INVESTING FOR RETIREMENT

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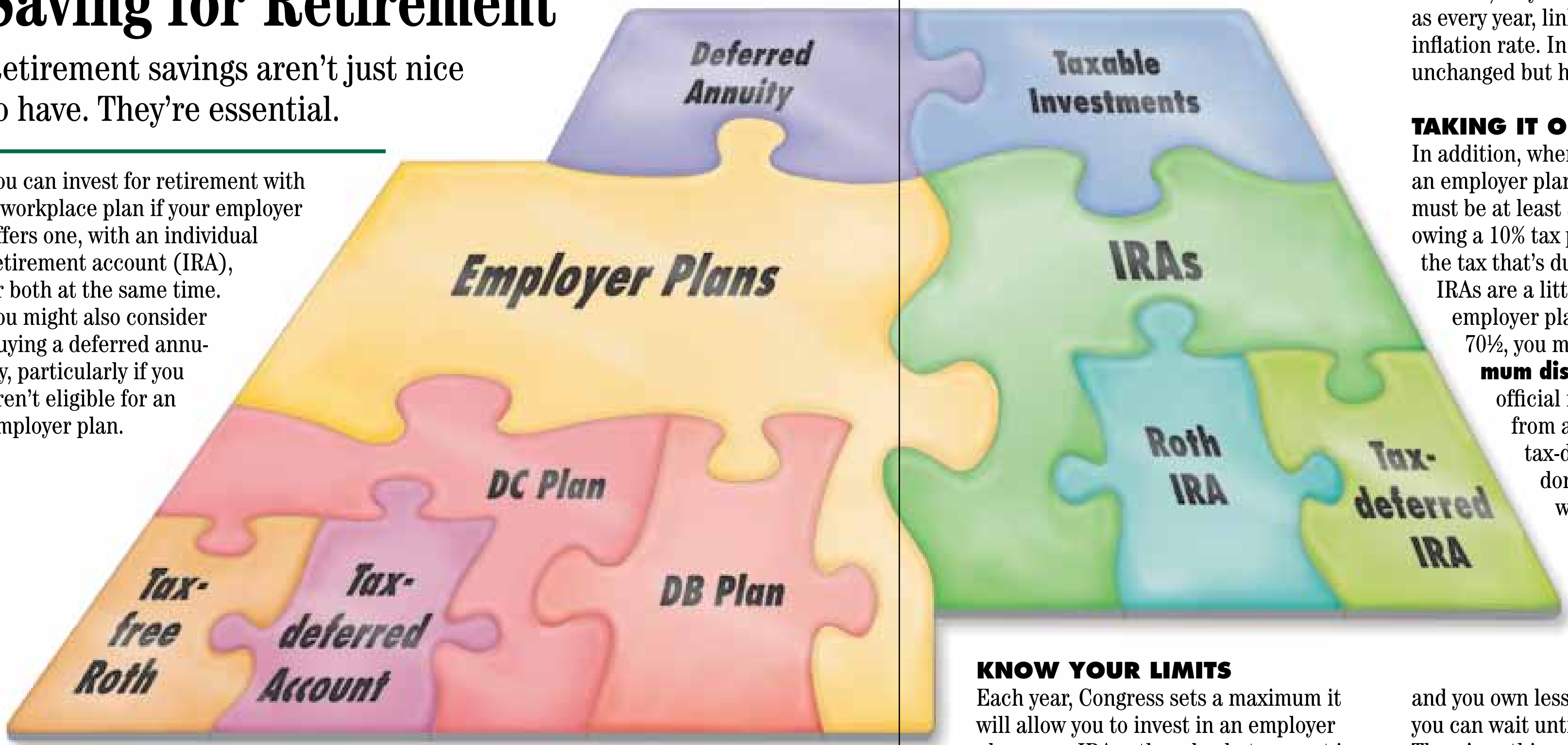
Saving for Retirement

Retirement savings aren't just nice to have. They're essential.

You can invest for retirement with a workplace plan if your employer offers one, with an individual retirement account (IRA), or both at the same time. You might also consider buying a deferred annuity, particularly if you aren't eligible for an employer plan.



All these retirement-specific accounts are similar in one way: Earnings you accumulate are tax deferred and automatically reinvested, so your account can compound more quickly than if you were withdrawing to pay annual income taxes or any other reason. Contributions may also be tax deferred.

