NOVEMBER 2003

Viewpoint

RETIREMENT ISSUES RESEARCH REPORT

LIFETIME INCOME PLANNING

**by Farrell Dolan, CFP, Fidelity Retirement Income Services, and
Van Harlow, CFA, Fidelity Management & Research Company**

AMERICA'S LIFETIME INCOME CHALLENGE

America faces a complex challenge: securing incomes that last a lifetime for a rapidly growing population of retirees. With lifespans rising, the U.S. Census Bureau projects America's over-65 population is on track to double by 2040 — to more than 70 million people. Over the past generation, America has also become a society of investors. Both retirement and employee medical benefits programs are placing more and more reliance on individual savings and wealth management. And a multi trillion dollar decline in stock values has sharply impacted the finances and psychology of retirees and those due to retire soon — the massive "Baby Boom" generation born between 1946 and 1964. This market correction highlights the increased urgency of investor education and planning for lifelong income in retirement.

TABLE OF CONTENTS

For investment professional use only.

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 including: 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 rely 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 lifetime income plans, cushion their investment portfolio against unforeseen financial shocks and update their plans regularly as their circumstances change.

AGING AMERICA AND THE BROKEN BUBBLE

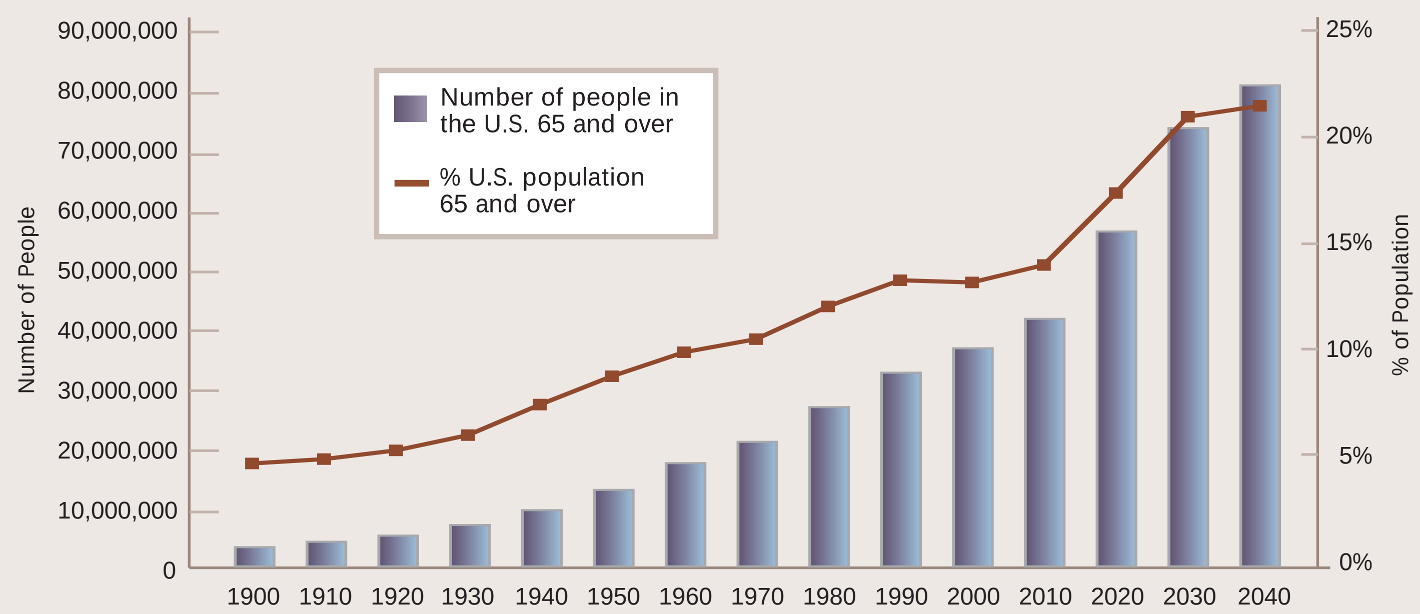
Over the past generation, a majority of American households became stock market investors — for the first time — directly or through their retirement savings plans. Now many of these investors have suffered a major financial setback. Three down years in American equity markets from 2000-2002 have resulted in trillions of dollars in wealth being lost. This severe stock market correction has most sharply impacted people in or close to retirement. 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 work force feel compelled to delay retirement, to raise their savings and to lower their expectations about post-retirement lifestyles that had, until recently, 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 nearly 50% by boom's end in the year 2000[1] — ***this most recent correction has made financing a comfortable retirement seem a more daunting challenge than ever.*** But there is no way to dodge it — individually or as a nation.

As Exhibit 1 demonstrates, more than 35 million Americans, one in eight, are over age 65 right now. By 2040, more than 77 million Americans will be over 65, about 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 — closing in on retirement.***

Boomers are turning age 50 at the rate of more than 12,000 a day, one person every eight seconds.[2]

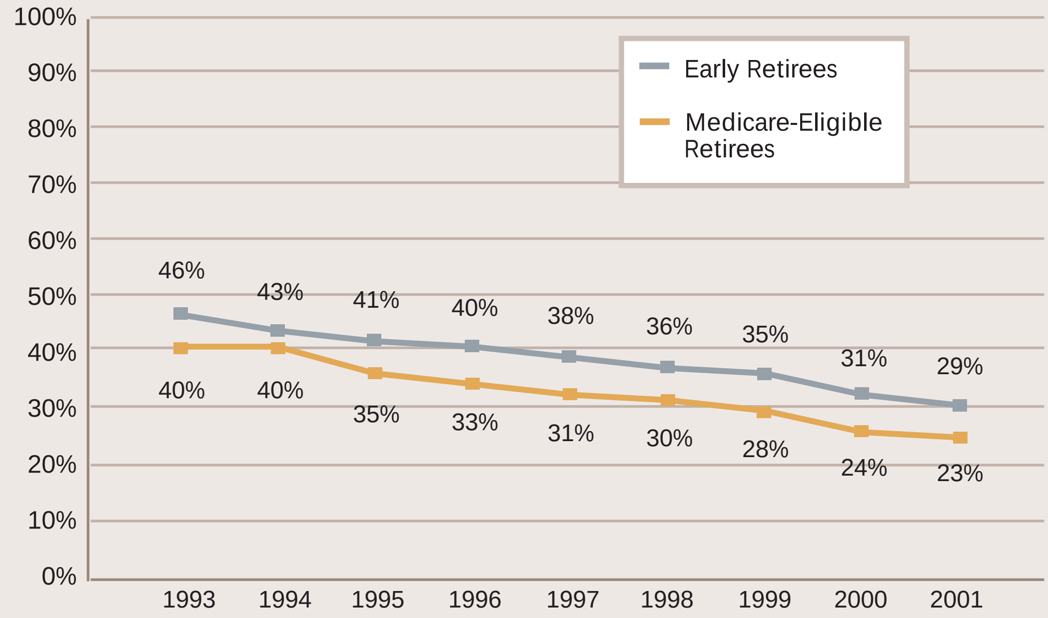
AGING U.S. POPULATION



U.S. Bureau of the Census. Bureau of the Census and NP-D1-A projections for 2010-2050 issued January 13, 2000. ***Exhibit 1***

[1] Securities Industry Association Study: "Equity Ownership in America – 2002."
[2] "Boomers at a Glance," American Association of Retired Persons (AARP), May 2001.

EMPLOYER-SPONSORED RETIREE HEALTH COVERAGE AMONG ORGANIZATIONS WITH 500+ EMPLOYEES



Source: Employee Benefit Research Institute Issue Brief 254. ***Exhibit 2***

And, increasingly, the burden of creating reliable sources of income that they won't outlive is passing to individual Americans. Meeting that challenge will not be easy.

