Starting to Save for Retirement

4-step action guide to help you fund a future 'paycheck'

Written by the Editors of *Kiplinger's Personal Finance*

WHEN I'M

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Funding Your Future Paycheck

4 STEPS YOU CAN TAKE TODAY

At the beginning of your career, saving for retirement may be low on your priority list. After all, you have a lot of competing money needs right now. You may be paying off student loans, saving for a house, or even starting a family.

But there's a great reason to begin saving for the future today. The sooner you start stashing money in a retirement fund, the bigger your nest egg will be. And that will come in very handy for covering a retirement that could last 20 or 30 years.

One of the best ways to spark a retirement savings habit is to think about providing for your future self. Connecting with the idea of the "you 40 years from now" makes your goal more tangible. Every dollar you save now, every financial sacrifice you make today, will mean more money in your pocket tomorrow.

What's more, in this age of "do-it-yourself" retirement saving, every choice is under your control. You decide if you'll join your employer's retirement plan or set up your own. You choose how much to contribute, and how to invest those contributions. You can even use the many online tools and apps available today to help you manage your investments.

Getting started is easier than you might think, and that's what this booklet is all about. It's an action guide that walks you through four of the most important steps you can take right now to help build a more secure future:

- Start saving what you can today to give your money maximum time to grow.
- Learn what retirement savings options are available.
- Choose investments based on your timeline and risk tolerance.
- Select a financial adviser to guide you along the way.

Now let's take a closer look at the four steps.

STEP 1:
Start saving early and often

The most important action you can take today is to put money aside consistently and to begin doing so as soon as possible. That's because the sooner you start, the more time that money will have to grow.

MAKE SAVING ROUTINE

A big part of ensuring that you will have saved enough is to make saving a habit. If you set up predetermined, regular contributions, you never have to remember to add to your retirement account. And fortunately, there are easy ways to automate the process.

Employers who offer a retirement plan will let you make automatic contributions through payroll deductions. If you don't have access to an employer-sponsored plan, you may still be able to automate contributions to an individual retirement plan from your payroll or bank account.

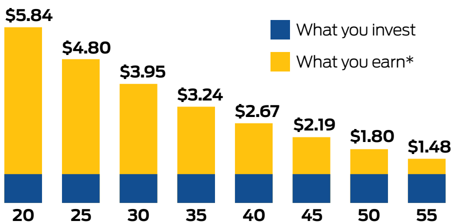
Automatically transfer money from your paycheck to an Individual Retirement Account (IRA) with the Acorns Later app, available at Acorns.com.

LEVERAGE THE POWER OF COMPOUNDING

When it comes to retirement savings, more time means more money, and that's due to the power of compounding. Here's how it works: You save some money, and it earns interest. Because of compounding, however, the next time you'll earn interest on your original money plus that interest.

The sooner you start saving, the more compounding will work in your favor. In fact, if you make just one large contribution, your nest egg would still grow over time, even if you never add another dollar to your savings. But it's a good idea to keep contributing; doing so will intensify the compounding effect.

The power of compound earnings: Here's how much $1.00 saved could be worth at age 65, depending on your age when you contribute



*assuming a 4% annual interest rate.

TAKE-AWAY ACTION STEP

See for yourself how much your money can grow using the power of compound interest. You can also calculate how much money you need to contribute each month to arrive at a specific savings goal. Here are a few tools to explore:

- Compound Interest Calculator at Investor.gov
- Compound Interest Calculator at Bankrate.com
- Savings Goal Calculator at Bankrate.com
- Compound Savings Calculator at 360financialliteracy.org

STEP 2: Understand your retirement savings options

Another critical step is to learn about the different options available for retirement savings. You can choose from a few types of special plans created specifically for retirement savings that can help your nest egg grow faster. Let's take a look at a few of these programs.

ENROLL IN YOUR EMPLOYER'S PLAN

Today, many employers offer what is known as a defined contribution plan. This type of retirement savings program can come in a few forms. The most common is the 401(k), if you work in private industry, or its twin, the 403(b), if you are a public or nonprofit employee.

You're in the driver's seat, and it's important to sign up for your company's plan as soon as you're eligible. You choose how much you want to contribute, up to the annual maximum set by the IRS, which is $18,500 in 2018 for individuals up to age 49. That money is deducted from your paycheck, but Uncle Sam chips in with a double tax break: Contributions and earnings are tax-free until you withdraw the money.

If you can't afford to contribute the maximum, put in as much as you can to start. Then, aim to increase your contributions every year until you hit the limits. Contributing the maximum also ensures you'll take full advantage of any employer matches.

