Educated Investor

For retirement plan participants

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Saving for retirement

How to balance today's needs with tomorrow's goals

Life is full of choices. House chores or a Sunday nap, a Caribbean cruise or a "staycation," French fries or a side salad? In our financial lives, we also face tough decisions — choices that can make saving for retirement challenging, especially when it means juggling more immediate demands on your money, such as college expenses, credit card debt, or saving for a car and/or house. To help you balance today's needs with tomorrow's goals, this issue of *Educated Investor* looks at these challenges and offers tips to keep your retirement savings on track while meeting your needs today.

Getting started

Too young to think about retirement? Think again.

Compound interest arises when interest is added to the principal of a deposit or loan, so that, from that moment on, the interest that has been added also earns interest.

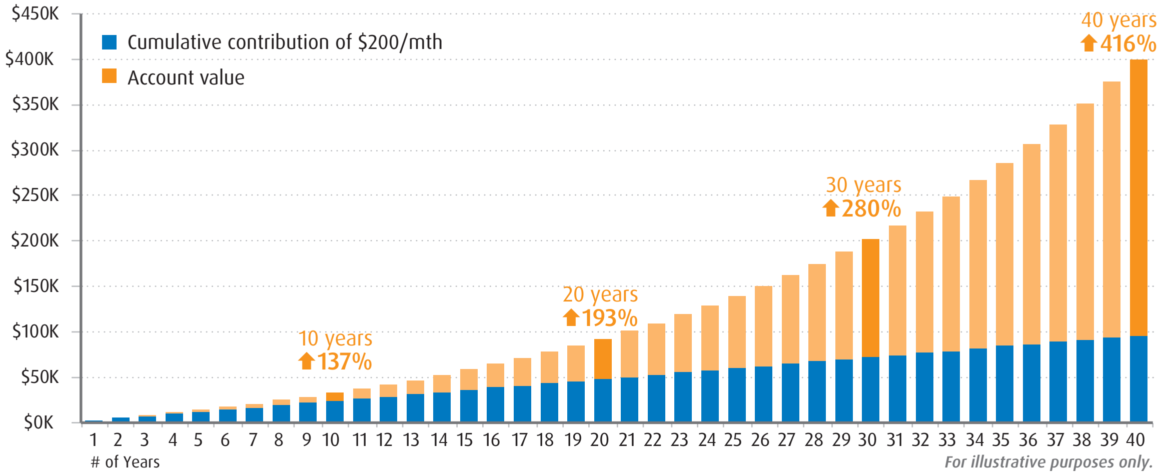
Wikipedia, The Free Encyclopedia

For many people in their 20s and early 30s, everyday costs can get in the way of planning for retirement. There are school loans to pay, rent checks to write, and then there's your social life! Even though retirement seems like eons away, don't put it on the back burner.

When you're in your 20s and early 30s, time is your best friend when saving for long-term goals like retirement. That's because the longer you have to invest, the greater the benefit of compound interest. It's easier to save smaller amounts over a longer period of time than it is to play catch-up later. To understand how, consider the following hypothetical example.

If you save just $200 a month in your retirement plan starting at age 25 and receive a 6% average annual return, your account value at age 67 would grow to $447,417. If you put off saving until age 35, your account value would only grow to $249,525, saving $200 per month. To accumulate the same savings starting at age 35, you need to save $387 per month. Compounding interest is your best friend. This only considers **your** contributions. Imagine the amount if your employer makes contributions and you regularly increase your contribution.

Tax deferred retirement saving with compounding interest at 6%



Leverage the years.

So how do you manage your money so you can maximize the benefits of your retirement plan? Here are five tips to help keep your savings on track in your 20s and early 30s.

1. Make a budget.

It may seem basic, but it's important to start budgeting and saving while you're young. By doing so, you'll form good financial habits early on, which will pay off in the years to come. Determine how much you need each month for your bills, how much you need for fun and how much you'll need to save for the future. The best way to get started is to track your spending for a month or two, then adjust your budget accordingly and stick to it. That way, if you have to choose between buying a brand-new car and paying off your student loans, you'll make sure you're making the right decision for your personal circumstances. To help you assess whether you're saving enough for retirement, go to **mybmoretirement.com** for an easy-to-use *Retirement Savings calculator*.

2. Pay yourself first.

Don't let current expenses distract you from what matters most: your future. If you haven't enrolled in your retirement plan, do it now. Have a set amount of pay sent straight to your retirement plan every payday, and if your employer offers matching contributions, make sure you contribute enough to take full advantage of the match. To understand the impact contributing at different levels has on your take-home pay, try the *Salary Deferral Take-Home Pay calculator* on **mybmoretirement.com**.

