Can early retirement work for you?

Many working people dream about early retirement. It sounds wonderful, but is it practical? There are many issues to consider before taking the plunge.

Social Security
In the past, you could start receiving full Social Security benefits at age 65; now that age is gradually being moved back for anyone born after 1938. If you were born in 1938 or later, you might not get your full Social Security benefits until you are 67. (See chart below.)

This change is designed to reflect increases in life expectancy, and it is likely to mean less money for you each month, especially if you retire early.

Under the new rules, people born after 1938 can still start receiving reduced benefits at age 62. However, their benefits will be reduced more than they have been in the past. For example, if you were born in 1960 or later and retire at age 62, your benefits will be reduced by 30%—compared to a 20% reduction if you were born before 1938. This difference could have a significant impact on your retirement income.

Even worse, some experts believe that Social Security is headed for financial troubles. (See story, page 2.) By the time you reach retirement age, Social Security may not be around.

Dear Participant:
Planning for your financial future is one of the most important responsibilities you have, and at Transamerica, we want to help.

Our cover story looks at early retirement issues like inflation, life expectancy, changing expenses and Social Security. We also examine your options for taking your 401(k) distribution when you retire.

On page 3, we explain the benefits and dangers of online investing. And we offer 10 tips that may help you cut your tax bill.

By providing you with helpful information, and with the best in products and services, we want to be your partner in achieving the future you want for yourself and your family.

Paul Henry
Worth a Look Publisher

Social Security retirement age

<table>
<thead>
<tr>
<th>Year of Birth</th>
<th>Full Retirement Age</th>
<th>Year of Birth</th>
<th>Full Retirement Age</th>
</tr>
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<tbody>
<tr>
<td>1937 or earlier</td>
<td>65 years</td>
<td>1955</td>
<td>66 years, 2 months</td>
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<tr>
<td>1938</td>
<td>65 years, 2 months</td>
<td>1956</td>
<td>66 years, 4 months</td>
</tr>
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<td>1939</td>
<td>65 years, 4 months</td>
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<td>65 years, 8 months</td>
<td>1959</td>
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<td>1942</td>
<td>65 years, 10 months</td>
<td>1960 and later</td>
<td>67 years</td>
</tr>
<tr>
<td>1943-1954</td>
<td>66 years</td>
<td></td>
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</table>

Source: Social Security Administration
Snapshot of Social Security

Since the Social Security Act was signed into law in 1935, Americans have counted on Social Security to help fund their retirement. But how does it work, and will it be around when you retire?

The Social Security system is founded on the philosophy that government, employers and employees should share responsibility for the elderly and the disabled. Social Security is funded by a tax paid by employers and employees. The theory is that people pay into the fund during their working lives and collect from it after they retire.

In actuality, because the first Social Security recipients contributed little and because inflation later raised benefits faster than contributions increased, each generation has been paying the previous generation’s benefits. As the huge baby boom generation begins to retire, the burden will be enormous; in fact, experts believe that Social Security is already financially in trouble. Several measures have been considered to prop up the system, including investing more of the fund’s money in stocks.

The Social Security Administration has taken steps to reduce the expenditures from the fund, including extending the age at which full retirement benefits are paid. (See story, page 1.) Further cuts may follow, and legislators are likely to debate additional action. Most experts agree that Social Security is far too important politically to be allowed to fail. However, they caution employees that they should be prepared to shoulder more of the financial burden of retirement.

Early Retirement

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For information about your specific benefits, contact the Social Security Administration at (800) 772-1213 or online at www.ssa.gov.

Inflation

Inflation is something else to consider. While inflation has been very low for the last few years, there is no guarantee it will stay that way.

Driving up costs

Even if inflation is only 3% a year, here is what happens to the price of a $20,000 car over 10 years:

<table>
<thead>
<tr>
<th>YEAR</th>
<th>PRICE</th>
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<tbody>
<tr>
<td>1</td>
<td>$20,000</td>
</tr>
<tr>
<td>5</td>
<td>$22,510.18</td>
</tr>
<tr>
<td>10</td>
<td>$26,095.76</td>
</tr>
</tbody>
</table>

Double-digit inflation could return and cut deeply into your savings. Even moderate inflation can take a toll on savings. (See illustration.) For example, an inflation rate of only 4% will cut the purchase power of your money almost in half in 20 years.

While you are working, inflation often is offset by salary increases. But after you retire, you must rely heavily on your investments, and inflation cuts into your rate of return. For example, if you are earning a return of 8% and inflation is 3%, you are really only 5% ahead.

Life expectancy

Compared to years ago, people today can look forward to a longer life expectancy — the earlier you retire, the longer you have to support yourself in retirement. Experts say you need 60% to 80% of your pre-retirement income in retirement. Especially if you retire early, you need to know your money will last as long as you do.

Longer life expectancy also brings financial concerns other than making your savings and investments stretch further. For example, you might want to buy long-term care insurance for yourself or for your parents—who also have a longer life expectancy.

Expenses

Most people expect their expenses to go down in retirement. You don’t have commuting and work-related expenses anymore. You may have paid off your mortgage and your children’s education expenses. But there are other expenses that may rise, especially if you retire early.

For example, you may have to begin paying for your own health insurance, at least until you become eligible for Medicare. Plus, you may spend much more on leisure activities such as golf, travel, eating out and going to the movies.

