

VOLUME 4 - NUMBER 1

- ◆ Q4 2009 Market Review: What a Difference a Year Makes!
- ◆ Form 5500 Electronic Filing Requirement
- ◆ Where Are Participants in Their 401(k) Recovery?



Q4 2009 Market Review: What a Difference a Year Makes!

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U.S. equity markets finished the year strong, up 5.9 percent for the fourth quarter and 28.3 percent for all of 2009 (Russell 3000). That is in stark contrast to 2008, which saw the Russell 3000 post a negative 37.3 percent during a time when many people thought the financial system was on the verge of collapse. International equities cooled off relative to their U.S. equity counterparts, up only 2.2 percent for the quarter, but still managed to beat U.S. equities for the year, returning 32.5 percent (MSCI EAFE). Currency played an important role in the international marketplace, as the depreciating U.S. dollar helped send returns higher for U.S.-based investors. As a whole, the U.S. fixed income market was up 0.2 percent for the quarter and 5.9 percent for the year (Barclays Capital Aggregate Bond). Unlike the majority of equity markets, fixed income had two storylines, complete with winners and losers. The losers were found in government securities. They may have been the darlings of 2008 (arguably the safest investments), but many produced

negative returns in 2009. The winners were the riskier fixed income securities, including corporate and mortgage-backed securities. They produced the best returns, carried the entire fixed income market and, overall, posted strong, positive returns for the year.*

Over 2009, the markets rebounded with one of the sharpest recoveries in history. Confidence in the U.S. financial system slowly began to grow and a renewed optimism of recovery was sparked with every positive, if somewhat surprising, healthy earnings reports from corporations (mostly attributable to cost-cutting). In large part, the turnaround in the markets stemmed from the Fed's aggressive actions to limit the damage from the credit crunch and the financial failures that emerged in 2008. Today, we are closer (if not back) to the same fixed income price levels found only days before Lehman Brothers collapsed in September 2008. Now, the challenge for the Fed is to figure out how to unwind much of what they put into place to avert the "Great Depression II." If they begin to tighten too early or by too much, any recovery may be choked off. Yet if they tighten too late, or not enough, then inflation could be the next big risk we face.

*Past performance is no guarantee of future returns.

Form 5500 Electronic Filing Requirement

On Dec. 31, 2009, the U.S. Department of Labor's Employee Benefits Security Administration converted to an all-electronic system of online filing for Forms 5500 and the new Form 5500-SF. The EFAST2 system allows the public to submit and access filings online at www.efast.dol.gov. The EFAST Web site has been updated to provide filers with a variety of tools and guidance, including 2009 and 2010 Form 5500 and Form 5500-SF schedules and instructions, frequently asked questions, user guides and a tutorial. Filers and preparers can register for an account, complete the required forms and schedules online in multiple sessions submit them at no cost and print copies for their records.

Important changes for the 2009 and 2010 forms include:

- » Mandatory electronic filing;
- » Introduction of the new, two-page Form 5500-SF for eligible small plan filers;
- » Expanded disclosure on Schedule C of indirect service provider compensation; and
- » Removal of IRS Schedules E and SSA (information on participants with deferred vested benefits who separated from the service covered by the plan now must be filed directly with the IRS).

Where Are Participants in Their 401(k) Recovery?

Both the mainstream press and reports from 401(k) vendors lead us to conclude that participants' 401(k) accounts either have, or are nearing, pre-recession levels. That said, the mixture of both relief and disbelief that plan sponsors are experiencing needs to be somewhat tempered. As with most issues, the "devil is in the details."

The Vanguard Group recently reported that 60 percent of its plan participants had the same or higher account balances in September 2009 as they did in September 2007 (near the market peak). Of the remaining 40 percent with lower balances, most were less than 20 percent below their peak value. Both Fidelity and Prudential (among other vendors) reported similar findings. On the surface this information may be difficult to believe. While it is true that the market rebounded substantially since its low point in Q1 2009 (the S&P 500 rebounded approximately 68 percent between March 9 and Dec. 31, 2009), it is still down roughly 25 percent from its peak in October 2007.

However, the reports of participant account recovery are in fact accurate. The reality is that many 401(k) accounts are relatively small. The national average account balance year-end 2007, prior to the market downturn, was estimated at \$65,000.* The smaller the account balance the greater the impact of new contributions (employee and employer) on the recovery of the account balance. For example, assume an "average" participant with an account balance of \$65,000. The participant contributes \$8,000 and receives an employer match of \$4,000. Those amounts, in addition to investment growth experienced in 2009, come very close to compensating for the losses experienced during the recent recession.

That said, plan sponsors should recognize that all participants will not have had similar experiences. Participants with higher account balances are likely still looking to recover losses incurred during the downturn of the market. Ultimately, deferrals drive the success of the participant's drive toward a healthy retirement

*"401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2007"
EBRI Issue Brief No. 324, Employee Benefit Research Institute, Dec. 2008

One cannot invest directly into an index.

The Russell 3000® Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

The MSCI EAFE® (Europe, Australia and Far East) Index is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the US & Canada.

The Barclays Capital Aggregate Bond Index is made up of the Barclays Capital Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Backed Securities Index, including securities that are investment-grade quality or higher, have at least one year to maturity, and have an outstanding par value of at least \$100 million.

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