Both short-term events and deep, long-term trends combine to make the job of financing retirement more uncertain and complex every day. Fallen stock prices have eroded most retirement portfolios. Personal savings rates are low. On the job, the movement from traditional defined benefit (DB) pension plans to defined contribution (DC) plans places more responsibility on employees for their retirement security.

More recently, as Exhibit 2 demonstrates, there has also been a strong movement by companies to drop extended medical care coverage for retired employees. ***By the end of the year 2001, only 23% of companies with over 500 employees still offered their retirees health care coverage. As recently as 1995, 35% of such companies offered retirees health coverage. The trend is clearly down.***

Yet total medical care spending in America continues to grow faster than general inflation, rising 8.7% in 2001 alone.[3]

As people live longer, they will need to stretch their financial resources over more years in retirement than they ever 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. Despite the magnitude of the 2000-2002 stock market drop, Americans over age 65 are clearly 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 10.2% in 2000 — significantly more progress than the decline in poverty rates from 22% to 11% for the population as a whole.

[3]U.S. Government Annual Report on Health Care Spending.

Americans over age 55 — who will be the fastest-growing age group in the decade through 2010 — are now entering their peak earning years. They are inheriting their parents' wealth and finishing payments on such big-ticket expenses as mortgages and college tuitions. The result may be even more net gains in wealth for many members of this age group over the course of the decade. For many retirees and those close to retirement, 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 individual Americans. All of us need to make plans to meet that responsibility. And if we do plan wisely, we increase the potential of enjoying our retirement years.**

Section II

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 to manage. 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 planning and investment decisions can be painful. For example, a 2003 post-retirement risk study by The Society of Actuaries found that the poverty rate among elderly widows was as high as 15% — nearly four times greater than poverty levels among elderly married couples. Lack of estate planning and adequate life insurance coverage were two important contributors to that gap. Another 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 towards 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, 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 generations. But as painful recent experience shows, stock markets can also decline rapidly and substantially. They may also deliver low returns for several years at a time.

Over longer time periods, though, equities have historically more than made up for those periods of decline. Since 1931, for example, every possible ten-year holding period has produced positive returns for U.S. stocks, as measured by the S&P 500.®

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 page: "***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 2003 study by LIMRA International, Inc., a life insurance marketing research organization, found that only about one in five retirees or 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.

(continued on page 8)

One of the most common and potentially disastrous mistakes in planning for lifetime incomes 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. You may as well try to forecast the weather on a birthday 20 years from now.

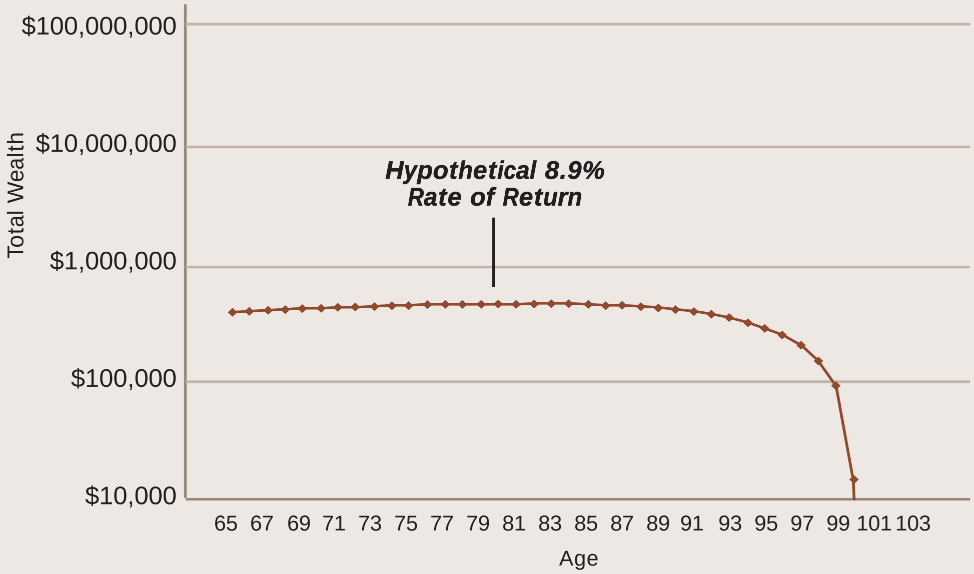
Referring to long-term averages does have some utility in the accumulation phase. It can encourage younger savers to look past short-term volatility, particularly in equities, and continue steadily building up their assets. With a very long time frame ahead, these investors should generally be able to count on markets reverting to the mean — and delivering something like they expect, assuming markets act similarly to the past.

Post-retirement, though, the options for correcting errors are more constrained. Planning lifetime 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.

That's why serious retirement planners use "Monte Carlo" simulations — probability pattern generators that show the full range of possible results from a given portfolio of assets. 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.

BUILDING A RETIREMENT PLAN AROUND AVERAGE RETURNS CAN GIVE A FALSE SENSE OF SECURITY

PLANNING BASED ON AVERAGES MAY NOT PROVIDE AN ACCURATE PICTURE



Source: Fidelity Investments. Hypothetical value of assets held in an untaxed account of $500,000, earning a hypothetical 8.9% rate of return with an inflation-adjusted withdrawal rate of 6.8%. Average 3% inflation rate assumed (historical average from 1926 through March 2003 was 3.06%); actual inflation rates may be more or less. The hypothetical 8.9% rate of return line assumes a steady return throughout the entire period. This chart is for illustrative purposes only and is not indicative of any investment. Past performance is no guarantee of future results.

Exhibit 3

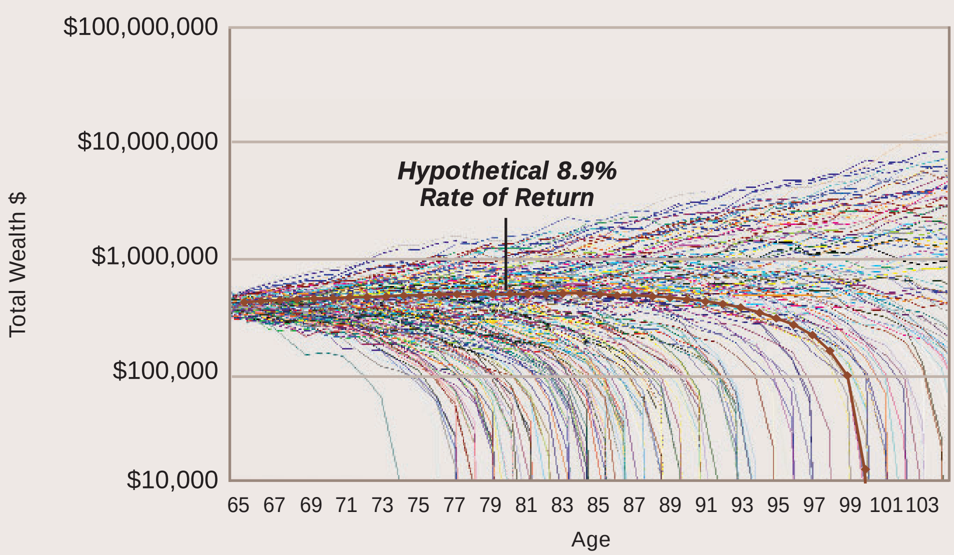
These two ways of assessing a portfolio produce dramatically different images of the likelihood of success. For example, in Exhibit 3 we see a hypothetical illustration of a portfolio's assets over more than 30 years based on an approximately 7% inflation-adjusted withdrawal rate, but assuming that historical average returns of 8.9% 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 historical returns for the portfolio and it shows a very wide range of possible outcomes.