AT A GLANCE

When you invest for retirement by deferring income to a plan your employer offers, you're participating in a **defined contribution (DC) plan**. The earnings you accumulate and the value of your account when you're ready to begin taking money out are determined by how much you—and your employer if your contributions are matched—contribute, the return on investment, and the number of years you participate. There are no guarantees about how much it will be.

Participation in the plan may be voluntary, so you must enroll. But employers are increasingly enrolling everyone who is eligible automatically, with the condition that you can drop out if you wish.

In contrast, a **defined benefit (DB) plan** is funded entirely by your employer with money that's separate from your salary. A DB plan pays a fixed, pre-established benefit when you retire. That income, called a pension, generally depends on how old you are when you begin to collect, the number of years you worked, and what you were earning. All employees are enrolled, and it's the employer's responsibility to meet its obligation to pay. However, these plans are increasingly rare.

PUTTING IT OFF

If you contribute pretax income to a tax-deferred employer plan, you reduce your salary and what you owe in income tax for the year. The tradeoff is that when you begin taking money out, you'll owe tax on what you withdraw at the same rate you're paying on your ordinary income.

Employers who offer a tax-deferred plan may have the option of also offering a Roth version of the plan. If you choose this alternative, you contribute after-tax income but are eligible to take tax-free withdrawals provided your account has been open at least five years when you retire and you're 59½ or older. Some employers allow you to split your contribution between a traditional account and a Roth account.

IRAs also have a tax-free version, called a Roth IRA. The big difference is that there are income caps that may limit your eligibility to contribute to a Roth IRA. There are no such limits with the Roth alternative in an employer's plan.

KNOW YOUR LIMITS

Each year, Congress sets a maximum it will allow you to invest in an employer plan or an IRA—though what you put in one doesn't affect what you can put in the other. If you split your contribution among IRAs or between traditional and Roth employer accounts, the total you can contribute is the same as if you were using one IRA or employer account.

If you're 50 or older, you're also entitled to make an annual **catch up contribution**, even if you've always contributed the maximum amount in the past.

Basic and catch-up contributions, which are higher for employer plans than for IRAs, may be adjusted as frequently as every year, linked to increases in the inflation rate. In some years they are unchanged but have never been reduced.

TAKING IT OUT

In addition, when you invest in either an employer plan or an IRA, you usually must be at least 59½ to withdraw without owing a 10% tax penalty in addition to the tax that's due—though the rules for IRAs are a little more flexible than for employer plans. And once you reach 70½, you must begin **required minimum distributions (RMDs)**—the official name for withdrawals—from all employer plans and tax-deferred IRAs even if you don't need the income. The withdrawal rate is fixed, based on your age.

There is an RMD exception with employer plans. If you're still working for the same organization and you own less than 5% of the company, you can wait until after you leave the job. There's nothing comparable for IRAs.

GETTING BACK TO BASICS

In addition, you can invest for retirement in a taxable investment portfolio that gives you more flexibility than retirement-focused plans plus some tax benefits of its own. Rules that apply to qualified plans and IRAs—like contribution limits and required withdrawals—don't apply to taxable accounts. This means you have more control over how much you invest and what you do with your account assets.

EMPLOYER LIMITS

Your employer may impose a contribution cap, separate from the government cap, on the annual contribution you can make to a workplace plan. It's typically set as a percentage of what you earn rather than as a dollar amount, and typically limits your contribution to less than the government's ceiling.

You may also face a limit if the IRS considers you a highly compensated employee (HCE). For 2015, that's the case if you earned more than $115,000 in 2014. If you're affected, what you're able to contribute is determined by the percentage of earnings that non-HCE employees of your employer contributed.

This rule and others, including the income limits for Roth IRAs, apply to help ensure that tax-advantaged plans are available on an equitable basis to all participants rather than set up to benefit more highly paid employees.

INVESTING FOR RETIREMENT

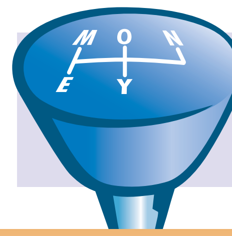
Portfolio Planning

You don't have to reinvent the wheel to plan your asset allocation. It's already been done.

Allocating and diversifying your portfolio isn't a one-time decision. It's the ongoing process of seeking the strongest possible return that's consistent with your investment goals, timeframe, and risk tolerance. An appropriate allocation when you're in your 30s may no longer be the best choice in your mid-50s. In most cases, you're the one who must make the adjustments.

