Title:
How to Avoid Ruining Retirement

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Summary:
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Article Body:

Wealth seems to be everyone's dream; the ability to relax a little more, to not stress so much about finances and to enjoy the "good life." So often it is believed that wealth is only attainable by those with large incomes. Those with smaller incomes may not put anything aside, assuming such small savings won't make enough of a difference in the long run. In my experience in the financial services industry, there were several times when I would help an elementary school teacher or janitor with their sizeable 403(b) account. Obviously for them, small savings over time made a big difference. In the same category are those who have large incomes and assume they always will. They constantly spend to the top of their income level and set little or nothing aside for the future. Yes, I also remember helping doctors or attorneys take loans out of their 401(k) accounts. I found that it wasn't so much what you made but everyday decisions that determined long-term success.

When I once asked a janitor of an elementary school how he had accumulated his 1.7 million dollar 403(b) he said, "I just started putting money into it when I first came to work here, a little bit each paycheck." Now, 40 years later as he approached retirement with a steady pension and a large 403(b) account he was financially wealthy. Avoiding financial mistakes is the key for anyone to retire well. This article lists some of those mistakes and ways to steer clear of them.

Waiting Until You're 55

Not starting to save soon enough is number one on our list. Beginning early to save for retirement can make a huge difference in the long run. To illustrate this, let's assume we have two people saving for retirement, we'll give them simple names that correspond with the age they started saving, Mr. 25 and Mr. 45. Mr. 25 puts $3,000 into an IRA each year until he retires at age 65. Assuming he gets an 8% growth rate on average, he amasses $839,343 or almost a million dollars by age 65. If Mr. 45 were to put the same amount aside but start at age 45 instead of 25, he would only have $148,269 saved, definitely not enough to start retirement with. For Mr. 45 to end up with the same amount as Mr. 25 he would have to save almost $17,000 per year until age 65. $17,000 per year for 20 years equals $340,000 cash out of pocket, whereas $3,000 per year for 40 years is only $120,000. Mr. 25 only had to save about one third the amount Mr. 45 did all because he started early. Letting compounding do the work for you allows you more money for other things you want.

1% Is Enough, Right?

Putting aside too small a percentage of income is another mistake people make. It may be difficult when just starting out and times are lean, but you will thank yourself in the long run if you make this a priority. Going back to Mr. 25 again from above, if he would have only put away $1,000 each year, his ending balance would have only been $279,781 in 40 years, again assuming the 8% growth rate. We know how much $3,000 per year would have saved him, but what about $6,000 per year? He would have $1,678,686. Doubling his savings doubles his end result.

I'm a Millionaire!

Not realizing just how much needs to be saved in order to retire is our next mistake. While the 1.6 million in the above example may seem like a lot of money, it won't pay the bills in 40 years. Assuming prices go up by 3% each year, 1.6 million will only have the buying power of a half a million dollars in 40 years when Mr. 25 wants to retire. Assuming Mr. 25 lives to the ripe old age of 90, a 1.6 million dollar account will give him about $2,300 dollars of income each month in real terms. This assumes that he earns 6% on his money after he retires. Does it seem odd that our 1.6 million dollars is now only worth $2,300 dollars per month? Inflation is the culprit. In actuality Mr. 25 will be getting about $9,800 dollars out of his account each month in retirement, but because prices for everything will be so much higher in 40 years it will only be able to buy the same amount that $2,300 dollars buys today. This is what "real terms" means. Mr. 25 will have to determine if $2,300 per month will be enough to live off of in retirement. Most likely it will not be enough unless he really likes ramen noodles.

Do I Get a Checkbook with my 401(k)?

Using Retirement Accounts as income before retirement is becoming a mistake that more and more people are making. This is especially true for those who have employers contribute to their retirement accounts. While it is tempting to assume this is just extra money you can spend, it has terrible long-term effects. Taking as little as $5,000 out of your retirement account at age 30, is like taking out $35,000 in 35 years. If it would have been allowed to stay in the account and grow over 35 years, it would have accumulated to almost $35,000. The other problem is that you will most likely have to pay taxes and a 10% penalty on the money because it is being taken out before age 59 1/2. Now to get $5,000 after the taxes and penalty, you have to take out over $8,000, which would equal over $55,000 lost in 35 years.

I'm Sure my Basket Can Hold All of This

Not diversifying or putting all your eggs in one basket is another financial blunder. I was a retirement specialist working with 401(k) and 403(b) account owners when the market crashed in 1999 and 2000. How vividly I remember talking with people in their fifties and sixties who in February of 2000 (right before the NASDAQ started falling) wanted to put their entire retirement account into technology. I discussed with them the advantages of diversification especially in such a volatile market. Some listened, but most didn't. The comment I remember the most is, "I don't have enough money to retire so I need it to grow really fast." The result was buying in at an all time high and then either jumping out along the way down or riding the market to the bottom. Those who stayed in for even a year lost more than half of their retirement in a technology fund.

Compare that to those who were diversified across several markets, domestic and international, and several types of investments, equity, fixed-income and short-term. Someone in their fifties, planning on retiring in 10 years would be diversifying if they had about 60% in stocks and the rest in bonds and money markets. This type of portfolio still lost money during that volatile time, but not nearly as much as a technology fund did. Those with a diversified portfolio lost about 5-15% in that same time period that the technology sector lost 50-65%. Trying to earn money for retirement by putting all your eggs in one basket, especially when you are close to retirement, is almost as risky as using the slot machines in Las Vegas. If you are behind in your savings, your best bet is to start contributing the maximum allowed and push back retirement for a few more years.

Won't Uncle Sam Take Care of Me?

Relying solely on Social Security will leave you with little income in retirement. In a message to the public issued by the Social Security and Medicare Board of Trustees in 2005 they stated, "We do not believe the currently projected long run growth rates of Social Security and Medicare are sustainable under current financing." They went on to say that without major changes to Social Security, it will begin to fall short in 2017 and will only be able to fund 74% of benefits by 2041. The suggested solution is to either increase taxes 15% or decrease benefits 13%, neither of which are good for retirement. To continue to live the same lifestyle that you are accustomed to, saving for retirement is essential.

Another Trip to the Doctor?

Not preparing for healthcare in retirement is something that we have recently had to think about. There is a good possibility of Medicare not being able to meet our needs in the future or we may need our own health insurance to carry us until Medicare kicks in. Being prepared to pay for premiums or medical expenses in retirement is becoming a necessity. A 2004 study found that an average retiree spent 22% of their income on healthcare costs. For someone on a $50,000 a year retirement income, this equates to $11,000 per year. Take that over a 25 year retirement and you are up to $275,000 for healthcare costs alone. Long-term care such as nursing homes or in home assistance is another cost that should be prepared for. With less and less employers covering healthcare in retirement, this is another area that is often overlooked when planning for the future.

Avoiding these financial mistakes will determine your quality of life in retirement. The next step is to get started. There are many brokerage firms that will educate you about your options at no cost. They can help you open a retirement account or determine if you are contributing enough to your current retirement account. The can also help you decide on what types of investments are appropriate given your age, timeframe and risk tolerance. The most important thing to remember is that it is never too late to start saving and even a little money set aside makes a big difference in the long run.