

Retirement Planning



Financial Fitness Seminar Series

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Chelmsford Public Library

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Agenda

- Retirement concerns
- Retirement plans
- Retirement mistakes and measures
 - Compounding effect
 - Asset allocation
 - Retirement savings
 - How to preserve your nest egg

Why Worry About Retirement?

□ Retirement concerns

- ✓ Nearly 50% people have less than \$25,000 saved*
- ✓ In one survey, one-quarter of baby boomers responded that they have not thought about retirement at all#
- ✓ Many companies are discontinuing pension plans
- ✓ Social security system may not be solvent
- ✓ Increasing life expectancy with increasing health care costs - \$4 trillion by 2016

□ Individuals are responsible for their retirement

* Source: EBRI 2007 Retirement Confidence Survey

Source: National Bureau of Economic Research

Three “Pillars” of Retirement

- Government sponsored: Social Security
- Defined Benefit plans (i.e. traditional pensions)
- Savings
 - Work-based retirement plans: 401(k), 403(b) and 457
 - IRA (Individual Retirement Accounts)
 - Personal savings accounts

Employer Sponsored Programs

Pension plans

- ❑ Defined Benefit
- ❑ No employee contributions – funded by the sponsor
- ❑ 20% of Americans are covered (down from 40% in 1975)

401(k), 403 (b) & 457

- ❑ Defined Contribution
- ❑ Employer match with employee contributions
- ❑ Tax deduction
- ❑ Tax-deferred growth
- ❑ Automatic dollar-cost-averaging

401(k), 403(b) and 457 plans

- 2008 Contribution Limits
 - Regular contributions: \$15,500
 - Catch-up contributions (>50 years old): \$5,000
- Can be “rolled-over” to an IRA after changing jobs
- Investment choices dictated by the plan
 - Cannot select individual stocks or funds outside the plan

IRAs (Individual Retirement Accounts)

Traditional IRA

- ❑ Pre-tax contributions
- ❑ Tax-deferred growth
- ❑ Withdrawals are taxed at ordinary income tax rates
- ❑ Mandatory withdrawals by age of 70 ½ (50% penalty)
- ❑ Withdrawals before age of 59 ½ subject to 10% penalty with exceptions

Roth IRA

- ❑ After-tax contributions
- ❑ “Qualified” withdrawals are tax exempt
- ❑ No mandatory withdrawals

IRAs

- 2008 Contribution Limits (both Traditional and Roth)
 - Regular contributions: \$5,000 (\$1,000 higher than the limit for 2007.)
 - Contributions for >50 years old participants: \$6,000
- You can fund your 2007 IRA till April 15, 2008!

IRAs – Income Restrictions

□ Roth IRA

- Adjusted Gross Income (AGI) must be under \$159,000 (increased from \$156,000 for 2007) for taxpayers filing a joint return.
- For single taxpayers, the AGI limit is increased from \$99,000 to \$101,000.

□ Traditional IRA: phase out limits

- Your filing status is married filing jointly and your AGI is more than \$85,000 but less than \$105,000.
- Your filing status is single, head of household and your AGI is more than \$53,000 but less than \$63,000.

IRAs

- Excellent way of adding to your retirement savings
- Maximum flexibility in investment options
 - Can select any brokerage
 - Can select individual stocks, bonds, mutual funds or ETFs

Five Common Retirement Mistakes

1. Not participating in a plan
2. Not contributing early or enough
3. Improper asset allocation
4. Miscalculating retirement needs
5. Cashing out 401(k)

