

Medicaid does provide some catastrophic protection for those who are willing to spend down their assets to the low level required to qualify should they need extended nursing home care. Consequently, LTC insurance is probably not necessary for individuals who are eligible or expect to be eligible for Medicaid.

For those who do choose LTC insurance, a five-year coverage plan may be worth considering because it strikes a balance between cost and adequate benefits. Exhibit 12 shows cost estimates for long-term care coverage for a couple with initial benefit maximums of $200 per day per person.

SECTION 5

Conclusion

The transition from full-time work and asset accumulation to retirement and asset draw-down brings on a new and complex set of financial decisions. The main challenge – achieving potential lifetime income solutions – is a serious one. If they plan wisely, most Americans can use investment income and insurance products to craft strategies that will reliably meet their own retirement lifestyle needs. But that is a very big "if."

Yet educating millions of Americans to understand and act on their own retirement security will require an immense effort by the financial services industry, employers, advisors, the media, government officials, and individuals – an effort that builds on encouraging average Americans to save and invest during the accumulation phase of their lives.

We believe that every retiree and pre-retiree should have a retirement income plan that realistically estimates their essential and discretionary expenses and seeks to ensure that they do not outlive their assets. We believe that essential expenses, including health insurance, should be covered first by predictable sources of lifetime income such as Social Security, pensions, annuities, or sustainable long-term withdrawals from assets.

This means making sure every retirement income plan has an asset allocation mix built into it that addresses inflation and health care costs and balances the need for long-term investment growth with the risk of short-term market volatility. What's more, we believe that retirement income plans should be flexible – so that they can be changed as a retiree's own circumstances change – and reviewed regularly and revised, if necessary, so that they stay on track. Above all, we believe that the single most important step is to begin the retirement income planning process – the sooner the better.

For those approaching retirement age, the process of retirement income planning itself can significantly affect such major decisions as current savings levels and the timing of retirement. For those already retired, planning can dramatically reduce the risk of outliving one's assets. Starting the planning process is the essential first step to seeking financial security in retirement.

By undertaking this process – discriminating between essential and discretionary expenses and ensuring that essential expenses will be met – retirement income planning can make it possible to set realistic goals well beyond personal needs, including bequests to charity and gifts and legacies for family members. Perhaps most importantly, retirement income planning can provide retirees and their families the comfort of knowing they've taken the first steps to a potentially secure retirement.

A five-step checklist for retirement income planning

STEP 1
Expense inventory

- Estimate monthly or annual expenses – dividing them into "essential" (food, housing, clothing, health care costs, insurance, etc.) and "discretionary" (travel, entertainment, etc.).
- Estimate any amount you wish to leave as a legacy and set those funds aside, at least for planning purposes.

STEP 2
Income inventory

- Draw up an inventory of all sources of income: Social Security, traditional pensions, lifetime annuities, or other predictable long-term income flows.
- Do an inventory of all financial and real assets (stocks, bonds, mutual funds, CDs, real estate, rents, etc.) that could be used to fund your retirement. Add estimated income from these assets to your predictable income flows to estimate total income.

STEP 3
Compare essential expenses with highly predictable income sources

- Compare your projected essential expenses with projected total after-tax income.
- This comparison will either show that your essential expenses are fully taken care of, or it will reveal an "essential expense gap" – which needs to be filled.

STEP 4
Allocate assets to cover essentials and to fund discretionary expenses

- Should there be any gap in income coverage for your essential expenses, close this gap – by either segregating a specific pool of assets to draw on systematically over time or by purchasing a guaranteed income product, such as an annuity – to help ensure that "essential" expenses are met.
- Once essentials are funded, the assets remaining may be used for discretionary expenses according to a systematic withdrawal plan.

STEP 5
Protect and update the plan

- Decide whether to protect your lifetime income plan with major medical, life, and long-term care insurance. Review your plan at least once a year, adjusting all elements – including expenses, asset allocation, and withdrawal rates – to meet changing personal circumstances.

