SELECT RE INVESTOR

NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION • RETIREMENT, SAFETY & INSURANCE DEPARTMENT

401(k) or Roth IRA—Where should I put my retirement money?



When it comes to building for your retirement, 401(k) plans are king. Especially if your co-op provides a matching contribution – free money is a very powerful compounding force. But the Roth IRA has been in the media a lot lately, and many investors want to know where to put money that exceeds their co-op's matching requirement. Here are a few points to help you decide:

1. Are you eligible for a Roth IRA? To make the full $2,000 contribution, your annual adjusted gross income cannot exceed $95,000 for singles or $150,000 for married couples filing jointly.

2. Contributions to your 401(k) immediately reduce your taxable income. Roth IRA contributions are made after-tax. What's the difference? Say you decide to contribute $2,000 of your salary and you're in the 28% tax bracket. With a 401(k) plan, your employer simply deposits the $2,000 into your account, via payroll deduction. But before making a Roth contribution, you would have to first pay taxes, which would leave you with only $1,440 to invest. In addition, you can only put $2,000 into a Roth IRA each year, but you can put up to $10,000 a year into your 401(k) plan.

3. What are your retirement prospects? Roth contributions can be withdrawn free of federal income taxes in retirement, while distributions from 401(k) plans are taxed at your current income tax rate. If, like many people, you believe you'll have less income and be in a lower tax bracket during retirement – choosing the 401(k) for your unmatched contributions will probably mean paying fewer taxes than choosing the Roth IRA.

If you stay in the same tax bracket during retirement (and all other factors are equal), you should end up with the same account balance – whether you made the $2,000 pre-tax 401(k) contribution

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A Look at Value Investing in a Growth Market

The S&P 500 has managed to recover from its hiccups in the last half of 1998. Optimists say the market is heading to new highs, while pessimists predict there's a bear around the corner.

When it comes to the outlook for stock funds, the predictions are as varied as the styles – such as growth versus value and large-cap versus small-cap. The performance of each style can differ substantially from the S&P 500 and other market indices because of the composition and objectives of the funds. But the question still arises – why has the S&P been achieving higher returns than the Growth and Income Stock Fund?

We've had an unprecedented bull market for eight years now, but 1998's market volatility should make every investor aware of the potential for ups and downs.

The short answer: The Growth and Income Stock Fund is a value fund – value funds are not built to excel in a growth market. And growth funds are not built to excel in a value market.

Managers of growth-oriented stock funds seek investment returns through rapid, near-term capital appreciation. They tend to invest in companies that are experiencing a faster-than-average gain in earnings and revenues. Internet and other technology stocks are examples of popular growth-style investments in today's market.

Value managers look for companies whose stock prices tend to be

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Value Investing in a Growth Market

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temporarily undervalued – the company's stock price is lower than the manager thinks it's worth. So value-style managers choose financially sound companies they believe will not only survive this temporary set-back, but will go on to prosper and gain market share. The Growth and Income Stock Fund managers follow this style. "We look for underpriced large- and mid-cap stocks with good management and long-term growth potential," said fund manager Stuart Teach.

Which style is better? Actually, the two complement each other over the long term. When one style is out of favor, the other tends to perform better. Many experts believe that value funds tend to perform better than growth funds when the market is down. But no one style will always perform well, under all market conditions.

The Standard & Poor's 500 Stock Index is an unmanaged index of 500 industrial, transportation, utility and financial companies, and is widely regarded as representative of the equity market in general. It includes many highly priced, growth-oriented stocks that have done well recently, such as Microsoft and Dell, that are not appropriate for a value fund and may not continue to do well in other market conditions. The S&P is also heavily weighted toward the top 25 public companies – about one-third of the S&P's return is generated by just 5% of its stocks. Value funds, however, tend to have high concentrations of financial industry stocks – which were hit hard by the financial troubles overseas in 1998.

We've had an unprecedented bull market for eight years now, but 1998's market volatility should make every investor aware of the potential for ups and downs. Investors who are risk averse or uncomfortable with short-term losses should add more stable funds, such as a short-term bond fund, to their investment mix. For all investors, however, diversifying among several types of funds and different types of assets will help you accumulate assets in various market conditions.

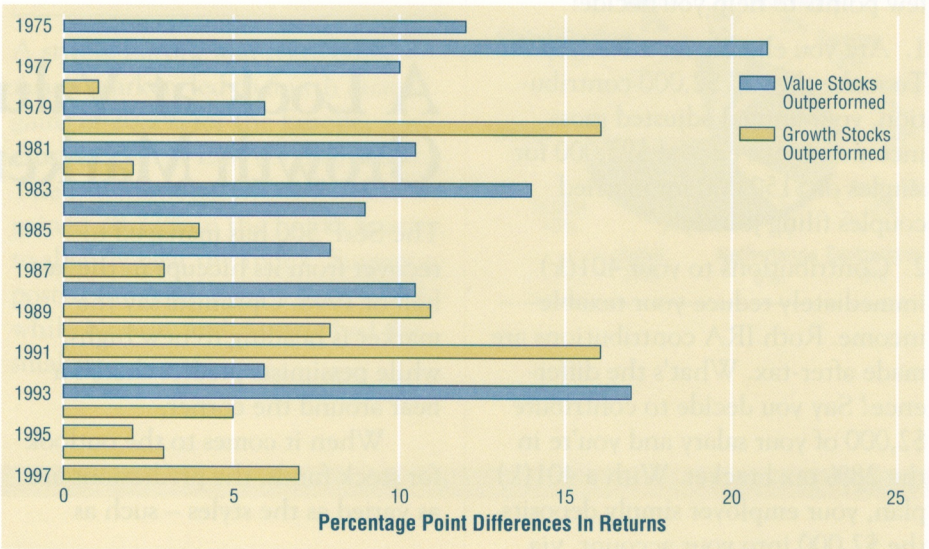
Poll Finds No Agreement On Social Security Options