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Online investing can make it easier than ever to manage your investments. You can buy and sell stocks and bonds at your convenience, and you can usually save money on broker fees. It can be a simple way to take a more active role in planning your financial future. Of course, it can be so easy that some people may forget that they are making serious investment decisions. To be effective, online investing should fit into your overall financial plan. You should learn about the securities you are buying and selling, and you should always take the long-term view.

You can make online investing work if you remember some tips:

- **You are using real money.** Online trading can seem like playing video games, but it is not. If you lose money, it comes out of your pocket.
- **Don't forget the basics.** The same general principles apply to online investing as to any other kind of investing. Keep in mind your asset allocation decisions, your goals and your feelings about risk when you are making trades online.
- **Don't shortchange your retirement plan.** Tax advantages and any employer match make a company-sponsored retirement plan the best way for most people to save for retirement. Don’t trade online with money you could be putting into your plan.
- **Study up.** With most online trading, you need to do your own research on the companies involved. You can do a lot of that research online; start with the finance or money sections of www.yahoo.com and www.msn.com, as well as www.quicken.com and other financial Web sites.

### 10 ways to trim your taxes

Did you get an unpleasant surprise this tax season? It is too late to lessen your 1999 tax burden, but there are some things you may want to consider for 2000. (It is important to know all the rules. Be sure to check with your tax advisor first before using these tips.):

1. You may want to make your January 2001 mortgage payment by December 31, 2000 (if interest is paid in arrears). You may be able to deduct the interest in 2000.
2. You may also want to make charitable contributions before December 31.
3. Think about deferring income. For example, you may be able to arrange to receive your bonus and pay tax on it in a later year.
4. Since you can only deduct medical expenses that exceed 7.5% of your adjusted gross income, try to bunch them in one year. For example, you may be able to prepay for ongoing expenses such as orthodontia or schedule elective surgery for a time when you have other medical expenses.
5. Similarly, see if you can group other deductions into one year so you can itemize.
6. Consider transferring some investment income into your children’s accounts to take advantage of their lower tax rate. Remember, though, that you may have limited access to that money and the child must be at least 14 years old.
7. If you have a lot of consumer debt, consider paying it off with a home equity loan; the interest on a home equity loan is usually deductible. However, your house could be at risk if you can’t make the payments.
8. If you have any educational expenses related to your career, expenses incurred looking for or moving to a new job, and expenses related to charitable work, you may be able to deduct them.
9. Remember that you may be able to deduct your state taxes as well as tax-related state fees.
10. Finally, plan on maximizing your retirement contribution. This is one of the easiest and most effective ways to cut your tax bill and provide for a secure retirement.
When you are ready to retire, you have several options for your 401(k) account balance. You might want to consult with your tax or financial advisor, but the basic options are:

Lump-sum distribution
You can take all the money in your account at one time, in a lump sum.

**Pros:**
- You get all your money, and you can use it for whatever you want.

**Cons:**
- If you are under age 59 1/2, you may be subject to a 10% early withdrawal penalty as well as 20% federal income tax withholding. At the end of the year, you may owe even more in taxes. Plus, you will owe taxes on any returns, unless you re-invest in a tax-advantaged vehicle.

IRA
You can roll your money into an Individual Retirement Account (IRA).

**Pros:**
- You keep your tax-deferred status, and you can avoid the 20% federal income tax withholding.
- You can withdraw as you need the money, paying taxes only on the amount you’ve taken out. (Of course, you’ll pay a 10% early withdrawal penalty if you are under age 59 1/2.) You can also choose from many different investments.

**Cons:**
- Over time, you may pay more tax on withdrawals than you might have paid on the lump-sum distribution, particularly if you were eligible for the special tax treatment on lump-sum distributions.

Annuities
You can take your 401(k) payment as a lifetime annuity.

**Pros:**
- You can guarantee a monthly benefit for the rest of your life. In addition, you may have an opportunity to choose from several different kinds of annuities.

**Cons:**
- Not all plans offer an annuity option. Plus, because the benefit is a fixed amount, the purchase power will be reduced by inflation. And you won’t be able to change the timing of the payments.

Leave it
You may be able to leave some or all of your money in your employer’s 401(k).

**Pros:**
- You will have the same tax advantages and investment options that you had before retirement.

**Cons:**
- You must have at least $5,000 in your account to leave it in your employer’s 401(k).

The bottom line
If you want to retire early, you need to plan early. You should start by figuring out how much you need to save. The Point, Click and Save software you received when you enrolled in your retirement plan can help you find out where you stand.

It’s always a good idea to put as much as possible into your retirement account. That way, you can benefit from tax-deferred compounding—earning returns on your returns, without paying any income tax until you withdraw your money.

Investing in your retirement plan helps you get the most out of your money. For example, if you spend $15,000 on a new boat, at the end of 15 years you would have an old boat. But if you put that $15,000 into your 401(k) account and earn a return of 8% a year, at the end of 15 years you would have $47,583.*

In other words, early retirement involves more than just giving notice to your employer. It requires careful planning, aggressive saving and making the most of your retirement plan.

* These hypothetical figures are for illustrative purposes only; actual returns may vary. Taxes are due upon withdrawal.