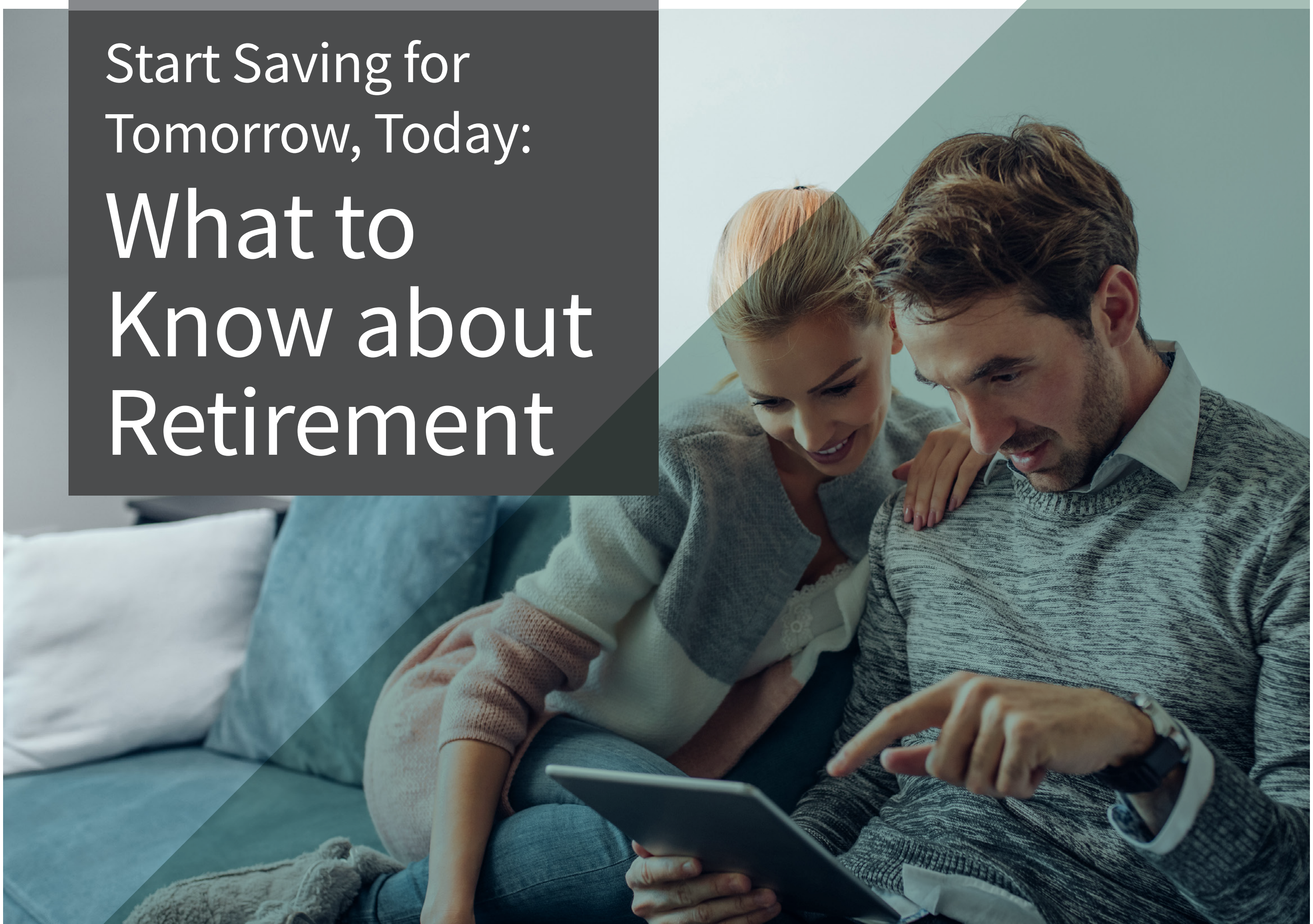
Start Saving for Tomorrow, Today:

What to Know about Retirement



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The twenties and thirties are an ideal time for getting established for future financial success. However, the various and competing financial goals and responsibilities such as student loans, home purchases, raising children, and saving for retirement can be daunting and overwhelming. Diversified Trust has compiled a series to help guide young people toward a brighter financial future.