More importantly, it shows that in real market conditions, this portfolio — which looked rock-solid based on projecting past averages into the future — actually has only a 57% chance of delivering income for 25 years through age 90 and drops to 46% 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 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.

BUILDING A SOUND RETIREMENT PLAN REQUIRES THAT MULTIPLE RETURN SCENARIOS BE CONSIDERED



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 an inflation-adjusted withdrawal rate of 6.8%. Please refer to the Important Legal Information page for important information about the methodology used in this chart and index information. Historical annual data from 1926 through 2002 is from Ibbotson Associates: stocks, bonds, and cash are represented by S&P 500, U.S. Intermediate Government Bonds, and U.S. 30-day T-bills. Average 3% inflation rate assumed (historical average from 1926 through March 2003 was 3.06%); actual inflation rates may be more or less. The hypothetical 8.9% rate of return assumes a steady return throughout the entire period. This chart is for illustrative purposes only and is not indicative of any investment. Past performance is no guarantee of future results.

Exhibit 4

THE CHALLENGE: FROM WEALTH-BUILDING TO LIFETIME INCOMES

(continued from page 5)

The differences between drawing taxable and tax-sheltered assets wisely or unwisely can add extra years of income; as Exhibit 5 on this page shows.

For an initial pool of $500,000 equally divided between taxable and tax-sheltered holdings, drawing down the taxable elements first can lengthen the portfolio's life by more than five years and deliver fully $415,000 more income.

There are several other key differences between the accumulation and distribution or "draw-down" 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 fluctuate substantially and unpredictably each year.

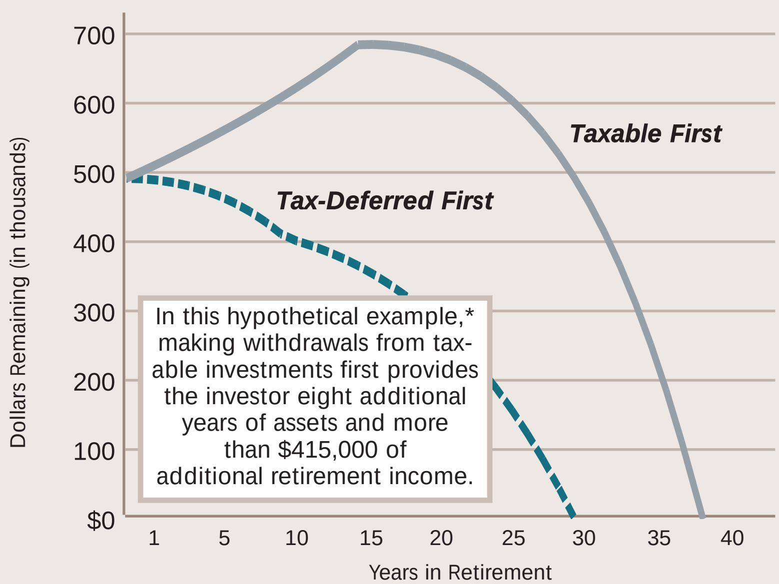
While younger savers can aim at a fairly predictable and controllable retirement date, ***retirees simply don't know how long they themselves or their spouses will live. They can't, then, forecast with much certainty how long their financial resources need to last.***

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; 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 — creating sound lifetime 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.

TAX-EFFICIENT WITHDRAWAL STRATEGIES CAN PROVIDE MORE INCOME DURING RETIREMENT



*Example assumes initial fully taxed investments of $250,000 and tax-deferred investments of $250,000, withdrawals of $20,000 after taxes, increased for 3% inflation. This illustration assumes a hypothetical 7% average annual investment return, a hypothetical 35% income tax rate applicable to tax-deferred account distributions, and a hypothetical 28% income tax rate (reflecting blended ordinary income, qualified dividend and long-term capital gains tax rates) applicable to taxable account earnings (taxed yearly). Not meant to imply the actual performance of any particular investment. Your own portfolio may earn more or less than this example.

Exhibit 5

THE 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"

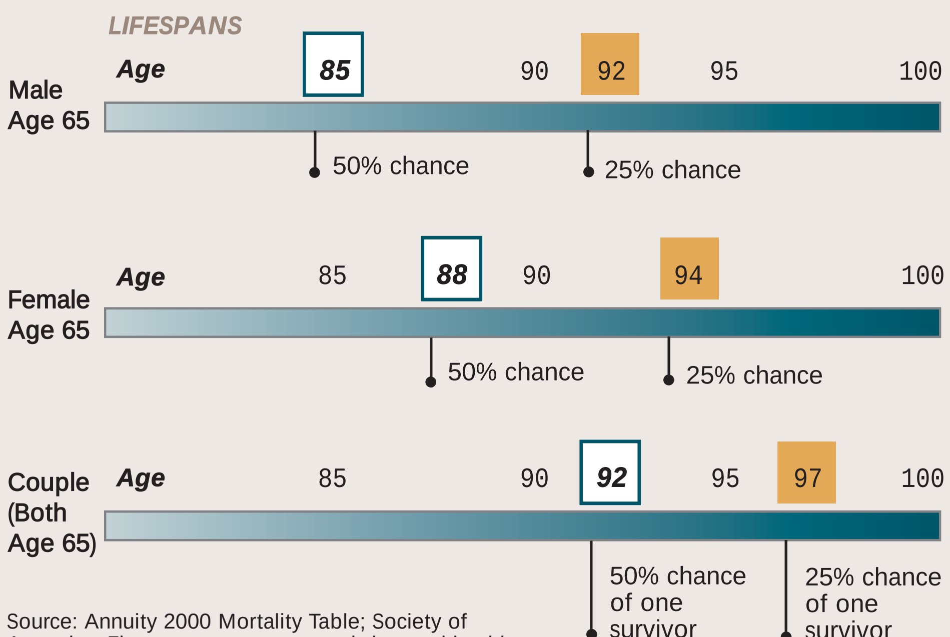
One of the most astounding success stories of the 20th century was arguably the sheer extension of human life spans. Advances in science and medical research have driven this success by increasing the likelihood that more infants will survive into adulthood and the probability that 65-year-olds will 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. Many 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 lifetime 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.

RETIREES NEED TO PLAN FOR POSSIBLE LONGER LIFE EXPECTANCIES



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

Exhibit 6

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 6 shows on the previous page, 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 of making 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 lifespan 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.

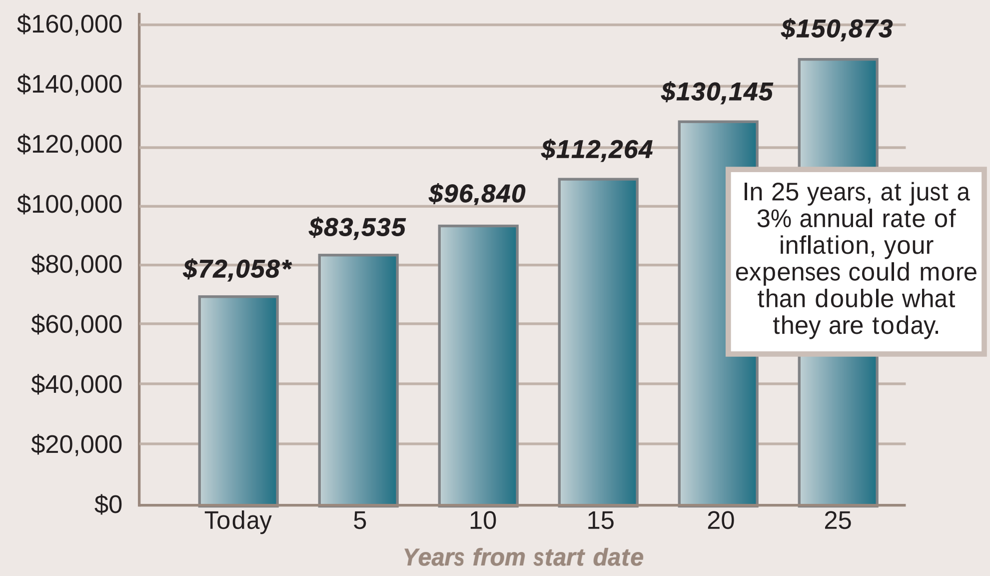
2. Inflation Risk

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

In fact, even in the 1990's, 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.[4]

EVEN LOW INFLATION CAN DAMAGE PURCHASING POWER



*$72,058 was the annual expenditure for individuals age 65+ with income greater than $70,000 from the U.S. Department of Labor, Bureau of Labor Statistics, Consumer Expenditures 2000 report. All other numbers were calculated based on a hypothetical 3% rate of inflation (historical average from 1926 through March 2003 was 3.06%) to show the effects of inflation over time; actual inflation rates may be more or less.