You also choose how to invest the money. Your employer will offer a set of choices—typically a variety of mutual funds—and you pick as many as you'd like to invest in. You'll also have the freedom to change your selections periodically.

Many employer plans now offer a Roth 401(k) or Roth 403(b) option. As with Roth IRAs (see below for more information), these accounts are funded with after-tax money. You don't get a tax break for contributing, but withdrawals are tax-free, if you've held the account for at least five years and are at least age 59½.

Roth accounts may be especially appealing to younger workers, who may be in lower tax brackets when they forgo the tax break but in a higher bracket when they withdraw in retirement.

Estimate your 401(k) balance at retirement based on expected contributions, employer matching, retirement age, and investment growth with a projection tool, available at NerdWallet.com.

OPEN AN IRA

If you don't have access to a retirement plan through your job—or if you want to put away even more money—you can open an IRA (Individual Retirement Account). These flexible, tax-advantaged accounts give you a wider range of investment choices than defined contribution plans do.

Once you've decided to open an IRA, your next step is choosing between traditional and Roth accounts. Both versions share an important feature: Money in these accounts grows tax-deferred (meaning you don't pay taxes on earnings as they accumulate).

Then the two types of IRAs part ways, with five key differences:

1. Contributions to a traditional IRA are tax-deductible when you make them, but Roth IRA contributions are not.
2. Earnings on traditional IRAs are taxed when you take the money out, but Roth IRA earnings are tax-free in retirement.
3. Money in a traditional IRA is locked in until you hit age 59½. Withdrawing funds before that means the full amount will be taxed, along with a 10% penalty (with some limited exceptions). But you can take your own contributions out of a Roth IRA any time. Plus, withdrawal of earnings is tax-free if you've held the account for at least five years and are at least age 59½.
4. You must take required minimum distributions (RMDs) out of your traditional IRA once you turn age 70½, but you never have to take money out of a Roth IRA.
5. There are no income limits for contributing to a traditional IRA, but you can't contribute to a Roth IRA if you earn more than $135,000 for single filers or $199,000 for married filers in 2018.

When deciding between traditional and Roth IRAs, a key factor to consider is the tax rate that applies to your income now and what it may be in the future. If you expect your tax rate to be higher when you retire, choosing the Roth means passing up a tax break now to claim a more valuable break later. But if you think your tax rate will be lower after retirement, a traditional IRA would let you claim a higher break now.

ARE PENSIONS STILL A THING?

Defined benefit plans, also known as pensions, are rare these days, but many public service jobs (think teachers, firefighters, and government workers) still offer them. Pensions promise employees a specific *guaranteed* payout when they retire, usually based on a preset formula. And the employer makes all the contributions and investment decisions.

Note: To get the most out of either type of IRA, contribute the maximum every year. For 2018, total contributions to all traditional and Roth IRAs cannot exceed $5,500 for individuals up to age 49.

Assess potential savings for Roth vs. traditional IRAs with TIAA's comparison tool, available at TIAA.org.

EXPLORE PLANS FOR THE SELF-EMPLOYED

If you're self-employed—and that includes freelance work and some side gigs—you can stash away even more retirement cash by taking advantage of one of these special options:

- Solo 401(k) plans let self-employed individuals contribute up to $55,000 in 2018, and can be set up as either traditional or Roth.
- SEP-IRA (Simplified Employee Pension IRA) plans are inexpensive and simple to set up, and also let you contribute up to $55,000 in 2018.
- Defined benefit plans for the self-employed work like personal pensions. Annual contributions are required, along with setup and annual service fees. These plans are generally geared toward very high earners, with a maximum annual benefit of $220,000 in 2018.

The IRS decides whether to change annual limits on contributions and benefits for a range of retirement plans; you can find the current year's limits at IRS.gov.

TAKE-AWAY ACTION STEP

Make sure you understand the rules regarding both contributions and withdrawals for each type of retirement savings plan. Check out resources like these:

- Types of Retirement Plans, Internal Revenue Service, IRS.gov
- Maximize Your Retirement Investments, Investor Protection Trust, Investorprotection.org
- Smart About Money, Smartaboutmoney.org
- National Association of Retirement Plan Participants; NARPP.org

STEP 3:
Create your ideal portfolio

Another important step is to select investments based on your timeline and personal risk tolerance. Choosing investments can seem complicated, but once you've got a handle on the basics, you'll be able to put together a solid portfolio (your collection of investments).

To get started, figure out how much risk you're willing to take, which will pinpoint the right investments for you.

