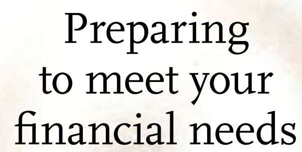
Ready for Retirement?



Preparing to meet your financial needs

By Carol Tice

A sales and marketing executive named Robert, 59, and his wife, Josephine, diligently saved for retirement, accumulating more than $1 million over 30-plus years. But then the Oakland, California, executive was hit with a double whammy: the steep stock market decline of autumn 2008 and a layoff from his job in November 2008. His portfolio shrank 30 percent, ending his plan to retire early at 62. For the past several years, he's been trying to determine the best strategy for recouping his losses and regrowing his retirement funds.

"I want to know what the experts think the market will do in the next few years," he says. "What's their best advice for shorter-term investing today?"

Seattle customer-service representative Anne, 36, decided to pull most of her money out of the stock market after it fell dramatically this past summer. Currently, her retirement nest egg is in low-interest savings accounts, along with $10,000 in gold and silver, and $2,000 in a foreign-exchange fund that actively trades various foreign currencies.

"I really don't know which way to go now," she says. "I want to make money, and I also want to invest in companies that are socially responsible."

Alison, 26, has done her best to put a little away for retirement each year from her salary at a technical college in a small town near Minneapolis, Minnesota. And at a prior job, she took advantage of a company-matched 401(k) retirement plan. But she and her 28-year-old husband, Jeff—who is just finishing nursing school—are struggling to meet their financial obligations. They have student loans, a car loan, a mortgage and two daughters, ages 1 and 3.

"Sometimes I wonder if it's better to pay down the student loans, the house debt or our car," Alison says. "What debt do we pay down versus how much money do we put in retirement?"

Like Alison, Anne and Robert, you may have questions about how to generate enough money for retirement. While there's no single answer—the right moves for you will depend on your age, risk tolerance, financial situation and desired retirement lifestyle—what is clear is that actively planning for retirement is essential.

The U.S. Department of Labor notes that experts estimate most retirees will need around 70 to 90 percent of their preretirement income to maintain an acceptable lifestyle. Below are recommendations for each working-life stage: early, mid-career and later the earning years. At every stage, be sure to weigh each potential investment's track record, performance against similar products, risk level, liquidity, fees and tax ramifications as you determine the best mix for you. In addition, make sure that each spouse/life partner has a retirement strategy of his or her own that will be adequate even if both people's benefits are no longer available because of divorce, death or other factors.

Teens and 20s: Start as soon as possible

It's simple math: Thanks to the magic of compounding, it's easiest to build a nest egg if you start early. Unfortunately, nearly 60 percent of workers under age 35 have no retirement account, the U.S. Census Bureau reported last year.

"The problem is simply getting them started at all," says Ramit Sethi, 29, a popular Generation Y finance blogger and the author of *The New York Times* bestseller *I Will Teach You to Be Rich*. Young people typically can't relate to the idea of retirement—it's too far off—he says, but they should be focused on retirement even more than the generations before them, since the Social Security system may not provide as much of a safety net 45 years from now.

Sethi recommends that young workers set up automatic payroll deductions to a company 401(k) or a personal IRA account, and thus put retirement savings on autopilot. Many such retirement accounts offer mutual-fund options, providing diversification.

Don't worry too much about what the market's doing any given week, Sethi says, because as a young worker, you have time to recover from downward stock-market slides. Putting 10 percent of your earnings into retirement accounts on a monthly basis—a method known as dollar cost averaging—has a good track record of building retirement wealth over time.

Even if you can't invest 10 percent a month, the Department of Labor notes that if you put just $1,000 at the beginning of each year into an IRA from age 20 through age 30 (11 years) and then never put in another dime, and the account earns 7 percent annually, with all earnings reinvested, when you retire at age 65, you'll have $168,514 in the account.

Of course, it's true that inflation will make that amount worth less in the future than it is now, and also that 7 percent reflects historical returns and past results are not indicators of future performance. Particularly these days, predicting return on investment is challenging, and you need to look carefully at the kinds of investments you use for your IRA or 401(k), but you're still farther ahead with a modest return than with no retirement savings at all.

Always take advantage of a company retirement

plan that includes a company-matching contribution, Sethi says. Never turn down free money. Plus, you can contribute to a 401(k) with pretax dollars and pay income tax only when you take distributions. The amount you withdraw each year is considered part of your annual income, and the tax rate is based on the tax bracket you're in when you make the withdrawals—presumably a lower bracket when you're a retiree than when you're an employee.