Retirement considerations are a key component of any deliberate financial planning exercise. But, as a young adult kickstarting your career, retirement may feel like light years away. While you will not be retiring anytime soon, saving for it cannot happen soon enough.

Based on a 2014 study conducted by PWC, only 24% of Millennials demonstrate basic financial knowledge. Among the overall population, Millennials are the age group with the lowest level of financial literacy, and only 27% are seeking professional financial advice on saving and investment.

▸ TIME = MONEY

Let's start with the question of, "Why now?" The most important principle when it comes to retirement savings is understanding the time value of money (TVM). One hundred dollars you earn today is worth exponentially more than $100 you would receive five years from now, thanks to the potential earning capacity of today's money.

Any amount of money is worth more the sooner it is invested, and thanks to the power of compounding, your initial investment can grow at a faster rate. Let's say you put $10,000 into your retirement account with a 5% rate of return. Your closing balance at the end of the year would be $10,500.

In year two, the 5% rate of return is not calculated on your initial $10,000, but rather the $10,500 balance. Therefore in year two it will gain $525, making your closing balance $11,025.

The same will happen in year three, with a 5% return on $11,025, closing year three at $11,576. That's $1,576 in growth in just three years. Imagine what that number is in 30 years! (There's a formula for that, if you're curious.) And, if you are contributing to that initial $10,000 on a regular basis, the amount of compound earnings is even greater.

▸ BUILDING THE NEST EGG

Once you have decided to save for retirement today, the next logical question is, "How much should I save?" The answer is, "As much as you can." While that may not be a satisfying response, it is truly the most accurate one.

Everyday expenses and short-term savings are likely a priority for you right now. You are just beginning to build a life for yourself, so there's no need to go into credit card debt just to save for retirement. However, any excess funds you might have should be contributed to retirement savings, no matter how small. As your earnings increase over time and you have more discretionary income, you can and should increase your retirement contributions. If you can afford to, consider maxing out your annual contributions to tax-deferred accounts so you can reap the benefits of those accounts.

Cash flow planning and potential withdrawal schedules can wait until further down the line, however, building as much of a retirement nest egg as possible early in one's career and consistently year over year should be the priority.

DECODING THE 401(K) AND IRA

Allocating savings to tax-deferred accounts in the early days of your career can make an incredible difference later in life. While a number of these accounts exist, priority at this phase of your planning should be placed on the 401(k) and the individual retirement account (IRA).

401(k) accounts are employer-sponsored retirement plans where funds are deferred into the retirement account directly from your compensation. In 2018, the maximum that a single individual can contribute into a 401(k) is $18,500. Most employers will offer to match contributions up to a certain amount. **Translation: free money.** For this reason, funding a 401(k) account should take priority over the funding of an IRA.

401(k) accounts are only considered active while you are currently working for the employer. Following termination of employment, funds from the 401(k) can then be rolled into an existing or new IRA account, and then a new 401(k) will likely be available from your new employer. Every 401(k) is different and may have some specific rules and regulations associated with the program, so it is important to review the plan information available from the plan sponsor.

An **individual retirement account (IRA)** has no affiliation with an employer unlike a 401(k). There are, however, two types of IRAs – a Roth IRA and a Traditional IRA.

A **Roth IRA** has income-eligibility restrictions, making it ideal for the early days of your career. To contribute to a Roth IRA in 2018, you must be making less than $135,000 (modified adjusted gross income), or less than $199,000 for married couples. You can contribute up to $5,500 per year, so long as you are under 50 years old.