NOTES

1. As measured by the S&P 500 through March 9, 2009.

2. "Equity Ownership in America – 2008," Securities Industry Association Study, p. 6.

3. "Oldest Baby Boomers Turn 60," U.S. Census Bureau, CB 06-FFSE. 01-2, January 3, 2006.

4. Centers for Medicare and Medicaid Services, 2008.
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METHODOLOGY & INFORMATION FOR EXHIBITS 3, 4, 6, 7, 8, 9, AND 10

Exhibits 3, 4, 6, 7, 8, and 9 are not intended to project or predict the present or future value of the actual holdings in a participant's portfolio or the performance of a given model portfolio of securities. The calculations and results generated for Exhibit 9 are based on historical monthly performance from January 1972 through December 2008 from Ibbotson Associates: stocks, bonds, and short-term investments are represented by S&P 500, U.S. Intermediate-Term Government Bonds, and U.S. 30-day T-bills, respectively.

For Exhibits 4, 7, and 8, several hundred financial market return scenarios were run to determine how the asset mixes may have performed. For Exhibit 7, the **Average Market** and **Extended Down Market** results are based on 50% and 90% confidence levels, respectively. The results for the Average Market highlight the number of years the hypothetical portfolio would have lasted in 50% of the scenarios. The results for the Extended Down Market are based on a 90% confidence level highlighting the number of years the portfolio would have lasted in at least 90% of the scenarios generated. For Exhibit 8, a 90% confidence level was utilized indicating that the percentage of assets withdrawn annually could have been supported for the number of years noted in 90% of the historical scenarios that were generated.

Monte Carlo simulation is an analytic tool for modeling future uncertainty. The charts in this presentation only represent a range of possible outcomes. Actual results will vary, and such results may be better or worse than the simulated scenarios.

For Exhibits 3, 4, 7, and 8, the estimated returns for the stock and bond asset classes are based on a "risk premium" approach. The risk premium for these asset classes is defined as their historical returns relative to a 10-year Treasury bond. Risk premium estimates for stocks and bonds are each added to the 10-year Treasury yield. Short-term investment asset class returns are based on a historical risk premium added to an inflation rate, which is calculated by subtracting the TIPS (Treasury Inflation-Protected Securities) yield from the 10-year Treasury yield. This method results in what we believe to be an appropriate estimate of the market inflation rate for the next 10 years. Each year (or as necessary), these assumptions are updated, to reflect any movement in the actual inflation rate. Volatility of the stocks (domestic and foreign), bonds, and short-term asset classes is based on the historical annual data from 1926 through the most recent year-end data available from Ibbotson Associates, Inc. Stocks, bonds, and short-term are represented by S&P 500, U.S. Intermediate Term Government Bonds, and 30-day U.S. Treasury bill, respectively. Annual returns assume the reinvestment of interest income and dividends, no transaction costs, no management or servicing fees, and the rebalancing of the portfolio every year.

For Exhibits 3, 4, 7, 8, and 9, which highlight varying levels of stocks, bonds, and short-term investments, the purpose of these hypothetical illustrations is to show how portfolios may be created with different risk and return characteristics to help meet a participant's goals. You should choose your own investments based on your particular objectives and situation. Remember, you may change how your account is invested. Be sure to review your decisions periodically to make sure they are still consistent with your goals. You should also consider all of your investments when making your investment choices.

For Exhibit 10, these estimates assume life expectancy at age 65 of 17 and 20 years, for males and females, respectively. A health care cost inflation rate of 7% is used; underlying this assumption are cost of service increase rates that vary by type of service, ranging from 4% to 9%. The estimates are representative of the amount needed in a taxable account. A 5% after-tax rate of return is assumed on savings in retirement. Medical costs are assumed to be incurred uniformly in each year in retirement after age 65.

Estimates are calculated for an "average" retiree. Actual costs will vary depending on actual health status, area, and longevity. Individuals who deviate from this average could require a smaller or larger amount of savings. These estimates assume that there is no employer-sponsored post-retirement health care coverage. These estimates assume that the retiree has traditional Medicare coverage, elects Medicare Part D, and, by virtue of their income level, continues to receive the current government Part B subsidy. These savings amounts do not consider the expected costs of expenses related to over-the-counter drugs, dental care, or nursing home care.