Exhibit 7

[4]Triumph of the Optimists: ***101 Years of Global Investment Return***, Eric Dimson, Paul March and Mike Staunton, Princeton University Press, 2002.

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 7 indicates, even a quite low 3% inflation rate can have an enormous impact on a retiree's purchasing power. For instance, retirees with roughly $72,000 of living expenses in 2003 would find they need more than twice as many dollars — over $150,000 — to meet expenses in just 25 years. If inflation were to accelerate to 5%, that figure would soar to over $244,000 — over three times the retirees' initial annual expense budget.

What's more, general inflation may not capture the impact on retirees of rising medical expenses. ***Between 1994 and 1999, for example, a study by Families USA found that "prices for the 50 drugs most commonly prescribed for older Americans rose 25.2%…nearly twice the 12.8% overall inflation rate for the same 5-year period."*** 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 can wait out the inevitable ups and downs of the stock market — counting on reversion to long-term average annual returns to get them back on track. But retirees and those close to retirement age feel they 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 averages.

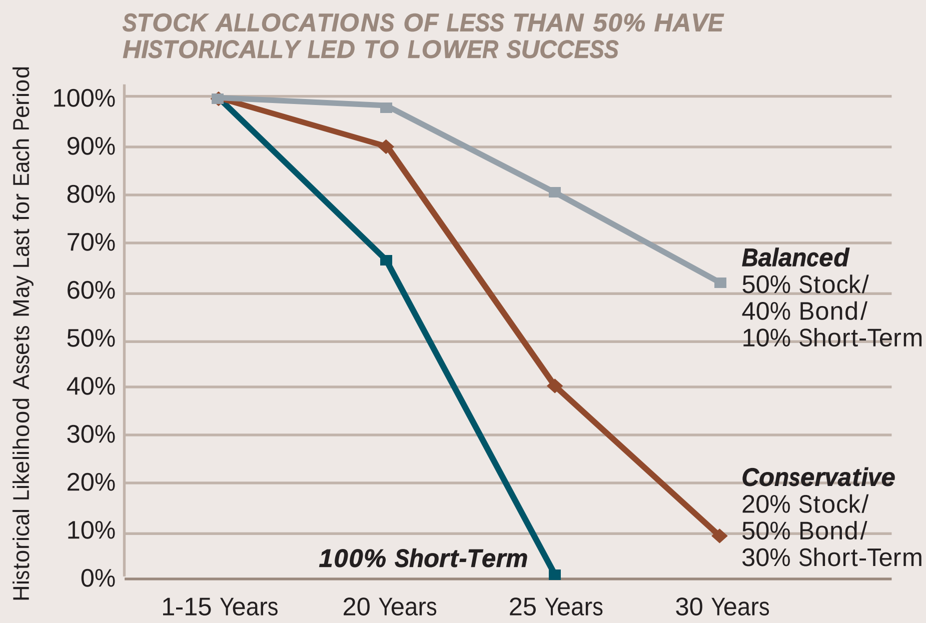
However, fear of being caught in a bear market causes some retirees to err on the side of what they wrongly perceive as "caution" — and they end up liquidating their stock holdings. But retirees should recognize that they, too, may have sufficient time to benefit from wise asset allocation strategies and carefully-sequenced plans for asset drawdowns to maximize the long-term income potential of any given pool of wealth. That's an especially important point to emphasize in the wake of several down years in the stock market. ***There is a real danger that many anxious retirees may overreact to this 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.***

Unless retirees have huge cash resources relative to their needs, adopting such an "ultra-conservative" strategy can actually be quite dangerous to their financial health. It can, in fact, seriously raise the risks of outliving 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 asset 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 8 on the next page illustrates the probability of exhausting three different

LONGER PLANNING HORIZONS REQUIRE GREATER EXPOSURE TO EQUITIES



Source: Fidelity Investments. Hypothetical value of assets held in an untaxed portfolio of stocks, bonds, and short-term investments with inflation-adjusted withdrawals of 5%. Please refer to the Important Legal Information page for important information about the methodology used in this chart and index information. Historical monthly data from 1926 through 2002 is from Ibbotson Associates; stocks, bonds, and cash are represented by S&P 500, U.S. Intermediate Government Bonds, and U.S. 30-day T-Bills. Average 3% inflation rate assumed (historical average from 1926 through March 2003 was 3.06%). Actual inflation rates may be more or less. This chart is for illustrative purposes only and is not indicative of any investment. Past performance is no guarantee of future results.

Exhibit 8

pools of assets ranging from 100% short-term investments, to a conservative portfolio (20% stock, 50% bonds, 30% short-term investments), to a balanced portfolio (50% stock, 40% bonds and 10% short-term investments).

Assuming an inflation-adjusted annual withdrawal rate of 5%, all three portfolios deliver reliable income flows for the first 15 years. Thereafter, the risk of exhausting funds rises significantly. The risk of depleting these assets becomes very severe 25 years out for the short-term and "conservative" portfolios, which show, respectively, nearly a 100% chance and roughly a 60% chance of running out of money. Yet the balanced portfolio shows an 80% chance of remaining intact and still delivering income at that 25-year stage.

Even if it seems counterintuitive, especially after the experience of 2000-2002, ***historical experience with asset class returns suggests that you need stocks for the long haul — and life in retirement is a long haul.***

The Bottom Line:* *Longer retirement planning horizons — reflecting greater awareness of longevity "risk" — make stock holdings even more vital for portfolios intended to provide income for life.

4. Excess Withdrawal Risk

Changing the annual rate of planned withdrawals can, of course, dramatically raise or lower that portfolio's prospects of lasting for a longer period of time. This is a variable largely in the control of a retiree.

So withdrawal rates can be adjusted to take account of a person's age, health, their desire to leave a legacy, and other variables.

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 correction has exposed this fallacy.

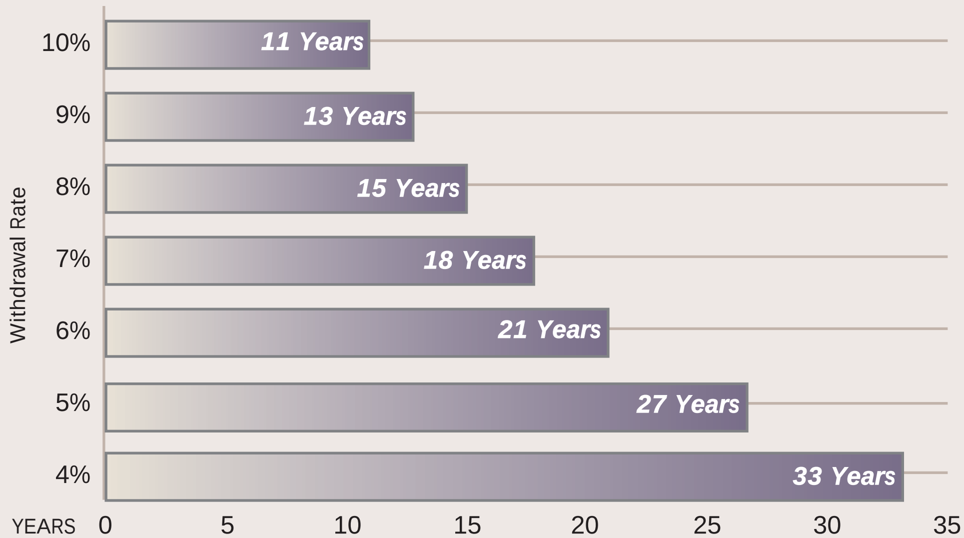
Many financial advisors today report that they are actually having to "downsize" retirees' budgets and lifestyle expectations. Some are even seeing customers forced to go back to full-time jobs — precisely because of overly generous withdrawals in their early retirement years.