There is no tax break on money contributed to your Roth IRA, but earnings and withdrawals are generally tax-free. So, if you are in a lower tax bracket now than you plan to be in the future, that works to your advantage. Roth IRAs don't require withdrawals during your lifetime, so you can even pass the account on to your children. If you are under 59 ½ years old, you can withdraw up to $10,000 of Roth earnings penalty-free to pay for qualified first-time home buyer expenses, provided it has been at least five years since your first contribution. Roth IRAs can be invested in anything – index funds, lifecycle funds, individual stocks, etc.

With a **Traditional IRA**, anyone with earned income can contribute, but tax deductibility is based on income limits and participation in an employer plan. The contribution limit for a Traditional IRA is $5,500 if you are under 50, and $6,500 for 50 and above. Anyone with earned income who is younger than 70 ½ can contribute to a Traditional IRA. Once you hit 70 1/2, you must begin taking required minimum distributions, in most situations. Traditional IRAs have a 10% early withdrawal penalty, which can be waived if you are under 59 ½ for first-time home buyer expenses, qualified higher education expenses, and some disability or medical expenses (up to $10,000).

TRADITIONAL IRA	ROTH IRA
WHO CAN USE IT?	
Anyone who earns or whose filing-jointly spouse earns "taxable compensation," until **age 70 1/2.**	Anyone who earns or whose spouse earns "taxable compensation," **no matter how old they are.**
MAXIMUM YEARLY CONTRIBUTION (2018)	
$5,500 — **$6,500** if age 50 or older.	**$5,500** — **$6,500** if age 50 or older.
Does not apply to rollover contributions	
CAN YOU EARN TOO MUCH TO CONTRIBUTE?	
No.	**Yes.** You must earn **less than $135,000** filing single, **$199,000** married filing jointly in 2018.
CAN YOU CONTRIBUTE TO THE IRA AT THE SAME TIME AS A 401(K)?	
Yes. However, **you may not be able to deduct the entire amount** from your taxes, depending on income and how much you contribute.	**Yes.**
ARE YOUR CONTRIBUTIONS TAX DEDUCTIBLE?	
Maybe.	**No.**
DO YOU HAVE TO TAKE OUT MONEY?	
Yes. You must start withdrawing money ("required minimum distributions") at 70 1/2.	**No, if you opened the account.** If you inherited it, you must take distributions, although the process differs between surviving spouses and non-spouse beneficiaries.
HOW DO YOU GET YOUR MONEY OUT?	
Withdrawals **after age 59 1/2 are taxed** as regular income. Any withdrawal made before then is subject to taxes plus a 10% penalty fee.	Withdrawals **after age 59 1/2 are not taxed,** as long as you've had the account for at least five years. You can withdraw contributions tax-free any time, but if under age 59 1/2 you must pay taxes and 10% penalty fee on earnings.

PASSING IT ON

You put money into a retirement account to ensure the financial security for you (and potentially others) and to maintain your standard of living beyond your working years. But all retirement accounts have a beneficiary in the event that you are no longer around to utilize those funds.

Determining a beneficiary for your retirement accounts is a very personal decision. It is also one that should be updated whenever there is a substantive change in your life. Early in your career, a parent, sibling or even philanthropic cause may be your preferred beneficiary. Following marriage, most individuals choose to update the beneficiary to include a spouse. Children may then be listed as contingent beneficiaries if something were to happen to the spouse. However, it's important to disclose to your estate planning attorney if you will be naming minor children as contingent beneficiaries of your retirement accounts, as this may require additional considerations.

You can always have more than one primary beneficiary on your accounts, but you must allocate proceeds on a percentage basis. Most beneficiary election forms will indicate how to break that out. You should also always consider including both primary and contingent beneficiaries.

Take some time to think about these beneficiary elections, and don't be afraid to make adjustments over time.

People are living longer than ever, which means you may be relying on your retirement funds for many years. But, if you start saving today, those funds should help you comfortably kick up your feet long after you stop punching the clock.

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