3. Create an emergency cushion.

Begin setting aside money in a risk-free savings account that you can easily access in case something happens. Your goal should be to accumulate enough money in this account to cover six months of household expenses. This will help protect you against the unexpected, such as unforeseen car or home repairs, or unreimbursed medical or dental expenses.

4. Avoid the credit card trap.

It's easy to build up debt, especially when you're already making do on a starting salary. However, taking on a large amount of credit card debt will only add to the challenge of making ends meet. Equally important, it may also reduce the amount of money you'll have to set aside for your future. Avoid carrying a credit card balance from month to month. If you have outstanding balances on several cards, focus on paying off the ones with the highest interest rates first.

5. Keep your eye on the prize.

There'll be times when you feel like your not-so-giant-paycheck isn't enough. Whatever you do, remember the benefits of compounding interest on your contributions. Contributing consistently to your plan is the best way to ensure your financial security for the future. Every dollar you divert to other needs will make it that much harder for you to catch up later on.

Contributing to your retirement plan at work should be a top goal, no matter your age. Don't think of it as subtracting money from your paycheck. Rather, consider those contributions as automatic payments to your future self. Years from now, when you're closer to the retirement of your dreams, you'll be glad you did.

Use this ***Savings Planner*** to see if you're on track to meeting your goals or if you have a retirement shortfall.

Staying on track

When a house can be more than a home

The time between age 35 and 50 is golden for many American workers. That's when many hit their stride in terms of earnings. At the same time, however, you may be finding that the demands on your money are greater than ever, especially if you're juggling saving for retirement with mortgage payments, the expense of a growing family, college in the near future and perhaps the responsibility for aging parents. Oftentimes, a logical place to look for additional cash to meet current needs is the equity in your home.

However, if you're facing college costs, having your child apply for financial aid, work study programs and/or local scholarships may make better sense, financially. After all, when your child graduates from college, he or she has plenty of time to pay off any student loans. Depending on when you plan to retire, the same may not be true for you. You owe it to yourself to do everything you can to ensure your retirement is as financially secure as possible. To help you weigh your options, consider the following three ways to unlock the equity in your home.

1. Refinance your mortgage.

Before you tap into the equity in your home, you may want to simply refinance your current mortgage. This can make sense, especially if the available interest rate is lower than what you're currently paying. By refinancing at a more attractive rate, your monthly payments will be reduced, potentially freeing up cash to help meet current expenses. Be sure to consider how long you plan to live in the house and any closing costs associated with refinancing to make sure this option makes good financial sense.

2. Take out a home equity loan.

If you have a low-interest mortgage already and need to borrow more, refinancing may not be your best choice. In many instances, it may be better to hold onto your current mortgage and borrow against your home equity using a home equity loan or second mortgage. A home equity loan works just like a regular mortgage: you receive a one-time lump sum amount that you'll need to repay monthly at a fixed rate of interest. Because that interest rate is locked in, you'll know in advance what your payments are each month, making it easy to budget for them. Another advantage of a home equity loan is that the interest is often lower than the rates available on a credit card; the interest you pay also may be tax-deductible (subject to a cap and other restrictions), helping to reduce the cost of borrowing.

To learn whether you're eligible for a home mortgage interest deduction, please read Internal Revenue Service Publication 936, available at **http://www.irs.gov/pub/irs-pdf/p936.pdf**.

Keep in mind that not everyone is eligible for a home equity loan since there are income and credit rating requirements for repaying the debt. Also, you could risk losing your home if you can't make the payments.

3. Secure a home equity line of credit.

A home equity line of credit (HELOC) is a revolving credit arrangement that uses your home as collateral. When you ask for a line of credit, the lender assigns a credit limit; in other words, a maximum amount you can borrow. You receive a set of blank checks or a credit card that enables you to borrow what you need, when you need it, up to the full amount approved. With a HELOC, you only pay interest on the amount you actually use, rather than the total amount you have available to borrow. And while the rate of interest you'll owe is variable, it still may be lower than other forms of consumer credit, since any loans are secured by the equity in your house. As with a home equity loan, the interest on your HELOC also may be tax-deductible, subject to certain limitations and caps.

Keep in mind that, although interest rates are currently low, they are likely to go up in the future. When they do, HELOC rates will rise as well. Also remember that each time you use your line of credit, the equity in your home is reduced by the amount you owe. When your line of credit is paid off, your equity is restored. However, if your home loses value during the loan period, you still owe the full amount you borrowed. And if you fall behind in your payments, you could lose your home through default and foreclosure, even if you've made all the payments on any first, or primary, mortgage you may have on the house.