Exhibits 9 and 10 look at withdrawal risk. Exhibit 9 shows how long a balanced portfolio of 50% stocks, 40% bonds and 10% short-term instruments would last if its owner withdrew between 4% and 10% a year, adjusted upwards annually for inflation. When creating this exhibit numerous possible return scenarios were considered, based on the historical performance for each asset class between 1926 and 2002. And the scenario was run at a 90% confidence level.

The exhibit shows that at a 10% withdrawal rate, a retiree could only count on a balanced investment portfolio lasting 11 years. However, at a 4% withdrawal rate, the investment portfolio would last for 33 years —

CONSIDER THE IMPACT OF WITHDRAWAL RATES ON A PORTFOLIO

NUMBER OF YEARS PORTFOLIO MAY LAST, BASED ON PERCENTAGE OF ASSETS WITHDRAWN EACH YEAR (90% CONFIDENCE LEVEL).



Source: Fidelity Investments. Hypothetical value of assets held in an untaxed portfolio of 50% stocks, 40% bonds, and 10% short-term investments with inflation-adjusted withdrawal rates as specified. Please refer to the Important Legal Information page for important information about the methodology used in this chart and index information. Historical annual data from 1926 through 2002 is from Ibbotson Associates: stocks, bonds, and cash are represented by S&P 500, U.S. Int. Government Bonds, and U.S. 30-day T-Bills. Average 3% inflation rate assumed (historical average from 1926 through March 2003 was 3.06%); actual inflation rates may be more or less. This chart is for illustrative purposes only and is not indicative of any investment. Past performance is no guarantee of future results.

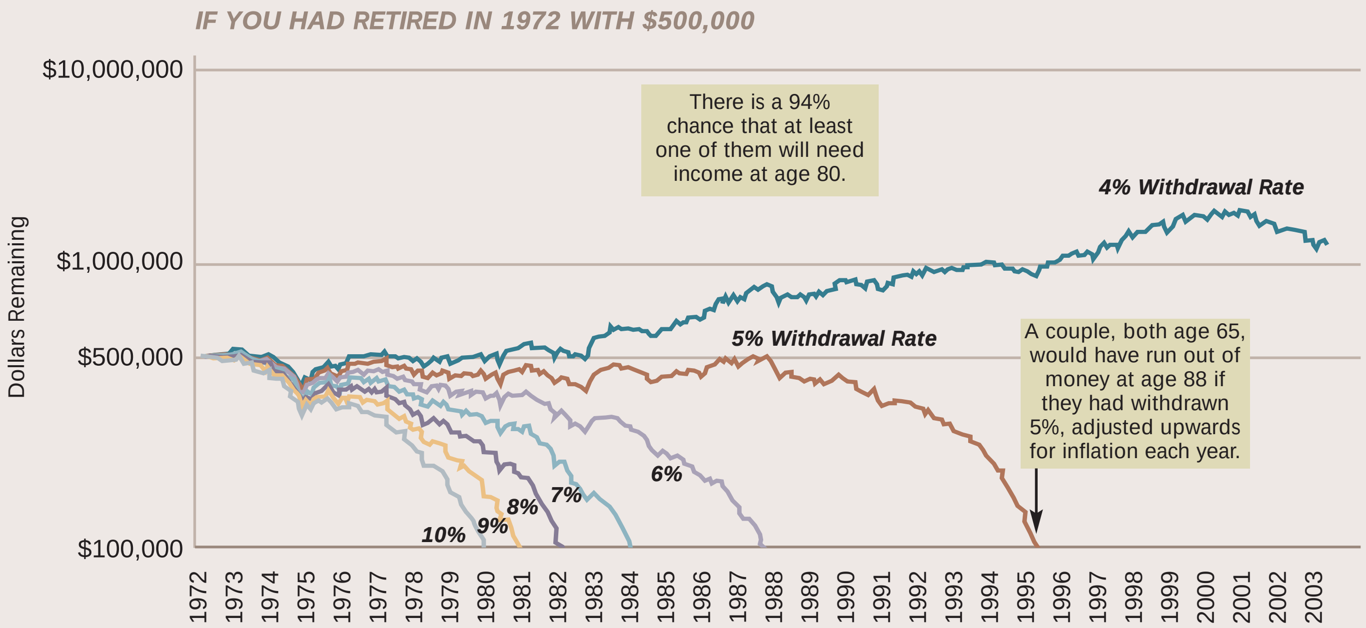
Exhibit 9

long enough to provide a 65-year-old with an income stream lasting to age 98. Moving that rate up to just 6% would risk exhausting those assets by age 85 — 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 10 looks at the impact that a range of inflation-adjusted withdrawal rates would have had on a $500,000 portfolio of 50% stocks, 40% bonds and 10% short-term investments over the period from 1972 and 2002. This period includes the great bull market of the late 20th century — roughly 1982 to 2000. But it also encompasses two of the worst bear markets in Wall Street history, five recessions, two major wars, two impeachments of U.S. Presidents and the rabid inflation and painfully tight monetary policy of the late 1970's — 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 1980's — if funds were drawn down at a 6% clip. 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.

PRUDENT WITHDRAWAL RATES CAN EXTEND THE LIFE OF A PORTFOLIO



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 Important Legal 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 January 2003 from Ibbotson Associates: stocks, bonds, and cash are represented by S&P 500, U.S. Intermediate Government Bonds, and U.S. 30-day T-bills. 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 based on Annuity 2000 Mortality Table from Society of Actuaries. Figures assume a person is in good health.

Exhibit 10

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 stark contrast, a 4% withdrawal rate — $20,000 in the first year, then adjusted upwards in later years for ***actual, historical inflation*** — could have done more than just sustain the asset pool. 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 would actually have risen to $1.7 million at the market crest in 2000 before falling back to just about $1.3 million by 2002. This portfolio would have been able to easily pay out more than $50,000 in 2002 — leaving a great deal more where that came from.

And note as well: there is a 35% chance that one member of this retired couple would still be alive in 2002.

This exhibit 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 returns to stocks — given enough time — and the critical importance of withdrawal rates.

This isn't to say that a 4% withdrawal rate offers magical security or assures asset immortality. Those outcomes depend on market performance. But it is clear that rates much above 4% begin — fairly quickly — to increase depletion risk in the "out years" of a retirement income plan.

The Bottom Line: The risk of being put on a path to depletion rises steeply at withdrawal rates over 4%. This risk can be magnified even further if a sustained market correction — similar to the 2000-2002 correction — occurs early in retirement. Consequently, retirees should consider using conservative withdrawal rate assumptions in the early years of their retirement. Those who have planned wisely and preserved their investments may have the ability to sustain reasonably higher withdrawal rates later in retirement, with less risk of depleting assets in their lifetimes.

