



December 31, 2005

«Plan_Name»

Dude, Where's My Retirement?

...as I tossed my old 2005 wall calendar into the recycling bin, I caught a glimpse of last January's New Year's resolutions, written in large red letters. Suddenly, it dawned on me...

"Uh oh... I've forgotten to save for retirement... again!"

If you can relate to this story, you're not alone. According to a recent survey conducted by the Employee Benefit Research Institute, more than half of all workers feel they are "behind schedule" when it comes to planning and saving for retirement.¹

The Institute says that more than half of American workers have combined savings and retirement plan balances of less than \$25,000 – an amount that is less than one year's income for a typical household. That's a serious shortfall, considering that retirement can last 10, 20, or even 30 years.

Building a Retirement Solution

Financial experts say most Americans will need 70-80 percent of their pre-retirement income to have a comfortable retirement. Using an income replacement approach, constructing a retirement strategy becomes somewhat like assembling a jigsaw puzzle, where the main funding "pieces" include savings, investment income, post-retirement wages, inheritance, private and public pension programs.

For most Americans, Social Security is an important contributor. According to the Center for Retirement Research, over the coming decades, Social Security is structured to replace roughly 37% of pre-retirement income for the average worker.²

However, due to the graduated nature of Social Security benefits, your actual benefits will vary. For example, a lower wage earner may receive over 50% of pre-retirement income, while a higher wage earner may receive less than 20% of pre-retirement income. For an estimate of your future Social Security benefit, visit www.ssa.gov/planners/calculators.htm.

Meeting the Inflation Challenge

Inflation is a major problem for retirement planners. In addition to eroding the current purchasing power of your savings, inflation can dramatically increase the number of dollars you will need to maintain the same standard of living in retirement.

For every \$10,000 of your current household income, to maintain the same standard of living in 30 years, you would need the equivalent of \$32,434, if you assume 4.0% annual inflation.

To provide for your retirement, you can use a 401(k) plan or other benefits that are offered by your employer.

How Much to Save?

If you're new to retirement planning, we suggest that you "warm up" by trying an online retirement calculator. In less than five minutes, you can be well on your way towards charting your retirement course.

Retirement calculators begin by asking for simple inputs such as your age, income, and planned retirement age. Then, based on your inputs, the calculator computes a sample investment plan that is designed to meet your goals.

You may wish to start with the calculator provided at your retirement plan accounting portal, www.myplanaccount.com. We suggest you experiment with a few different calculators, varying your inputs, and comparing your results. Before long, you should be able to develop a ballpark estimate of how much you might need to save.

However, please be aware that retirement calculators are for educational purposes only, and are not intended as investment advice. Before taking any action, we strongly recommend that you consult a qualified financial advisor.

Online Retirement Calculators

<http://www.myplanaccount.com>

Available through the portal for your retirement plan accounting information.

http://sites.stockpoint.com/aarp_rc/wm/Retirement/Retirement.asp

AARP's calculator. One of the best free tools available. Takes 3-5 minutes to run.

http://apps.nasd.com/investor_Information/Tools/Calculators/retirement_calc.asp

NASD's simple, easy tool. Excludes Social Security benefits. Takes 1-3 minutes to run.

NWCM also provides retirement planning calculators to its clients via web access.

Making Use of Your Employer's Plan

Once you and your investment advisor have settled on a savings target, you will need to identify appropriate investments. Your employer's 401(k) provides a convenient way to automatically invest in a broad range of diversified investment products. Your employer and the website www.myplanaccount.com provide a description of what plans are offered, and direct you to the appropriate educational and enrollment materials.

But most importantly, mark your 2006 calendar to "remember" to plan for your retirement.

You'll be glad you did.

- (1) Employee Benefit Research Institute's 2005 Retirement Confidence Survey.
- (2) Just the Facts on Retirement Issues, Center for Retirement Research at Boston College, January 2005.

December 31, 2005 Market Commentary and Outlook

Outlook for 2006

2005 is likely to be remembered as the year that housing, energy, and consumer prices began to flare up. While final figures are not yet available, it is estimated that consumer prices rose by 3.5-4.0%, significantly faster than the prior decade's 2.5% average rate.