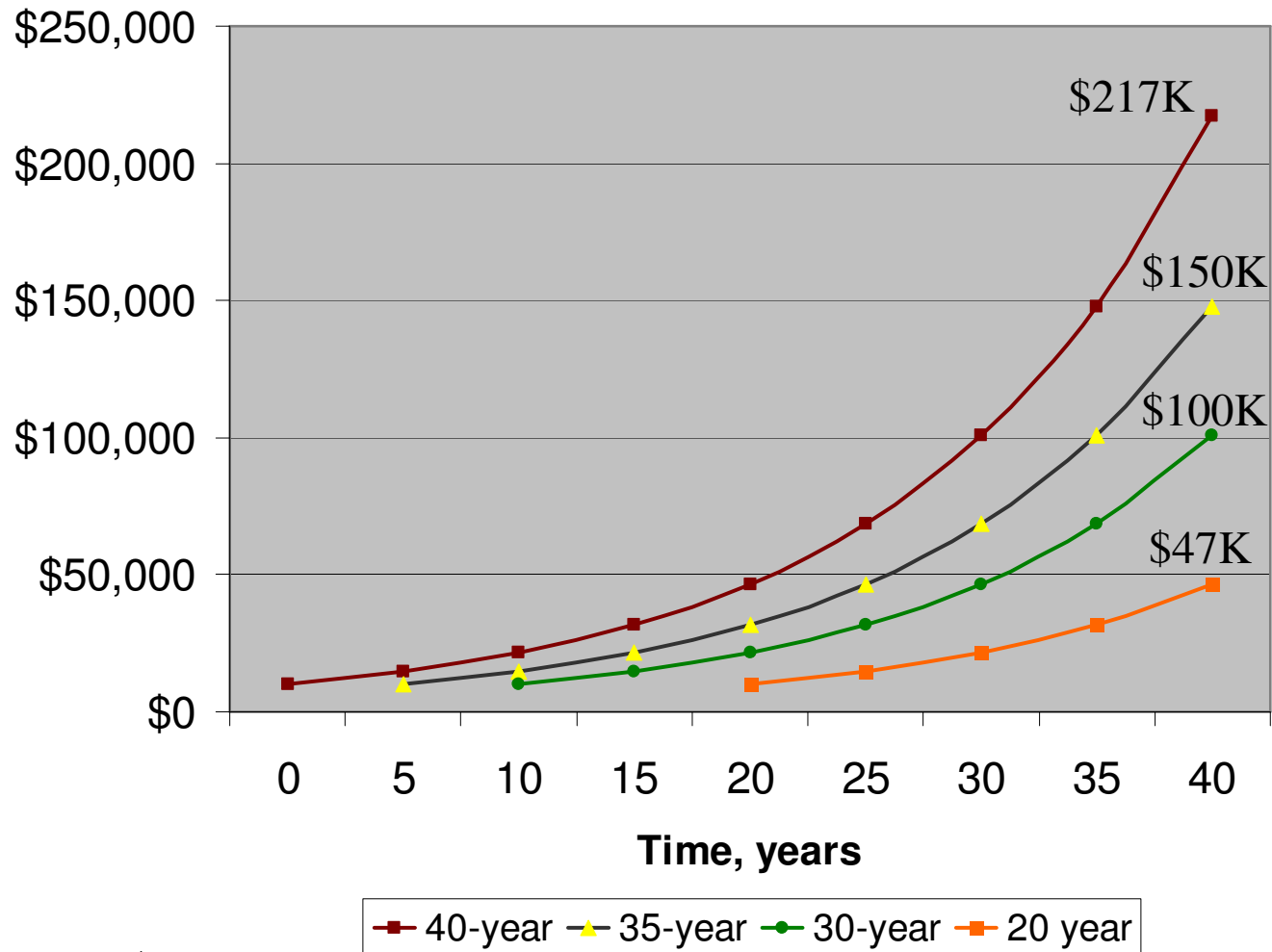
1. Not participating in a plan

- 25% of eligible do not participate in 401(k) (Source: Nationwide Financial)
- Contributing 10% of \$50,000 annual salary, or \$5,000, to a 401(k) means:
 - + \$1,500 (50% company match up to 6% of salary)
 - + \$1,250 tax savings (25% tax bracket)
 - + \$400 profit (8% return on contribution)
 - → **\$3,150 or 63% return on \$5,000**