5. Health Care Expenses Risk

However their portfolio performs, 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-1990's, health care managed care programs and other cost con-

SAVING FOR RETIREE HEALTH CARE COSTS

(Savings needed to supplement Medicare.)

Age at Retirement	Total Savings Required	Annual Savings Required Starting at Age 35	Annual Savings Required Starting at Age 45
55	$260,000	$5,260	$16,620
60	$210,000	$2,660	$7,160
65	$160,000	$1,310	$3,240

Source: Fidelity Workplace Services; September 2002 Health and Welfare Report.

Exhibit 11

tainment 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 8.7% in 2001 to reach an all-time high of over 14% of America's gross domestic product, the broadest measure of all goods and services produced in the United States.[5]

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 2002 study by the Fidelity Employer Services Company — ***"Retiree Health Costs: Addressing the Growing Gap"*** — estimates that a couple retiring today at age 65 will need current savings of $160,000 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 11). A couple retiring at age 60 would need to plan on spending substantially more on health care costs — an estimated $210,000 over the course of their retirement.

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 1995 to 2001, among companies employing more than 500 workers, the percentage offering retiree health benefits fell from 35% to just 23%.

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 full Medicare coverage is not yet available.

None of these estimates include possible long-term care expenses. Yet roughly 50% of Americans now turning age 65 will be admitted to a nursing home at some point in their lives. About half of those people will stay six months or less. But roughly one in ten will stay three years or more. However long the stay, full-service nursing home care is expensive. Estimates show that one year of such care ranges between $33,000 in low-cost states like Louisiana to over $91,000 in Connecticut (see Exhibit 14).

That makes maximizing savings 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.

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.

[5] U.S. Government Annual Report on Health Spending.

Section IV

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 view 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 stage 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.

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 Dykwald underscores the importance of these factors.[6] In Dykwald'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 cho-

[6]***Study on Retirement Satisfaction*** by Harris International, Ken Dykwald and sponsored by AIG SunAmerica.

sen 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 and 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 percent of men between ages 62 and 64 still in the workforce was over 57%. Twenty years later, in 1996, that had fallen to just over 44%. But by 2002, the percent of men at that age still working had ticked back up to 52%.[7]

[7]U.S. Bureau of Labor Statistics.

This evidence isn't enough to declare a "trend" away from early retirement. But financial pressures from declining stock values and changing attitudes towards work and leisure do seem to be combining to raise 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 a few months beyond age 65, 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. What's more, unless the current law is changed, benefits for delaying retirement are set to increase even more over coming years while penalties for “early” retirement rise. According to Social Security Administration data, a Baby Boomer born in 1948 and now earning $50,000 could expect a monthly benefit (in 2003 dollars) of $1,010 on retiring at age 62; $1,453 on retiring at age 66; and $1,998 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.

MATCH THE RELIABILITY OF CASH FLOW TO THE IMPORTANCE OF THE EXPENSE

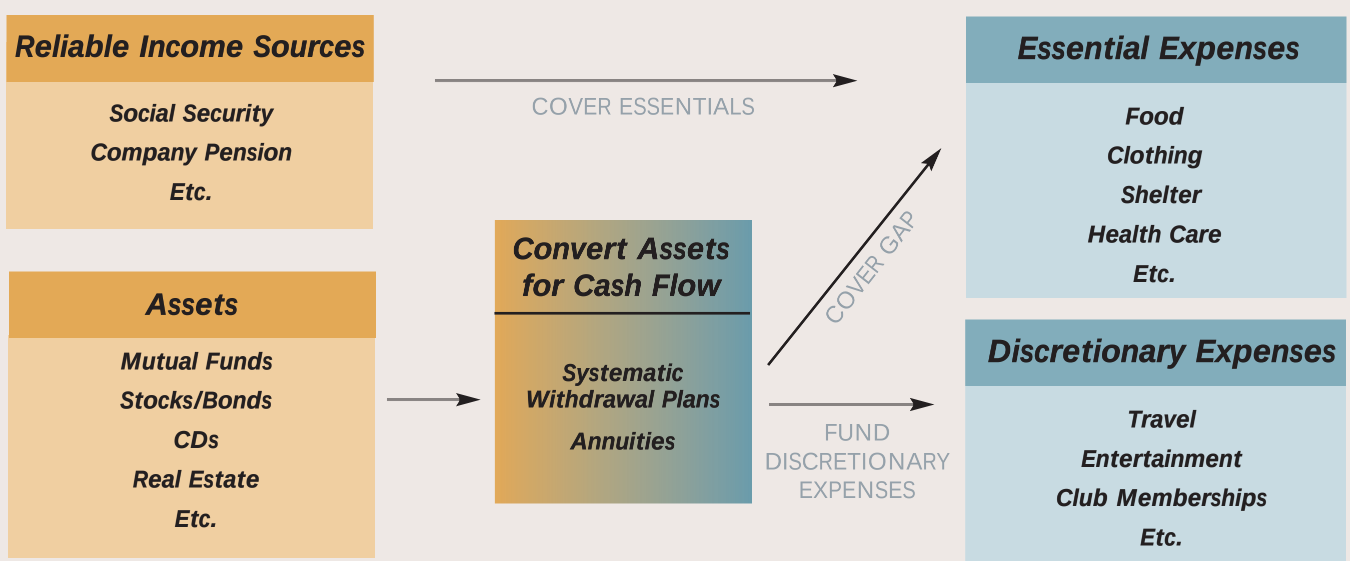


Exhibit 12

*Source: Social Security Administration data.

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

Exhibit 12 illustrates a basic template for approaching lifetime 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.

While a SWP strategy can create long-term income streams 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 annuities. They can provide a specific amount of income for a lifetime or, if so desired, shorter periods of time. 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 fixed annuities pay a set level of income that will not adjust for inflation.

Like other types of insurance there is a cost element to an annuity, which helps to fund the income payments. 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. (Exhibit 13 provides more detail on the trade-offs between SWPs and annuities.)

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 pay-outs for life.

- ***Pension Plans*** refer to traditional defined benefit programs, which also provide predictable lifetime income. Some, but not all, pensions 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, over specific periods of time. 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 can be safely drawn from a given asset pool should 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 for over a century.* But equities have also been subject to sharp drops, including a record 68% fall in a single year during the Great Depression of the 1930's and more recently the three-year decline of more than 30% experienced from 2000-2002. 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 2700%. 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.

  Professionally managed bond funds** can also play multiple roles in a retirement portfolio. 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 the certainty of knowing that their principal will be returned on a specific date (depending on the creditworthiness of the issuer of the bond) may prefer investing in individual bonds. A common investment strategy for doing so is a bond ladder. This entails investing in a multiple number of bonds, which provide regular income streams for specific periods of time — typically five or ten years into the future.

*Source: FMR.

**Unlike most FDIC-insured bank products, such as CDs, a bond fund's yield, share price and total return will vary and you may have a gain or loss when you sell your shares.

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 mini-portfolio of bonds retirees may be able to "lock-in" a predictable income stream for a targeted period of time and then reassess their income needs at the end of the period. Because a bond ladder can provide a known amount of income for a number of years forward, using this strategy may also enable retirees to segregate another pool of assets for investment in growth-oriented mutual funds or equity pools — relatively free from concerns about day-to-day stock market fluctuations. 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 Deposits (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.

- ***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 which 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 non-refundable 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 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.

Trade-Offs Between SWPs and Annuities

Choosing among these financial vehicles and strategies to create personalized income plans for retirees involves some trade-offs. One of the most salient trade-offs is the decision whether to rely solely on a Systematic Withdrawal Plan (SWP) from a diversified pool of assets or whether to liquidate a portion of that pool to purchase a guaranteed lifetime income product such as an annuity.