So, how do you decide which option is right for you?

Consider what you intend to use the money for. Because a home equity loan is given in a lump sum, it may make sense for one-time major expenses, such as a single home improvement, a new car or debt consolidation. In contrast, a HELOC may be better suited if you anticipate having ongoing expenses, such as ongoing home improvements, college tuition, medical expenses or a situation that requires you to access funds on an ongoing basis.

Nearing retirement

A golden egg? How to make the most of Social Security

Many people underestimate the importance of Social Security to their financial stability in retirement. Yet Social Security is one of the few sources of retirement income that is guaranteed to continue for as long as you live. Deciding when and how to start taking your check is a crucial decision — one that could cost you significantly in terms of lifetime benefits. Here are three tips to help you maximize your Social Security benefits.

1. Know the basics.

The amount of your Social Security payments depends on your earnings history, the age you sign up and the dependents you have. To get a quick estimate of your benefits, go to **mybmoretirement.com** for an easy-to-use ***Social Security calculator***. You can claim Social Security benefits as early as age 62; however, your full benefit isn't available until you reach what's called "full retirement" age (FRA), which is now between 66 and 67, depending upon your year of birth (see chart shown right). Knowing your FRA is important because the age at which you claim benefits will impact your eligibility for certain spousal benefit strategies (see Tip 3).

2. Think twice before claiming early.

According to the Social Security Administration's 2013 Annual Statistical Supplement, **two-thirds** of all eligible workers choose to take their retirement benefits early. While doing so can make sense for some, it's important to understand the impact of that decision. For one, you'll receive a reduced benefit for claiming early. So, for example, let's say your Social Security benefit at FRA of 66 is $2,000 per month. By claiming at age 62, your monthly check would decrease by 25% to $1,500 a month. With the exception of cost-of-living increases that may come along the way, this lower benefit will apply every month for the rest of your life.

What if you wait until age 70 to collect? Your Social Security benefits will be eligible for delayed retirement credits. These will increase your monthly benefit by 8% for each year beyond age 66 (up to age 70) that you wait. Let's again assume that you'd receive $2,000 per month at FRA (age 66). If you wait until age 70 to claim benefits, your monthly check would increase to $2,640, an increase of 32%.

Another good reason to wait? If you're still working and haven't reached your FRA, your Social Security benefits will be reduced $1 for every $2 you earn above $15,480 in 2014. After FRA, you can earn any amount without penalty.

3. Understand your spousal benefits.

Filing early for Social Security can have consequences for spousal benefits, too. When you apply for Social Security benefits, your spouse may also be eligible for benefits based on your earnings, up to 50% of the benefit you receive. Up to 85% of a married couple's Social Security benefits may be taxable once their income tops $44,000 in 2014 ($34,000 for individuals). If you take reduced benefits as a result of early retirement, your spouse's benefit will be similarly reduced. If your spouse hasn't earned much in his or her career, taking your benefits prior to reaching FRA could have a profound impact on your spouse's survivor benefits should something happen to you.

The issue becomes even more complicated if your spouse is entitled to benefits of his or her own. That's because married couples have access to certain claiming strategies, such as file-and-suspend, that can boost their lifetime benefits by tens of thousands of dollars or more. The caveat is that many of these strategies can only be used when the primary earner waits until FRA or later to claim benefits.

Spousal benefits may also apply in the event of divorce. If you were married for at least 10 years to your ex-spouse before divorcing, he or she may also be entitled to spousal benefits based on your earnings, even if you have remarried. This assumes your ex-spouse is age 62 or older, unmarried, and the benefit you're entitled to is more than your ex-spouse's. If you are divorced and your ex-spouse has a higher earnings record, you may be entitled to spousal benefits, assuming you are not remarried.

Whether a higher benefit at a later age is worth the wait depends on many factors, including your ability to meet your current living expenses with another source of income, your spouse's age, if you're married, and something that's unknowable — how long you'll live. For a real-life comparison of your lifetime benefits, contact your investment professional or go to the Social Security Administration's website at **http://www.socialsecurity.gov/planners/benefitcalculators.htm**.

Things you can count on.

Social Security is one of the few sources of retirement income that is guaranteed to continue for as long as you live.

This chart illustrates FRA for retired workers and spousal benefits. For survivor benefits, the FRA is different for some years of birth.

Social Security benefits retirement age

Year of birth	Full retirement age (FRA)
1943–1954	66
1955	66 + 2 months
1956	66 + 4 months
1957	66 + 6 months
1958	66 + 8 months
1959	66 + 10 months
1960 and later	67

Source: http://www.socialsecurity.gov/retire2/agereduction.htm

Continuing the momentum

Turning your savings into a steady stream of ongoing income is a crucial step in living the lifestyle you want in retirement.