2. Not contributing early or enough

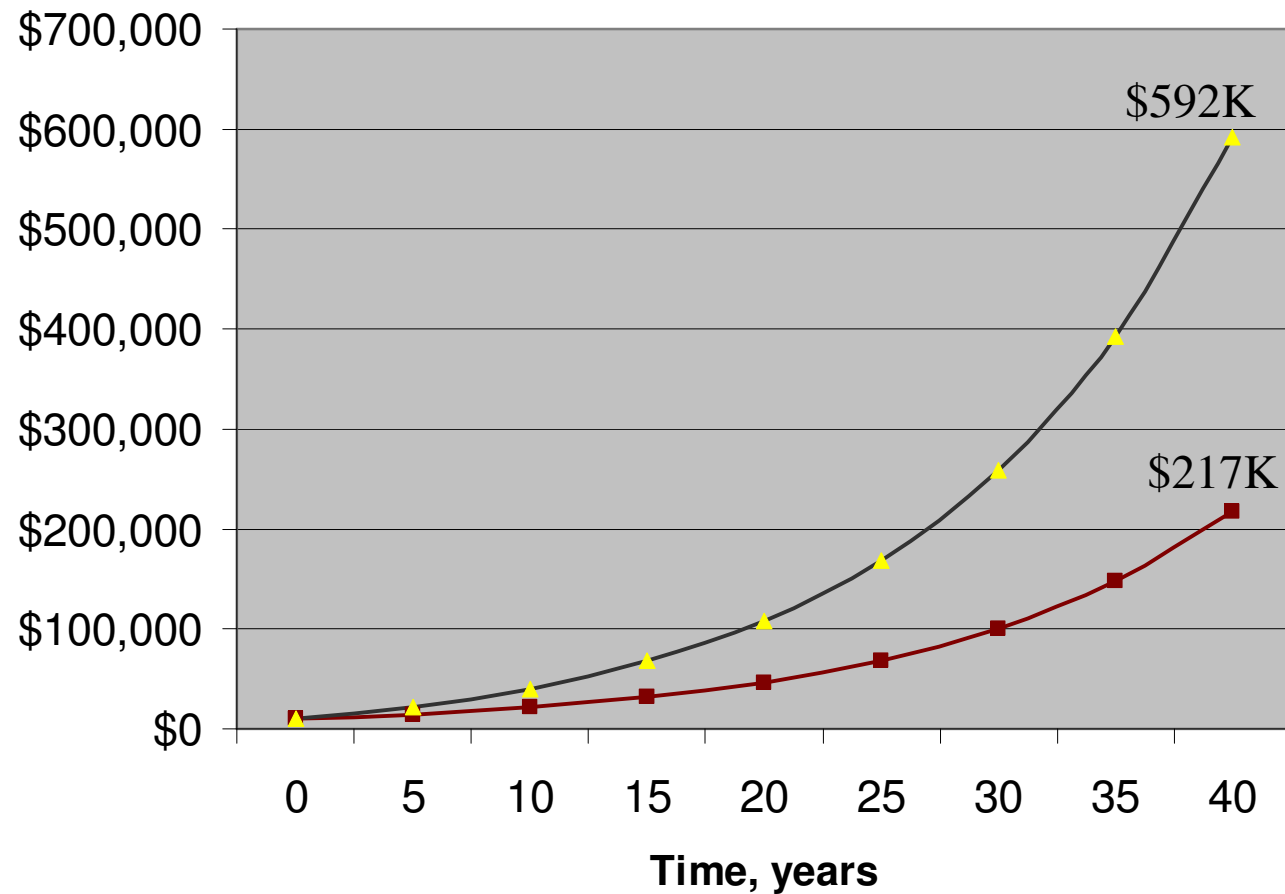
- ❑ Participation in 401(k) plans among people under 30 years of age is less than 20%
- ❑ Fewer than 10% of 401(k) participants contribute the maximum amount allowed
- ❑ Measures
 - Power of Compounding
 - ❑ Time is our friend
 - ❑ We can accelerate the compounding effect with regular savings
 - Consider contributing at least the minimum to get company match
 - It's never too late to start!