CASH IN THE BANK

A cash investment is a way to have money available for emergencies and for new investment opportunities. While keeping the bulk of your money in a regular savings account has serious limitations as a long-term investment strategy, the logic behind a cash reserve makes a lot of sense. If all your assets are invested in stocks and long-term bonds, and you need to **liquidate**, or turn them to cash quickly, you may take a loss if the market is down. That doesn't happen if they're already in cash.



SHIFTING GEARS FOR SHIFTING GOALS

As retirement gets closer, you might want to shift from seeking growth toward providing income.

LOOKING AHEAD*	STOCKS	BONDS	CASH
30 YEARS until you need the money	**80%** Stocks have the potential to grow in value over time and may pay regular dividends.	**15%** Bond issuers pay interest, usually on a regular schedule, and promise to repay principal at maturity.	**5%** Cash in insured accounts preserves principal and provides regular if typically modest income.
12 YEARS until you need the money	**60%** You may gradually reduce your allocation somewhat to reduce portfolio volatility.	**30%** You may gradually increase your bond holdings as you reduce you stock holdings.	**10%** You may start taking profits on stock and adding to your cash reserve.
5 YEARS until you need the money	**40%** Stock always has a role to play in your investment portfolio.	**40%** Bonds tend to be less volatile than stock and provide a larger annual yield.	**20%** You may want to have two or three years worth of income available in cash.

TAKING STOCK

In an asset allocation model, stocks represent growth. While some stocks pay dividends that provide a regular income, stocks are essential to long-term investment planning because historically they have increased in value. While it's always possible to lose a lot of money in the stock market in any one period, stocks in general—though not every individual stock—have characteristically rebounded from past losses to provide long-term gains.

You may have as much as 80% of your total portfolio in stocks (or stock funds) while you're in your 20s and 30s. That means every time you invest $1,000, $800 of it would go into stocks, mutual funds, or ETFs. However, as you get older, say in your 50s and 60s, the percentage of stocks in your portfolio is usually scaled back. Generally the greater the risk a particular stock carries, the more suitable it is for younger investors or those with substantial assets elsewhere.

STASHING THE CASH

Option	Characteristics
Bank money market account	• Instant access • Better interest rates than savings account • May reduce cost of checking account • Check-writing privileges • FDIC-insured
Money market mutual fund	• Easy access • Interest may be higher than bank money market account • Check-writing privileges • Not FDIC-insured, may lose value
CDs	• Money available (with early withdrawal penalty possible) • Interest rate slightly higher than money market accounts • Due dates can be staggered for convenience • Bank CDs FDIC-insured
US Treasury bills	• Easy to purchase • Little inflation risk • Can be sold any time, though at a potential loss • Extremely safe

* These hypothetical allocations are intended only as illustrations and do not predict the return of any specific portfolio.

THE BOND'S THE THING

Bonds have traditionally been seen as income-producing investments. If that's your goal, you buy a bond, hold it to maturity and receive a regular interest payment every six months or year. Then you get the principal back when the bond matures. As an added plus, bonds issued by the US government have limited credit risk so there's unlikely to be a **default**, or failure to pay what's due. That's one reason these bonds appeal to investors—often those nearing retirement—who are looking for steady income and don't want to risk losing their principal.

On the other hand, like other bond investments, they are subject to **market risk**. This means if demand is down, perhaps because newer bonds are paying a higher rate of interest or because people are selling bonds to invest in the stock market, your bonds may be selling for less than par value. If you bought at issue and sell before maturity, you could lose some of your principal.

Whatever your age, you'll probably want to consider investing in bonds—or bond mutual funds or ETFs—because they can help reduce the overall volatility of your portfolio. For example, you might buy some mix of government, corporate, and municipal bonds of different maturities and with different ratings.

The advantage of bond funds or bond ETFs over individual corporate or municipal bonds is that it's easier to achieve greater diversification at lower cost.

However, with a fund, there's not a fixed interest rate, since the fund owns bonds with varying rates, and there's no maturity date, as it owns funds with different terms. In addition, there's no promise to return your principal, though it's possible that you may be able to sell your shares at a higher price than you paid to buy them.

OTHER FIXED INCOME

Pass-through securities are another type of fixed-income investment. They are created by bundling together a group of loans, such as mortgages or student loan debt, a process known as securitization. Among the best known are the mortgage-backed securities called GNMAs, or Ginnie Maes, which are insured by the Government National Mortgage Association. As borrowers repay the principal and interest on the underlying loans, those payments are passed along to investors. Most individuals invest in Ginnie Maes by buying a GNMA fund.