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This is the second part of a three part series on the subject of retirement planning. As stated in last month's newsletter, this discussion will not attempt to answer every question you may have concerning this critical subject. To try to do so would be well beyond the scope of this monthly newsletter. My goal here is to stimulate you to further examine your own circumstances concerning your own retirement planning.

Doing so might provide the needed insight into constructing or modifying your own retirement plan or it might motivate you to seek professional assistance in developing a retirement plan that will accomplish your goals. That decision is yours and yours alone.

Retirement Planning Part II How do I get there?

Retirement income is composed of three major sources of income:

- 1. Social Security*
- 2. Pension Income*
- 3. Personal Retirement Savings*

Much has been written on the subject on the future of Social Security as we currently know it. And since none of us have a crystal ball to be able look into the minds of our future political leaders, the best we can do at this stage is to begin with the assumption that the retirement income we will receive from the Social Security Administration is consistent with the projections currently available from the Administration itself. The amount of Social Security Income we will receive depends largely on two variables:

- 1. The amount we paid into Social Security (up to the current ceiling)*
- 2. When we decide to retire*

Since the amount we paid into Social Security is dependent upon the amount of income we received from our chosen professions, there is little we can do to change the constants in place that determine this amount.

When we decide to retire, however, is a variable that we can do something about. Should we retire early with partial income benefits for the rest of our lives? Should we retire at the normal retirement age and receive larger income benefits? or Should we work beyond the normal retirement age to maximize the income benefits we can receive?

The answer to that question largely depends on how much we will have provided by Pension Income and/or Personal Retirement Savings.

For the purposes of this discussion, Pension Income is retirement income provided by an employer to his employees. The retirement income provided by this plan is fixed based on your company's policy of retirement benefits per pay grade and length of service with the company. And like Social Security Retirement Income benefits, the amount of Pension Income you can expect to receive is projected in advance by the company. This type of retirement plan is referred to as a defined benefit plan. If the company you work for has this type of Pension Income plan in effect for its employees, then, the amount of retirement income you can expect to receive can be determined by consulting your company's plan administrator. In addition to, or in place of a fixed pension plan, some companies offer their employees a plan whereby they will match a certain percentage of the employee's income that the employee contributes to the plan. This type of plan is referred to as a defined contribution plan. Some of the most common types of defined contribution plans include profit sharing plans, 401(K)'s, and 403(B)'s. The amount of retirement income an employee can expect to receive from a defined contribution plan is uncertain because it is based chiefly on three critical factors:

- 1. The amount that you contribute to the plan*
- 2. The amount your employer contributes to the plan*
- 3. The average return on investment dollars contributed to the plan*

And because the amount of retirement income you will receive from a defined contribution plan is based largely on personal contributions made to the plan, I have chosen to include more detailed discussion on this plan under the heading of Personal Retirement Savings.

Personal Retirement Savings is the one area of retirement income planning that you have the most control over. And while Personal Retirement Savings can include any savings that you have at retirement time, this discussion is focused on the types of savings plans earmarked specifically for retirement, so that you can calculate with a fair degree of certainty the amount of retirement income you might have at retirement time.

Personal Retirement Savings should be constructed to maximize your growth of investment to provide the financial resources you need to supplement your fixed retirement income (i.e. Social Security and Pension Income) to allow you to retire with the level of income that you desire. To maximize the growth of your retirement savings three elements need to be considered:

- 1. How taxes can affect your savings growth*
- 2. How long you have to save before retirement*
- 3. What rate of return you need from your retirement savings to attain your goal*

In order to reduce the effect of taxes on your retirement savings, you need to put as much of your retirement savings into tax deferred retirement plans as possible. The two most common tax deferred plans are the 401(K) and the IRA. Since taxes are not assessed on either of these two plans until you begin to withdraw funds at retirement, the money invested into these plans is allowed to grow unencumbered until you begin to withdraw funds.