To cool growth and quench inflation, the Federal Reserve instituted a program of "measured" increases in short-term interest rates. By gradually raising rates by ¼% at each meeting, the Fed hoped to make the transition as painless as possible. By year-end 2005, the situation appeared to be showing some signs of changing. Home and auto sales had eased, and short-term interest rates, at 4.25%, no longer encouraged speculative borrowing.

Incoming Fed Chairman Bernanke once described central banking as fixing a car engine while it's still running. If that's the case, his first task will be to lift the hood and give America's economic engine a tune-up.

It's a delicate task. If Mr. Bernanke raises interest rates too high, he runs the risk of choking off borrowing and economic activity, triggering a recession. Corporate revenues and profits would fall, causing jobs to be lost.

However, if he leaves interest rates too low, a renewed surge in borrowing and speculation could develop, causing price inflation and disruptive speculative bubbles.

The most desirable outcome would be for Mr. Bernanke to gently guide the U.S. economy to a more moderate and sustainable pace of growth. Given the right mix of skill and luck, the odds of success are reasonably high.

Over the long term, we believe that U.S. stocks should provide good opportunities for growth and income. However, over the next year, stocks may be affected by a number of short-term positive and negative factors:

Bullish Scenarios for U.S. Stocks

- **Cheaper energy.** Oil prices move lower as new supplies are brought online in response to the recent price surge.
- **Pent-up stock demand.** Investors, sidelined in 2005 by rising rates, rush into equities as signs emerge that the Fed has completed its mission.
- **Productivity gains.** Global technological advances and subdued labor costs lead to a surge in corporate profits.

Bearish Scenarios for U.S. Stocks

- **Economic slowdown.** Trying to bring inflationary pressures under control, the Federal Reserve raises short-term interest rates to a level that causes an economic slowdown.
- **An end to home equity wealth extraction.** Higher interest rates cause real estate prices to flatten or decline, eliminating the opportunity for homeowners to withdraw wealth from

their homes.

- **Deleveraging.** Faced with ever-rising borrowing costs, speculators and hedge funds sell off their holdings that were purchased on margin. As cash yields top 4%, traditional investors find cash-like investments to be increasingly attractive relative to 2%-yielding equities.
- **Dollar instability.** The U.S. trade deficit, at over 6% of GDP, may trigger instability in the U.S. dollar and/or interest rates. America's trading partners have grown increasingly nervous about the size of their dollar holdings. Overseas investors own about half of all U.S. government debt, up from less than 35 percent in 2002. Should our trading partners diversify away from the dollar, the cost of credit in America could rise sharply, causing asset prices to fall.

In balance, taking these bullish and bearish factors into account, U.S. equities appear to have a less attractive outlook in the near-term than they do in the long-term. Diversified non-U.S. stocks, on the other hand, may be less susceptible to some of the bearish factors that are identified in this article, while still offering attractive opportunities for growth.

Outlook for Bonds in 2006 and Beyond

Yields on Treasury-grade bonds, generally ranging between 4.0% and 4.5%, are just slightly higher than recent inflation.

In our view, bonds are problematic today, because they compensate investors poorly for the risks they take. If interest rates or inflation were to rise, or if credit risks were to increase, bonds would likely fail to preserve an investor's purchasing power. Presently, we find cash equivalents such as money markets and short-term instruments to be attractive relative to bonds, providing competitive yields with greatly reduced risk.

Portfolio Implications

In our judgment, it would be imprudent to concentrate too much of one's portfolio in U.S. stocks or bonds at this time.

In our managed portfolios, we've taken steps to improve diversification, while restraining risk. We've nudged up our use of cash and international equities, while trimming domestic equities, particularly smaller companies, within each investment policy mandate and constraints.

When designing a portfolio, each asset class plays an important role. Cash equivalents seek to provide current income, preservation of capital, and protection against rising interest rates and inflation. Bonds are used for current income and protection against deflation. International equities provide access to the most rapidly-growing regions of the world, while providing currency diversification. Domestic large- and small-cap equities provide the opportunity for capital growth and dividends.

By using innovative investment tools and taking into account changing market conditions, we seek to maximize the amount of return per unit risk for each of our investment strategies.

Have a happy and prosperous New Year!

Investment Committee
Northwest Capital Management
January 4, 2006

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