If you can't get a company match, consider an IRA. If your wages are higher now than you expect them to be when you retire, look into a traditional IRA, which is taxed much the same as a 401(k). If your wages are modest now—since you're at the beginning of your career—and you're therefore in a low tax bracket, Sethi suggests considering a Roth IRA. In a Roth IRA, the money you contribute is taxed before you contribute it, but you don't pay any taxes at all, not even on earnings, when you make withdrawals if you've held the Roth for at least five years and withdraw funds after age 59.5.

To free up money to use for an IRA or 401(k), Sethi recommends limiting debt-related interest charges by saving monthly toward predictable expenses such as a car purchase, a wedding and travel. Another way to limit debt is to contribute monthly to an emergency fund for items such as car repairs, home repairs and other unexpected expenses, Sethi says. And pay attention to your overall debt as you make financial decisions. The Department of Labor recommends that nonmortgage debt for workers of all ages not exceed 10 percent of take-home pay, and that total nonmortgage and mortgage debt not exceed 36 percent of take-home pay.

Each person's specific situation will determine how best to balance repayment of existing debt with contributions toward retirement savings. A key question may be whether you're paying more in debt interest than you could make on a retirement investment. If so, you may be farther ahead to first pay off debt such as high-interest credit card debt.

For low-interest debt, such as a student loan on which you also qualify to deduct the interest from your federal taxes, you might be farther ahead to invest more money in retirement savings than to pay off your loan early. If your employer offers matching funds for your contributions to a 401(k), it may make sense to contribute up to the amount of the match and then consider how to divide up any additional discretionary money, perhaps allocating some to retirement and some to debt reduction. However, remember that because decisions on how best to allocate money are so situation-specific, the best way to make them is by consulting a qualified financial adviser.

Expert help may be available free through your company's 401(k) plan, notes Peter Fisher, a partner at Human Investing, a retirement-fund advisory firm in the Portland suburb of Lake Oswego, Oregon. "One of the biggest mistakes 401(k) plan participants make is not taking advantage of the free investment counseling many plans offer," he says. "We're completely unprepared for investing. When you get your first 401(k), it's like giving car keys to a 12-year-old. People spend more time planning a trip to Disneyland than they do planning how they'll retire."

In a case such as Alison and Jeff's, says Seattle certified financial planner Robin Tan, the couple might want to look at cutting expenses to liberate more cash for retirement savings. For instance, student-loan debt can often be consolidated or refinanced to lower payments, he says.

Other options might include selling the current car and getting a cheaper car they can pay cash for; shopping at Goodwill for the children's clothes, since those clothes are out-

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Resources

The Department of Labor website offers information and worksheets to help people of all ages prepare for retirement. Visit www.dol.gov/ebsa/publications/10_ways_to_prepare.html. The DOL has also produced a booklet, *Taking the Mystery out of Retirement Planning*, designed especially for workers within 10 to 15 years of retirement. Visit www.dol.gov/ebsa/publications/nearretirement.html, or call 866-444-3272.

The U.S. Securities and Exchange Commission provides information on topics ranging from investing basics to target-date retirement funds; visit http://m.investor.gov.

For information on IRS catch-up-contribution rules, visit www.irs.gov/retirement/participant/article/0,,id=211396,00.html.

The website www.socialfunds.com offers a free guide to socially responsible mutual funds.

The FDIC provides a guide to what's insured and not insured at www.fdic.gov/consumers/consumer/information/fdiciorn.html.

The Investment Company Institute has a brochure about hedge funds: www.ici.org/investor_ed/brochures/faqs_hedge. —*C.T.*

grown quickly; and cutting back on incidentals, such as lattes.

Sethi recommends that young workers make target-date retirement funds a core part of their retirement strategies. These funds can have an end date that is near your target retirement date, and they adjust to a progressively more conservative investment mix as the target date nears. Investments differ from fund to fund, so be sure to evaluate each option, Sethi says. Also, look for a mix of growth- and value-oriented investments in the target-date funds, and in your retirement portfolio overall.

Your retirement funds should not be strictly U.S.-focused, he says. If your target-date fund does not include international funds as part of its diversification, you can increase your international holdings by separately purchasing a fund such as an Asia-focused fund.

He adds that young savers should be heavily invested in equities—stocks that provide an ownership share in a company—rather than taking an overly conservative approach.