Power of Compounding



Starting investment: \$10,000
Rate of return: 8%

Compounding Effect with Regular Additions



Starting investment: \$10,000
Rate of return: 8%

■ 40-year ▲ 40-year + \$100 monthly

3. Improper asset allocation

- ❑ Too conservative
- ❑ Conventional Wisdom
 - ❑ Subtract your age from 100 to find out % of assets to invest in stocks.
 - ❑ For example, a 70-year-old should have 30% (100 – 70) of her assets in stocks.
 - ❑ Another example: a 30-year-old should have 70% of her assets in stocks.
 - ❑ Invest in company stock

Investment Options

Options: cash, bills, bonds and stocks

Average annual returns from 1926 - 2003

- ❑ Treasury bills: 3.7%
- ❑ Intermediate-term Treasury bonds: 5.4%
- ❑ Large-cap stocks: 10.42%
- ❑ Small-cap stocks: 12.7%

Source: Ibbotson Associates

Investment Options

According to Jeremy Siegel, author of *Stocks For The Long Run*, between 1802 and 2002

- ❑ Stocks beat bonds for 80% of 5-year rolling periods, 90% of 10-year rolling periods, and 100% of 30-year rolling periods

However, you can lose money in the stock market! The broad market index (S&P 500) dropped 50% from 2000 to 2002.

Asset Allocation

□ Target-date retirement funds

- Funds with dates that roughly match your retirement date (for example 2020, 2030 etc.)
- Diversified mix of stocks and bonds appropriate for the age
- Fund gets more conservative as the target-date approaches

□ Cautions

- Fund of funds: look for extra layer of expenses
- Look beyond the target-date for asset mix

Asset Allocation – another approach

- Any money you need in the next year should be in cash.
- Any money you need in the next five years should be in a safe fixed-income investment, such as certificates of deposit or bonds.
- Any money you don't need in the next five to 10 years is a candidate for the stock market.
- Limit company stock to $< 10\%$ of portfolio

4. Miscalculating retirement needs

- Conventional approach: Need 70-80% of your current income in retirement
 - Reduction in work-related expenses
 - No Social security taxes
 - No Mortgage payments
 - No Retirement plan contributions
 - “Downsize” lifestyle
- Obstacles
 - Lifestyle choices
 - Increasing medical costs

Protect Your Nest Egg

- How to calculate retirement income
- Add
 - Estimated annual social security benefits
 - Projected annual pension benefits
 - 4-6% of you estimated next egg
 - ➔ annual retirement income
- Withdrawal rates $> 5\%$ increases the probability of prematurely using up your nest egg

Retirement Savings

Calculate the size of nest egg needed

- Need \$50,000 annual retirement income
 - \$10,000 annual social security benefits
 - \$20,000 annual pension benefits
 - Need \$20,000 [$\$50k - (\$10K + \$20K)$] from your nest egg
 - **Nest egg = $\$20,000 / 4\% \rightarrow \$500,0000$**

5. Cashing out 401(k)

- When changing employers, you can:
 - Cash out
 - Stay with old 401(k)
 - Rollover into new 401(k)
 - Rollover into an IRA

To “roll” or not to roll

Scenario: Leave a job with \$50,000 in 401(k)

Cash Out

- ❑ - \$5,000 (10% penalty)
- ❑ - \$12,500 (25% tax bracket)
- ❑ - \$2,500 (5% state tax)
- ❑ = **\$30,000** leftover

Roll it to IRA

- ❑ No taxes
- ❑ No penalties
- ❑ Could earn 8% return (tax-deferred)
- ❑ In 20 years → **\$233,000**

Extra credit

- Additional reading
 - Details of different retirement plans
 - Savings and retirement calculators
 - Asset allocation strategies
- Online resources
 - www.irs.gov
 - www.fool.com
 - www.money.cnn.com
 - www.fidelity.com
 - www.morningstar.com

Upcoming Seminars

- February 14: Break – no seminar
- March 13: Dan Caplinger
- April 10: Sham Gad (new date)