IMPORTANT: Any projections and simulations are hypothetical in nature, do not reflect actual investment results, and are not guarantees of futures results. Over time, results may vary with each use. It is not possible to invest directly in an index. All indexes include reinvestment of dividends and interest income. Although past performance does not guarantee future results, it may be useful in comparing alternate investment strategies over the long term. Performance returns for actual investments will generally be reduced by fees or expenses not reflected in these hypothetical illustrations.

OTHER IMPORTANT INFORMATION

Diversification does not ensure a profit or guarantee against a loss.

U.S. stock prices are more volatile than those of other securities. Government bonds and corporate bonds have more moderate short-term price fluctuations than stocks but provide lower potential long-term returns. U.S. Treasury bills maintain a stable value (if held to maturity), but returns are only slightly above the inflation rate.

You must make your own determination whether a particular investment is consistent with your objectives, risk tolerance, and financial situation. Fidelity is not recommending or endorsing any particular investment in this research paper.

The MSCI EAFE® Index is an unmanaged benchmark index comprised of 21 MSCI country indexes representing the developed markets outside North America, including Europe, Australasia, and the Far East.

The Ibbotson U.S. 30-Day T-bill data series is a total return series that is calculated using data from the *Wall Street Journal* from 1977 to present and the CRSP U.S. Government Bond File from 1926 to 1976.

The Ibbotson Intermediate-term Government Bond Index data series is a total return series that is calculated using data from the *Wall Street Journal* from 1987 to present and from the CRSP Government Bond file from 1934 to 1986. From 1926 to 1933, data was obtained from Thomas S. Coleman, Lawrence Fisher, and Roger G. Ibbotson's Historical U.S. Treasury Yield Curves: 1926–1992 with 1994 update (Ibbotson Associates, Chicago, 1994).

The S&P 500 Index is a registered service mark of The McGraw-Hill Companies, Inc., and has been licensed for use by Fidelity Distributors Corporation and its affiliates. It is an unmanaged index of the common stock prices of 500 widely held U.S. stocks and includes reinvestment of dividends. It is not possible to invest directly in the index.

The Consumer Price Index is a widely recognized measure of inflation calculated by the U.S. government that tracks changes in the prices paid by consumers for finished goods and services.

All index returns include reinvestment of dividends and interest income. It is not possible to invest directly in any of the indexes described above. Investors may be charged fees when investing in an actual portfolio of securities, which are not reflected in illustrations utilizing returns of market indexes.

This information is for educational purposes only.

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Fidelity believes that every retiree and pre-retiree should have a retirement income plan that realistically estimates their expenses and seeks to ensure that they do not outlive their assets.

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One goal – your financial success.

Like the market, your investment needs may certainly change over time. Through our focus on insight, diversification, and dedicated support, you'll know that your advisor and Fidelity have the same goal as you – your financial success.

Experience leads to Insight

Your advisor has the professional focus and mission for helping you achieve your financial goals. When you combine that knowledge with Fidelity's 60 years of investment insights, it results in intelligent options for you.

Investment choice leads to Diversification

Your advisor understands that being properly diversified is critical to your long-term financial success – and diversification is the cornerstone of Fidelity's philosophy. Supported by a global research team, Fidelity offers extraordinary breadth and depth of investment options across all asset classes, providing you and your advisor with the advantages of choice.

Commitment leads to Dedicated Support

Fidelity delivers the attention, responsiveness, and dedicated support necessary for your advisor and you, working together, to manage your assets the way you expect.

With your advisor and Fidelity behind you, you can be confident about making well-conceived and informed investment decisions for today and tomorrow.

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Diversification
Dedicated Support

Before investing, consider the funds' investment objectives, risks, charges, and expenses. Contact your investment professional for a prospectus or visit advisor.fidelity.com for a Fidelity Advisor fund prospectus or, if available, a summary prospectus containing this information. Read it carefully.

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