An annuity may provide another source of predictable income at the cost of paying an insurance premium and giving up some flexibility. But annuitizing may also reduce a person's bequest to heirs in exchange for a guarantee of income for life. Exhibit 13 illustrates this key trade-off in more detail, contrasting results for a couple using a systematic withdrawal strategy (SWP) alone and a SWP strategy supplemented by a variable income annuity, with a 1% annual annuity charge.

In this example, a hypothetical couple both age 65 begin with a retirement pool of

*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% penalty tax.

$500,000 — $300,000 of which is in tax-sheltered accounts. Their guaranteed income sources are $10,000 a year in Social Security payments and $20,000 from pensions. They expect their total expenses to run at $45,000 a year. ***Assets, pension income and Social Security income used to cover the couple's anticipated annual expenses were adjusted for inflation and taxes.***

The case study looks at two approaches to closing the gap between the income the couple receives from pension and Social Security payments and the annual expenses they anticipate in retirement. In Case A, the couple relies solely on withdrawing assets from a balanced portfolio allocation of 50% stocks, 40% bonds and 10% short-term cash investments to close the income gap.

This strategy fills their gap and meets all of their inflation-adjusted expenses until age 87. At that point their $500,000 asset pool is gone and their only anticipated income

CASE STUDY: TRADE-OFFS OF PURCHASING AN ANNUITY

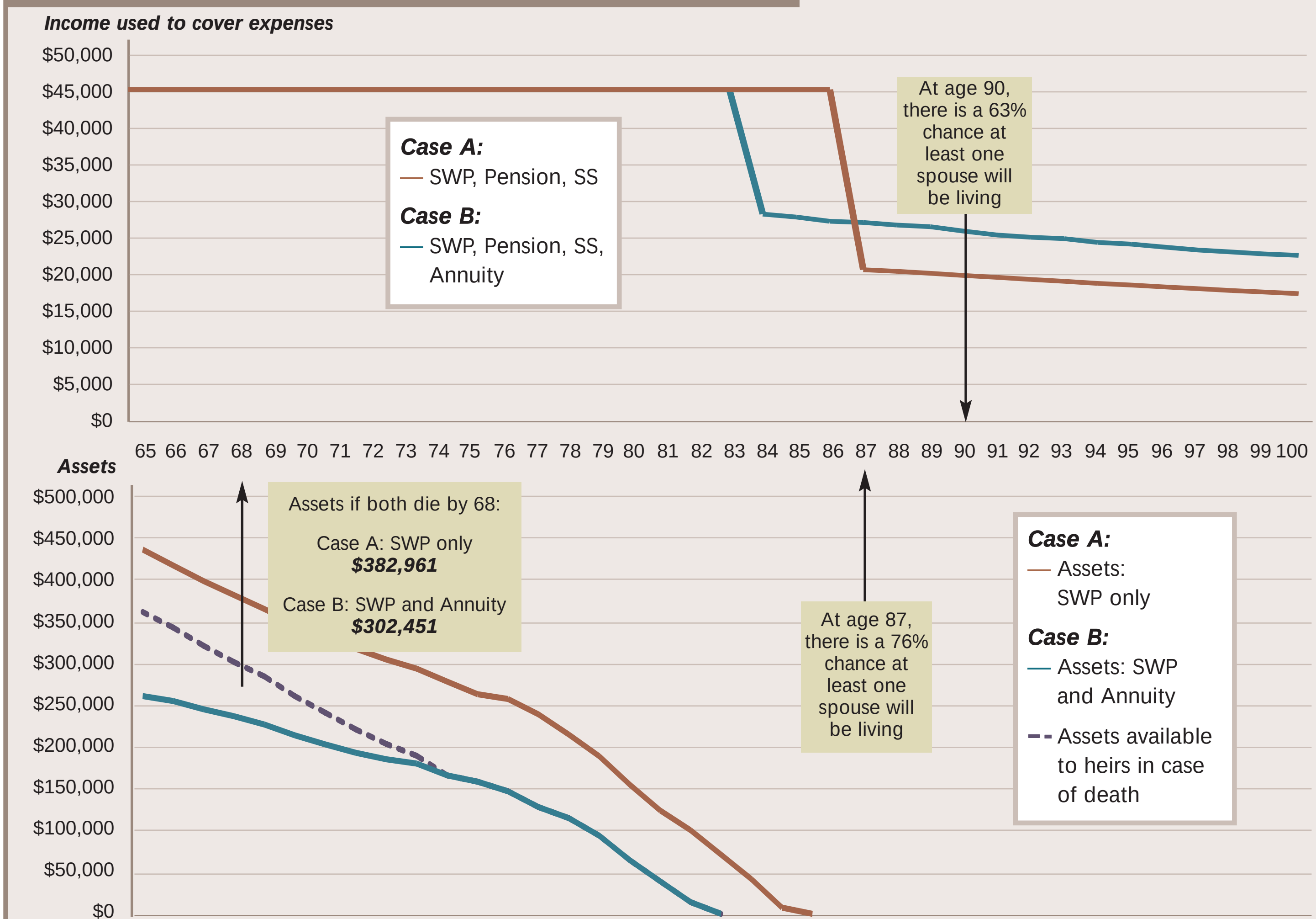


Exhibit 13

Source: Fidelity Investments. Exhibit assumes a couple, both age 65, with $500,000 in assets of which $300,000 is tax-deferred and $200,000 is taxable. Annual income sources include: $10,000 from Social Security with a cost of living adjustment, and $20,000 from pension with no cost of living adjustment. The hypothetical value of assets for Case A in the bottom chart reflects an asset mix of 50% stocks, 40% bonds, and 10% short-term investments. The hypothetical value of assets for Case B in the bottom chart assumes that $200,000 was used to purchase a Variable Income Annuity that includes: a Joint Life with 100% survivor income feature with a 10-year guarantee period; a 1% annual annuity charge; a 5% benchmark; and a portfolio invested 50% stocks, 40% bonds, and 10% short-term investments. The remaining $300,000 balance in Case B is invested 50% stocks, 40% bonds, and 10% short-term investments.

Return and inflation rates are based on historical risk premium approach as described in the Important Legal Information section of this document. Volatility of stocks, bonds and short-term asset classes based on historical annual data from 1926 through 2002 from Ibbotson Associates. New actual rates of return and inflation may be more or less. This chart is for illustrative purposes only and is not indicative of any investment. Past performance is no guarantee of future results.

Please refer to the Important Legal Information page for further detail about the methodology used to produce this exhibit and index information. Stocks, bonds and cash are represented by the S&P 500, U.S. Intermediate Government Bonds, and U.S. 30-day Treasury Bills.

comes from pension and Social Security payments. By depending on systematic withdrawals alone, the couple has ensured that there are more assets for heirs if they both die before age 87. However, the risk is that at age 87, when there is a 76% chance that one of the couple will be alive, their income stream will be substantially less than if they had purchased an annuity to supplement their income.

In Case B, the couple fills their income gap by using a systematic withdrawal strategy (like in Case A) and an income annuity. They use $200,000 to purchase an annuity that provides a lifetime income that fluctuates based on the performance of a portfolio consisting of 50% stocks, 40% bonds and 10% short-term investments. To add to that income and close the gap needed to cover expenses, they also withdraw assets from their remaining $300,000 which is invested, as before, in a balanced portfolio. In Case B, the portfolio is depleted three years earlier, by age 84, than in Case A because substantial assets were used to purchase the annuity. But Case B, which includes an annuity, kicks off substantially more income beginning at age 87 than Case A, which relied solely on a SWP to supplement Social Security and pension income.

The downside of including the annuity in their plan is that it reduces the amount of a possible bequest if the couple dies in the early years of retirement. However, the downside is mitigated somewhat in the exhibit because it is assumed that the couple chose a 10-year guarantee feature that provides the option of continuing the income payments to their heirs or paying them a lump sum if the couple dies within 10 years of purchasing the annuity. The tradeoff for the couple is that they receive less in income versus an annuity that does not offer this feature.