If you're entrepreneurial, consider taking a chance on *you*, he says, by starting a business or working for a promising startup, even if it doesn't pay much at first. Early in your career is the time to take these gambles, which could skyrocket your income. If the startup fails, there's still time to recover at another job.

Thirties and 40s: Make good decisions

As you move into your 30s and 40s, your income typically grows, making it easier to save for retirement. At this point, you're old enough to start picturing your retirement lifestyle, which will help you determine how much money you'll need in your golden years, says Seattle-based CPA and certified financial planner Lisa Simonson of wealth-management firm Laird Norton Tyee. For instance, if you plan to keep working part-time, or you plan to sell most of your possessions and become a campground host, you may not need as much income as someone who envisions traveling extensively or continuing to maintain a large or expensive home.

Even if you've had setback recently because of the economy, it's important to be planning for retirement, Simonson says. Put whatever you can into a diversified portfolio.

Since some countries are experiencing their own economic turmoil right now, she believes it's better to invest a meaningful portion of your portfolio in international equities that include stocks across an emerging-market region such as Asia,

than to invest in stocks or funds focused on only a single country.

Simonson's take on the current stock-market gyrations? "This is a cycle, albeit a painful one," she says. "We still believe in the fundamentals of investing in capital markets."

Since it's difficult to guess when stocks will go up and down, trying to time the market means you often miss gains, she adds. A 2011 study by mutual-fund giant Fidelity Investments showed that those who responded to the fall 2008 stock market crash by selling all their equities and not purchasing any more between October 1, 2008, and March 31, 2009, had on average made back, as of June 30, 2011, only 2 percent of their losses. Those who maintained an asset-allocation strategy that included equities caught the next wave of stock growth and on average had made back 50 percent of what they'd lost.

Fidelity also reported that those who stopped contributing to their 401(k)s from October 1, 2008, to March 31, 2009, had on average gained back, as of June 30, 2011, just 26 percent of what they'd lost compared to 64 percent for those who continued making regular contributions.

A consistent buy-and-hold strategy is usually better than cashing out of the market as Seattle investor Anne did, and then trying to figure out the best time to get back in, says CFP Robin Tan. He adds that if Anne desires a mutual fund that reflects her values, there are "socially responsible" funds that get solid returns and are designed around a variety of values, from corporate fiscal conservatism to environmental responsibility.

A diversified portfolio might possibly include 5 percent in gold and silver, Tan says, but remember that gold and silver don't pay interest or dividends, and that the price of gold may have peaked or may soon peak.

Fisher from Human Investing believes that target-date retirement funds are the best choice for most investors of all ages because most people don't have time to actively manage their portfolios. Be sure to look for a fund that's invested appropriately for your time remaining until retirement, he adds.

And as you acquire more assets, such as a home, and as you have children, you need life insurance, too, says financial planner Tan. Without it, a family tragedy could force the liquidation of your retirement assets.

Just as for 20-somethings, look at where you might trim expenses to find more money for retirement investing. The Department of Labor notes that if you cut

out just $64 in entertainment expenses each month—for example, two trips to the movie theater with snacks—and instead invest that money, with a theoretical 5 percent rate of return and all earnings reinvested, you'll have $9,998 in just 10 years.

Fifties and 60s: Prepare for launch

Nearer to retirement age, your investment moves become even more critical. If you're behind in saving, take advantage of the IRS' catch-up rules that take effect at age 50 to put away more if you can, says Laird Norton Tyee's Simonson. Allowable catch-up amounts vary by type of retirement account, but you may be able to contribute an additional $1,000 a year to your IRA or an additional $5,500 a year to your 401(k).

Even if you're able to contribute only an additional $200 a month to a retirement account, you can more than double your existing balance in just 10 years, assuming a 5 percent rate of return per year and all earnings reinvested, according to the Department of Labor. Thus, if your current retirement-account balance is $40,000, at the end of 10 years, you'll have $97,066.20.

As you strive to determine how much money you'll need for retirement, consider that based on current estimates, a man retiring today at age 65 can expect to live approximately 17 years in retirement, and a female retiring today at age 65 can expect to live approximately 20 retirement years, according to the Department of Labor. Since those are just averages, the department recommends that you plan for approximately 30 post-retirement years to make sure you won't outlive your funds. Allow for widely varying inflation rates, including inflation rates for medical costs, which some experts believe will rise about 7 percent a year in the coming years. Studies show that almost 20 percent of retiree income will be spent on health care, notes the Department of Labor.