If your employer offers a 401(K) plan in which he matches a certain percentage of your income that you contribute to the plan (typically 2% - 6% of your income), then, you should maximize your contributions to this plan before considering any other retirement savings option. The employer matching contribution is the greatest return on your investment that you could possibly ever receive on an investment. For example, let's say that your employer matches 50% of your contribution to your 401(K) up to 6% of your total income. If you contribute \$100 per month to your 401(K) then your employer would contribute \$50 per month to your plan. That is a 50% return on your contribution alone! And when you consider that your contribution and your employer's matching contribution are allowed to grow tax free (until you retire and begin withdrawing funds), then you truly have an opportunity to maximize your retirement savings potential. An added opportunity is that most 401(K) plans allow you to choose the funds in which you want to invest. By developing an investment portfolio that focuses on maximum growth (for the level of risk you are willing to assume), then you are able to greatly enhance your potential for achieving your retirement savings goals.

Currently, (2006) you can contribute up to \$15,000 (\$20,000 if you are age 50 or older) of your income to your 401(K) plan. And while your employer may only match a limited percentage of this amount, the entire contribution, both yours and your employer's is tax deferred until you get ready to retire.

Once you have maximized your 401(K) contribution, then you should consider setting up an IRA for yourself and your spouse (if you are married). Like the 401(K), contributions and earnings are tax deferred until retirement. Currently, (2006) you can contribute up the smaller of your taxable compensation or \$4,000 (\$5,000 if you are age 50 or older), for both yourself and your spouse (if married). There are two types of IRA's to choose from:

- 1. Traditional IRA **
- 2. ROTH IRA ***

Consult your tax advisor to determine which IRA would be best for you.

If you are self-employed, you can also set up and contribute to a tax deferred retirement plan designed primarily for small businesses, such as SEP-IRA or SIMPLE-IRA. Consult your tax advisor to determine which small business retirement plan would be best for you.

Only after you have completely exhausted the limits to the two retirement plans discussed above should you consider investing in a taxable retirement savings plan. Because doing so may limit your growth potential to reach your retirement savings goal.

In addition to the benefit of having your retirement savings grow unencumbered by taxes, the next consideration to maximize your retirement savings is to save as long as possible before retirement. Because of the magic of compounding, the longer you have to save the greater the growth potential of those savings.

As an example, let's consider three different scenarios with the goal of saving \$250,000 by retirement age of 65. In each example, we will assume an average rate of return of 8% on each of their investments and each person contributes to their retirement savings plan until reaching retirement age of 65.

- 1. Bob, Age 25*
- 2. Bill, Age 35*
- 3. Ben, Age 50*

If Bob were to begin saving at age 25, he would need to save \$71.61 per month to have \$250,000 by retirement age.

If Bill were to begin saving at age 35, he would need to save \$167.75 per month to have \$250,000 by retirement age.

If Ben waited to start saving until age 50, he would need to save \$722.46 per month to have \$250,000 by retirement age.

The bottom line is the longer you wait to begin saving for retirement the greater the amount you must save consistently or the longer you must continue to work to reach your retirement savings goal.

Lastly, you can maximize your retirement savings by investing in funds that offer the highest possible returns with the least amount of risk. This can be accomplished by diversifying your investments in an array of investments that offer the greatest balance of asset allocation for the risk you are willing to assume. If you need an average rate of return of 10% on your retirement savings to achieve your retirement savings goal, then, you must be willing to invest in something other than a Certificate of Deposit offered by the local bank. To reduce the risks you incur with higher rates of return, then your investments need to be diversified among investments that offer higher rates of return as well as investments that offer stability. This may require that you either consult with a competent financial professional to assist you in developing a sound

retirement investment plan or personally gain the knowledge necessary to develop your own investment strategy to accomplish your retirement savings goal.

In conclusion, successful retirement planning is a long term process. The earlier you begin to prepare for retirement the greater the potential you have for achieving your retirement savings goals, the more options you have concerning the lifestyle you be able to enjoy in retirement, and the greater the choices you have of deciding when you want to retire.

Next month we will look at some draw down strategies to ensure that you don't outlive your retirement resources once you reach retirement.

Til next time,

Charlie

** Your contributions to a Traditional IRA may be tax deductible for the year of the contribution. Consult your tax advisor to determine whether your contributions to this type of IRA would be tax deductible.*

*** Although your contributions to a ROTH are never tax deductible in the year of the contribution, all contributions and earnings are tax free when you begin withdrawals at retirement time.*

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