In retirement

Making the most of your retirement dollars

After a long career, you may have accumulated retirement savings in a variety of accounts, including your retirement plan at work, individual retirement accounts, and other investment and savings accounts. One of the biggest challenges in retirement is how to balance those resources so that you can manage your expenses when you're living without a paycheck. How do you decide which of your sources of retirement income to tap first? The following tips can help you create a stream of income to meet your needs.

1. Determine your withdrawal rate.

One of the most important steps to creating a sound retirement income strategy is determining how much you can safely withdraw each month without outliving your savings. To develop a sustainable strategy, you'll need to take into account your age, life expectancy, cost of living and rate of return on your investments. That said, many experts believe a good rule of thumb is to draw down no more than 4% of your portfolio per year, adjusting that rate each year to account for inflation. For example, if your nest egg is $250,000, you would withdraw $10,000 ($833 per month) the first year. Assuming an annual inflation rate of 3% (its historical average), you'd withdraw $10,300 the second year, $10,609 the third year, etc. Go to **mybmoretirement.com** for an easy-to-use *Depletion Calculator*, which looks at how long your money will last given various retirement scenarios.

2. Don't forget your RMDs.

If you're age 70½ or older, you first must take required minimum distributions (RMDs) from your qualified retirement plans, including your plan at work and any Individual Retirement Accounts you may have (excluding Roth IRAs). Neglect these and you may have to pay a 50% excise tax on the amount not distributed as required.

3. Manage your taxes.

When turning your retirement savings into income, taxes can have a significant impact on how long your money lasts. One way to help minimize the impact of taxes on your savings is to think of your assets as going into three tax groups.

- **The first group is for your taxable accounts.** These investments, such as stocks, bonds and cash investments, are typically subject to taxation at capital gains or qualified dividend tax rates. Because these rates are currently lower than the ordinary tax rates you'd pay on money withdrawn from traditional IRAs and other retirement plans, in many circumstances you may want to consider these assets for retirement income before some of your tax-advantaged savings.
- **The second group is for your tax-advantaged accounts.** These include your retirement plan and any traditional IRAs you may have. If possible, consider leaving these assets untouched for as long as you can so that your savings can compound tax-deferred until you're required to take RMDs starting at age 70½.
- **The third group is for your tax-free accounts.** This includes any Roth IRAs you may have. Because contributions to a Roth IRA are made with after-tax dollars, earnings are tax-free once you reach retirement age. Because Roth accounts in IRAs or

qualified plans aren't subject to RMDs, you can leave these assets to compound tax-free for as long as you want. Another reason to preserve any Roth savings you may have is that Roth IRAs, unlike other retirement accounts, pass to your heirs free of tax. They also allow beneficiaries to spread out their withdrawals over their lifetimes. This enables your heirs to extend the tax-free growth of your assets.

This is a simple way to think about the tax implications of your withdrawal strategy. The tax environment is always evolving and your individual circumstances are unique, however. As a result, you may want to discuss your retirement income strategy with your investment professional and/or tax advisor.

4. Consider Social Security.

There's another reason to delay taking Social Security. If you have substantial outside sources of income, either from wages or investment income, you may have to pay federal income tax on your Social Security checks. For example, up to 85% of a married couple's Social Security benefits may be taxable once their income tops $44,000 in 2014 ($34,000 for individuals). If you delay taking Social Security, the higher benefits you'll receive may help you avoid having to tap your other sources of retirement income for anything more than any required minimum distributions you must take starting at age 70½. This may make it easier for you to keep your income below the Social Security earnings threshold. Of course, waiting to take your benefits depends on your health and life expectancy. In some cases, it may make sense to take your benefits prior to FRA, despite a reduced benefit.

The decision of when to begin taking Social Security benefits can also impact the longevity of your other retirement assets. See "Nearing retirement" for a more in-depth look at Social Security.

5. Monitor your asset allocation.

Taking income from your various accounts can throw your asset allocation strategy out of whack. That's why you'll want to review your portfolio periodically to make sure your mix of investments continues to reflect your risk tolerance and income goals throughout retirement.

Turning your savings into a steady stream of ongoing income is a crucial step in living the lifestyle you want in retirement. Fortunately, making the most of your sources of income doesn't have to be difficult; it just means understanding the rules, penalties and tax implications associated with each of your accounts. For more information, speak with your financial professional. He or she can help you determine the most tax-efficient way of tapping your savings for your unique circumstances, needs and goals.

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We invite your comments and suggestions for topics to include in future issues.
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