Three-fourths of American adults think they should have the option of investing part of their Social Security withholdings in the stock market, according to a poll conducted for The Associated Press – but only half would probably opt for that. Two-thirds, however, opposed allowing the government to invest their Social Security funds in the market. These are several options under consideration as the government searches for ways to keep the Social Security Trust Fund solvent as baby boomers prepare to retire.

The poll also found that 75% of Americans feel fundamental changes are needed in the Social Security program – but they do not want to

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Growth Versus Value Stocks: 1975-1997



This comparison of the difference in returns between growth and value stocks shows that value stocks outperform growth stocks some years, and in other years, the reverse is true. While growth funds have outperformed value funds the past five years, historically, their returns have been similar and many fund managers expect the value style to rebound again soon.

Source: Standard & Poor's/BARRA

QUESTIONS & ANSWERS

Q. Why doesn't the share price of the Growth and Income Stock Fund track the movement of the Dow more closely? Lately it seems they are often moving in opposite directions.

—Associated Electric Co-op, Springfield, MO

A. Very few portfolios, except those that invest strictly in Dow stocks, will track the Dow Jones Industrial Average, which is comprised of only 30 "blue-chip" stocks. With over 6,000 stocks available to investors, the Dow is not a reliable measure of stock performance. A movement by any one of its 30 stocks will have a large impact on the Dow's price. It's more a barometer of how the large Fortune 100 and multinational companies are doing.

The Standard & Poor's (S&P) 500 Index (500 stocks; 88 industry groups) measures a much wider universe of stocks and industry groups than the Dow and is a better indicator of overall stock performance. The S&P 500 is the benchmark widely used by portfolio managers and consultants to evaluate stock portfolio performance.

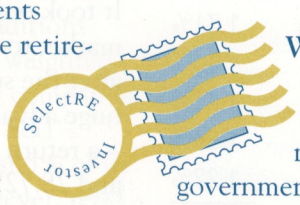
In addition, there are different styles of management – for example, growth versus value and larger companies (large cap) versus smaller companies (small cap). The performance of these different styles can differ substantially from the S&P 500, the Dow and each other. The Growth and Income Stock Fund managers pursue a value strategy, looking for underpriced stocks with good management and long-term growth potential, and buy mid-size and large companies. Different styles do well in different market conditions. No one style will always perform well under all market conditions. That's why we recommend that you diversify your assets and not put 100% of your money into any one fund.

Questions about investing or the SelectRE Pension Plan? Write to the address provided, or e-mail Pat Stewart at pat.stewart@nreca.org.

Poll on Options

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work more years until retirement or pay higher taxes. Respondents strongly opposed raising the retirement age to 70 or raising taxes across the board to help shore up the system. But they were less resistant to smaller steps, such as reducing cost-of-living increases when necessary or taxing only higher-income workers to raise money. The poll of 1,006 people taken December 2-6, has a margin of error of 3 points.



What do you think? Do you want to invest your own Social Security money? Or have the government invest it? Fax your response to (703) 907-5522 and we'll publish the results in the next edition of *SelectRE Investor*!

401(k) or Roth IRA

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or the $1,440 after-tax Roth contribution every year. It's usually only when your tax bracket will be higher after retiring that the Roth account provides more income.

4. Look at the availability of the funds during your working years. Remember – you're saving for retirement, so this shouldn't be the main factor in your decision. But it is important to know the differences.

Loans may be available from your 401(k) plan, which you repay to your account with interest. Your employer may also offer hardship withdrawals for certain financial circumstances, although you must still pay income taxes plus a 10% penalty on these withdrawals.

Roth IRAs allow you to withdraw your contributions tax-free and without penalty, after you've had the account for five years – including a distribution of up to $10,000 for first-time home purchasers. So while the Roth IRA may offer more access, the 401(k) plan will help ensure that the money you invest for retirement stays invested for retirement.

Your first priority should be to contribute enough to your 401(k) plan to get your employer's full match. Above the employer's matching amount, the 401(k) plan can provide more benefits than a Roth for most people. But if you're already contributing the maximum pre-tax amount allowed to your 401(k) plan ($10,000 for 1999, although lower limits for your individual plan may apply), a Roth IRA is an excellent way to further boost your retirement savings.