But, if both the husband and wife died at age 68, their heirs could continue to receive the annuity's income payments for the final 7 years of the guarantee period or the heirs could elect to have the remaining balance paid out in a lump sum. Assuming the couple's heirs choose to take a lump sum payment, the 10-year guarantee feature would mean approximately $65,000 more in assets would pass to the estate than if the couple had decided to purchase an annuity without the guarantee feature.

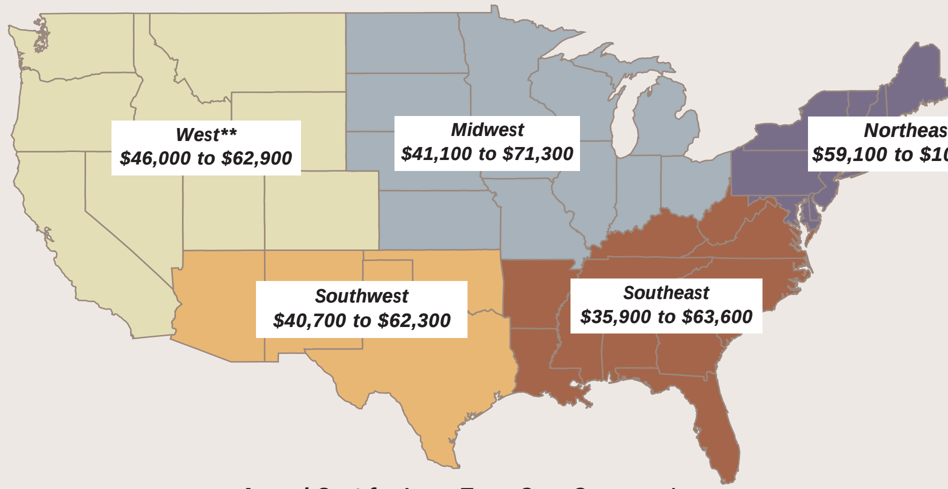
Trade-Off: Long-Term Care Insurance

The government's Medicare program 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 insurance (LTC) and the risks that lack of such coverage may inflict serious damage on their assets if they do face prolonged nursing home stays. Exhibit 14 illustrates the costs of annual nursing home coverage 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 a 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

ANNUAL NURSING HOME COSTS BY REGION



Annual Cost for Long-Term Care Coverage*

Age 45	Age 50	Age 55	Age 60	Age 65	Age 70	Age 75
$1,361	$1,399	$1,512	$2,117	$3,062	$5,027	$8,883

*The costs shown are for non-inflation-adjusted coverage and assume the couple qualifies for standard health rates. Policy coverage is assumed to be a lifetime benefit covering up to $75,600 per year in costs, and includes a 180-day elimination period. Where nursing home costs exceed $75,600, long-term care insurance will not cover all costs of a nursing home stay. Source: General Electric Capital Assurance Company, 2003.

**Excludes HI, AK

Exhibit 14

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, at an average cost ranging between $35,900 and $105,500 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 many 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 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, it may be worthwhile to purchase a policy that does provide lifetime benefits, if the costs are affordable. Exhibit 14 shows cost estimates for non-inflation adjusted LTC insurance. Insurance that includes inflation protection can run as much as 50% higher. Given these higher costs, some people may wish to consider purchasing a LTC policy that does not adjust for inflation — and using other assets, such as equity investments to self-insure against the inflation risk of long-term care.

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 for a secure retirement.

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. It is also eminently within reach. ***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.

Fidelity believes that every retiree and pre-retiree should have a lifetime income plan that realistically estimates their 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 planning process — ***the sooner the better.***

For those approaching retirement age, the process of 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 essentials will be met, 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 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.

IMPORTANT LEGAL INFORMATION

Exhibits 3, 4, 7 8, 9, 10, and 13 are not intended to project or predict the present or future value of the actual holdings in a participant's portfolio or of the performance of a given model portfolio of securities. The calculations and results generated for Exhibits 3, 4, 8, 9, and 10 are based upon historical performance analysis of the stated asset groups, goals and assumptions. The historical annual data utilized is from 1926 through 2002 and is from Ibbotson Associates: stocks, bonds, and short-term investments are represented by S&P 500, U.S. Int. Government Bonds, and U.S. 30-day T-bills.

Investors may be charged fees when investing in an actual portfolio of securities, which are not reflected in illustrations utilizing returns or market segments.

For Exhibit 13 the 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 of 4% and .72% for stock and bonds, respectively, are added to an assumed 10-year treasury yield of 4.61%. Short-term asset class returns are based on a historical risk premium of .73% added to an inflation rate of 1.87%. The inflation rate was calculated by subtracting an assumed TIPs yield of 2.74% from the assumed 10-year treasury yield of 4.61%. Volatility of the stocks, bonds, and short-term asset classes for Exhibit 13 is based on the historical annual data from 1926 through 2002 from Ibbotson Associates as mentioned above.

Exhibit 13 reflects the following tax assumptions: (i) progressive federal income tax rate schedules in effect for a given year are based on current law (assuming constant rates for 2010 and beyond), (ii) standard deductions, exemptions, and tax brackets are adjusted for inflation, (iii) a 5% state individual income tax rate applies to all types of income, with the exception of Social Security income, (iv) the initial cost basis of the taxable account is equal to fair market value, (v) tax-deferred account and annuity distributions, taxable account bond and short-term investment income, and pension and Social Security income are taxable as ordinary income, (vi) stocks held in the taxable account generate a mix of 2% qualified dividends and a variable rate of long-term capital gains or losses (based on a 20% annual investment turnover rate and the overall account return for a given year), and (vii) the impact of alternative minimum taxes and 5-year long-term gain taxes is not reflected.

For Exhibits 4, 8, 9, and 13, several hundred financial market return scenarios were run to determine how the asset mixes may have performed. For Exhibit 8, the percentage shown is designed to indicate whether, based on historical market conditions, there may have been enough money for the asset mixes to last for each of the time periods indicated. For example, if in 125 of 250 scenarios the money would have lasted 20 years, the chart would display 50% underneath 20 years. The 50% number would illustrate that in half of the market simulations, the asset mix would have lasted 20 years. For Exhibit 9, 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. For example, the assets could have supported a 4% withdrawal rate for 33 years in 238 of 250 scenarios. Exhibit 13 illustrates a similar concept to Exhibit 9; a 90% confidence level was used for the income chart, meaning that there was still a 1 in 10 chance that the level of income specified could not be generated. A 75% confidence level was used for the asset growth chart, stating that there was a 1 in 4 chance that the assets specified could be lower. Of course, there can be no assurances that the future market conditions would resemble historical market conditions.

For Exhibits 3, 4, 8, 9, 10, and 13 that highlight varying levels of stocks, bonds, and short-term investments, the purpose of the 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.

Diversification does not ensure a profit or guarantee against 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.

As with all your investments through Fidelity Investments, 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 S&P 500® Index is a registered service trademark 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 stocks of 500 widely held U.S. stocks that includes the 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.

Information provided is general and educational in nature. It is not intended to be, and should not be construed as, legal or tax advice. Laws of a specific state or laws relevant to a particular situation may affect the applicability, accuracy, or completeness of this information. Consult an attorney or tax advisor regarding a specific legal or tax situation.

This research paper is a product of Strategic Advisers, Inc., a registered investment advisor and a Fidelity Investments company.

For investment professional use only.

Clearing, custody, or other brokerage services may be provided by National Financial Services LLC, or Fidelity Brokerage Services LLC, Members NYSE, SIPC

Fidelity INVESTMENTS®

356399