UNDERSTAND YOUR RISK TOLERANCE

Risk plays a big role in retirement investing because markets can be unpredictable, and the value of investments can rise or fall. When you have a lot of time left before you retire, your money has time to recover from losses, and that allows you to take more risk than you could if you had to retire in just a few years.

At the same time, sticking with "safe" investments carries its own share of risk. That's because safer investments typically don't earn as much as riskier ones. While your nest egg might be more secure, it won't grow as much or as quickly, resulting in less money when you're ready to retire.

DIVERSIFY YOUR INVESTMENTS

You can manage the trade-off between risk and return by including different types of investments in your portfolio, a strategy called *diversification*.

Here's how it works: If you invest in only one type of asset, you won't have any cushion if the value of that asset declines. Having a mix of different investment types, also known as your *asset allocation*, provides that cushion, reducing your risk.

The main types of assets found in retirement plans are stocks and bonds:

- **Stocks** represent pieces of ownership in a company, with unlimited growth potential and the risk that the company could perform poorly and lose value.
- **Bonds** are more like loans, with guaranteed interest and principal payments; they don't have the same growth potential as stocks but carry less risk that you'll lose your money.

Even though stocks are generally considered riskier investments, they have historically outperformed every other type of investment over the long term. The point is that while you may lose money in any given year by investing in stocks, when you're young, you have time for your portfolio to recover.

So, inside your retirement account, you decide what portion you want to invest in each type of asset. But you'll also want to make sure you *diversify* your holdings within each asset class. In other words, you'll want to own different shares of each type of investment.

Mutual funds and ETFs (exchange-traded funds) make that easy. Each fund holds a wide variety of investments. For example, a stock fund might hold 350 different stocks, many more than you would likely buy on your own.

REVIEW YOUR ALLOCATION MIX REGULARLY

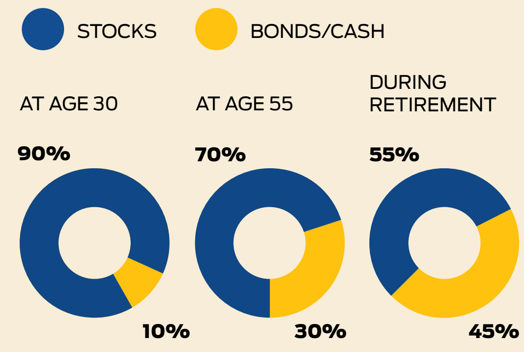
Circumstances change, and when they do, you might need to rebalance the holdings in your retirement portfolio. The three main reasons to make changes to your investments are:

Your risk tolerance has changed. Your risk tolerance will naturally change as you get closer to retirement. The most common way to address that is to increase the percentage of lower-risk investments in your portfolio.

Your life situation has changed. When your personal situation changes—getting married or having children, for example—it's a good idea to review your retirement savings as a part of your overall financial plans.

Market performance has changed the value of your investments. Revisit your retirement holdings periodically (at least once a year) to see if the actual diversification still matches your plan.

SAMPLE DIVERSIFICATION STRATEGIES



CONSIDER TARGET DATE FUNDS

Target date funds—based on the approximate year you plan to retire—put retirement investing on autopilot. These mutual funds automatically adjust their holdings toward more conservative investments as the target date approaches. You'll be able to easily tell that date: It will be in the name of the fund, such as Retirement 2040.

Here are a few things you need to keep in mind when considering a target fund:

- Target date funds are designed to be the only investment in your retirement portfolio; holding other funds defeats their purpose.
- Like any other fund, target date funds are not risk-free and may experience significant losses.
- Not all target date funds are the same: Each fund takes its own path and timetable for moving into more conservative holdings.
- It's important to know whether it's a "to" fund or a "through" fund. "To" funds aim to get to their most conservative portfolio mix on the target date. "Through" funds won't hit that final portfolio until after the target date, taking fund holders through retirement.

KEEP AN EYE ON FUND FEES

Funds come in two main types—managed and passive—and they charge very different fees.

- Managed funds count on financial professionals to actively choose every stock (or bond) in the fund's portfolio, and decide when to buy or sell to earn the highest profits. That expert advice comes at a price, in the form of higher fees and higher portfolio trading costs.
- Passive funds include a preset list of stocks (or bonds), usually based on an index, such as the S&P 500. This hands-off style allows for much lower fees and trading costs.

Bottom line: Choosing passive funds can minimize fees. That's a double bargain, as index funds often outperform actively managed funds.

Search a database of 30,000 funds and then discover how fees and expenses would affect the value of your investment over time with the Fund Analyzer tool, available at FINRA.org.