It's also important to keep key dates in mind during your retirement planning. For example, at age 59.5, there are no tax penalties on retirement-account withdrawals, but money you spend will be money that doesn't have additional time to grow. As you approach age 65, be aware that you may have to sign up for Medicare by a certain time or pay a significant late penalty reflected in the cost of your premiums. At age 70.5, you must start taking minimum withdrawals from retirement accounts or you may incur significant tax penalties.

As you advance in your working years, continue to look for ways to generate money for retirement investing, and avoid

taking on large debts. Perhaps you'll want to buy a used car instead of a new one and put the monthly savings into your retirement account. Maybe you have vacant land that's not producing much income, and you'll want to sell it to fund an income-producing investment. And can you do without a premium cable subscription? If you put $80 a month into an investment that earns 5 percent, with all earnings reinvested, you'll have $12,474 at the end of 10 years, according to the Department of Labor.

Also, for many people, the last two decades of employment are not the time to give large amounts to children and grandchildren. Take care of your own finances now to minimize the need to ask others to bear a financial burden for you down the road, the Department of Labor advises.

During your remaining working years, be sure to pay close attention to how you're allocating your retirement assets. Being too exposed to risks such as a dramatic stock-market decline can mean postponing retirement while you wait for a turnaround, as happened to Robert. One investing view holds that the percentage of investments you have in nonstock vehicles such as bonds and CDs should equal your age. For example, at age 50, you should have only half your money invested in stocks.

Nearing 60, Robert still has nearly 70 percent of his holdings in stock-invested mutual funds. He also has a small number of individual stocks, which is a high-risk strategy, says Tan, noting that Robert's nervousness about what stocks will do shows he's over-exposed to market risk. A more typical stock percentage for Robert's age would be 45 to 60 percent.

Tan says that the marketing executive should aim to put the rest of his retirement funds in investments such as multisector bond funds and CDs, with staggered maturity dates to provide a steady flow of available cash and to earn interest until the money is needed. Be aware, though, that bond funds are not all the same and that they can lose money.

Money-market accounts are also sometimes cited as good places to keep funds that you may want to access quickly. It's important to know that money-market deposit accounts at an FDIC-insured bank are FDIC-insured, while money-market mutual fund accounts are not. The managers of money-market mutual funds strive to retain all of the investors' principal, but that's not guaranteed.

Tan says that Robert—who has started a sales-and-marketing consulting business—can obtain the funds to rebalance his port-

folio to a better mix for his age by putting the next several years' retirement contributions into nonstock investments, or he could liquidate some individual stocks that have done well and put that money into the nonstock investments.

To keep the stock-invested portion of Robert's money growing, Tan recommends a mix of international and domestic-stock mutual funds, with perhaps 10 percent of Robert's retirement portfolio in diversified international funds and 5 percent in riskier emerging international markets.

For additional mutual-fund investing—which should be approximately 30 percent of Robert's total retirement money, Tan says—it would likely be best to stick with a domestic index fund. Index funds contain a mix of investment holdings designed to match the components and performance of the holdings in a market index, such as the S&P 500. This mix of investments is designed to provide a hedge against a downturn in any particular industry sector.

For more adventurous investors seeking a hedge against stock-market swings, one option is to choose a fund with investments that may do better when the stock market is down. Laird Norton Tyee's Simonson notes that these may include new mutual funds coming on the market that contain commodity futures, foreign currencies and even small hedge funds.

Unlike traditional hedge funds, mutual funds using hedging strategies are required to follow SEC regulations, she says. Also unlike traditional hedge funds, these mutual funds are not allowed to make investments that can't be covered by cash reserves, and investors must receive full and timely disclosure of all the fund's holdings.

No matter what your age, be sure to revisit your mix of investments as your retirement savings grow. An annual check-up can identify whether your portfolio has gotten out of balance because of something such as big returns in one fund, says Tan. Though it's tempting to keep putting more money into a fund that's done well, remember that mutual-fund results tend to vary over time, and allowing your percentage in any given area to exceed your targeted mix can put you at higher risk. One way to help even out your asset allocation, Simonson says, may be to change where you'll put deposits in the coming year. ■

Writer Carol Tice lives in Seattle. This article is not meant to constitute financial advice. Be sure to consult a qualified financial adviser for recommendations specific to your situation.