TAKE-AWAY ACTION STEP

It's helpful to know what types of stocks and bonds are available and how to assess the potential of an individual security or mutual fund. Check out resources like these to learn more:

- 360 Degrees of Financial Literacy, American Institute of CPAs, 360financialliteracy.org
- The Basics for Investing in Stocks, Investor Protection Trust, Investorprotection.org
- A Primer for Investing in Bonds, Investor Protection Trust, Investorprotection.org
- Mutual Funds and ETFs: Maybe All You'll Ever Need, Investor Protection Trust, Investorprotection.org

STEP 4:
Get great financial advice

Another key step is to get the guidance you need along the way. The most important thing is to select an adviser you can count on to put your interests first.

LOOK FOR A FIDUCIARY

For the most reliable service, you'll want to work with a *fiduciary*. Fiduciary professionals are legally and ethically obligated to put you first, and avoid any conflicts of interest.

A fiduciary financial adviser can help you set financial goals, choose specific investments, and make adjustments as needed. Since these advisers work for fee-based compensation, their pay is the same no matter which investments you make—unlike brokers who can earn higher commissions if you make more or certain trades.

Find a fee-only adviser who specializes in helping younger clients, with the Find an Adviser search tool, available at XYPlanningNetwork.com.

CONSIDER GOING ROBO

But personal, fee-based financial advice can be pricey. Typical annual fees run about 1% of the value of your investments, though some advisers charge as much as 2% per year and others charge less. And in most cases, that doesn't include expense ratios (what funds charge for operating expenses, expressed as a percentage of assets) for your underlying holdings.

For investors with a simple portfolio, the newer breed of robo advisers may be all they need. Typical robo rates hover around 0.25% per year, plus expense ratios.

Answer a few questions online, and the automated services—using complex algorithms—will match you with an appropriate, diversified portfolio of low-fee funds. The robo advisers monitor and rebalance your investments in tax-efficient ways, all with almost no human interaction.

This approach is very appealing to young, tech-savvy investors who are comfortable with the hands-off style. Robo advisers such as Betterment, Wealthfront, and Schwab Intelligent Portfolios have seen major growth in the past few years.

CHOOSE A HYBRID SERVICE

Recently, many financial services firms have begun offering platforms that combine robo advice with input from certified financial planners. Betterment and Schwab have jumped on board, as well as many traditional adviser networks and brokerage firms.

Pioneers such as Vanguard's Personal Adviser Services and Personal Capital have offered hybrid advice since their debut. Both programs start by taking a digital accounting of your cash and investments. Then comes a consultation with a certified financial planner (by phone or via computer), who will craft a strategy to meet your goals.

Two downsides: Expect to pay a bit more for hybrid services—between 0.30% and 0.91% of assets per year. And don't expect to develop an ongoing relationship with a dedicated adviser, as you would at a traditional money-management firm. When you call, you'll talk to the first person available.

CONSIDER A ROBO ADVISER WHEN

- You're just starting out and need help picking funds.
- You like the idea of passive, index funds.
- You're worried about overpaying on fees.
- You're comfortable with a hands-off approach.

TAKE-AWAY ACTION STEPS

- **Check out a specific adviser.** Your State Securities Regulator can confirm an adviser's licensing and education. Find your state regulator on the North American Securities Administrators Association (NASAA) website at NASAA.org.
- **Investigate robo advisers.** Subscribe to The Robo Report (theroboreport.com) to receive a free report rating the 18 largest services by performance in equity, fixed income and total portfolio.

BUILD YOUR FOUNDATION

Now that you've learned more about key ways to launch your retirement savings, you're ready to put a plan into action. Imagine your future—and then achieve it with a smart and steady savings plan that puts your financial security first.

ABOUT WHEN I'M 65

How we live and thrive in retirement is changing dramatically in the 21st century. ***When I'm 65*** is a groundbreaking documentary, produced by Detroit Public Television, and community engagement program that examines the choices all Americans must make today to plan for a financially secure and fulfilling future.

> *"When I'm 65 offers jargon-free explanations and can-do action plans for all ages—Millennials, Gen Xers and Baby Boomers alike."*
>
> *–Don Blandin, CEO and President of Investor Protection Trust*

Watch the documentary and find upcoming workshops and conferences at **www.WI65.org**, **facebook.com/WI65project**, or **twitter.com/WI65project**.

THE INVESTOR PROTECTION TRUST (IPT) is a nonprofit organization devoted to investor education. More than half of all Americans are now invested in the securities markets, making investor education and protection vitally important. Since 1993, the Investor Protection Trust has worked with the states and at the national level to provide independent, objective investor education.

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