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For Investors

INVESTING FOR RETIREMENT

When you start thinking about retirement, one of the first things to consider is what it will cost you to live comfortably. That gives you a basis for determining the income you'll need.

Some things will probably cost less when you retire: You won't be commuting. Your mortgage may be paid off, or nearly so. Your children may be college graduates with jobs, not living in their old rooms. There may be other expenses that will drop as well.

On the other hand, certain things will probably cost more. Health insurance and out-of-pocket healthcare costs top the list. Real estate taxes and property insurance may go up. You may want to spend more on travel, hobbies, or other things you've been waiting to do until you had more time. And you'll still be spending money on food, clothing, and other necessities.

The consensus is that in retirement you'll need at least 70% of your last working year's income to maintain your lifestyle after retirement. You will probably need more if you're single or the primary breadwinner in your family. Inflation is a primary factor: Your costs will increase over time, some faster than others. Each year that you're retired you're likely to need more income than the year before.

Investing for Retirement

Six Primary Sources of Retirement Income

- A pension from a private company or public organization
- Social Security benefits
- An annuity—a contract between you and an insurance company—that provides guaranteed income for a certain period of time
- Income from tax-sheltered retirement accounts, such an employer-sponsored 401(k), 457, or 403(b) plan, and an individual retirement account (IRA)
- Income from taxable investment accounts
- Income from a post-retirement job

TAX-SHELTERED ACCOUNTS

To increase the chances of accumulating more money for retirement income, people can invest in tax-sheltered or tax-advantaged retirement account, such as an employer-sponsored 401(k) or 403(b) or individual retirement account (IRA).

Tax-sheltered plans offer retirement savers some important benefits:

- Retirement account earnings and sometimes the contributions made to those accounts are tax deferred.
- Account values can compound faster because of the tax deferral, which may mean the potential for larger account balances.
- Savers can make extra contributions after they turn 50, when they can perhaps afford to save more.
- There's no penalty for early withdrawals if the money is used for certain allowable expenses, such as paying college tuitions, covering medical bills, and making a down payment on a first home.

Those invested in tax-sheltered plans, however should be aware that there are some strings attached:

- There are annual contribution caps, which means which means the benefits of tax deferral may apply only to a limited amount of money.
- There is a penalty for withdrawals before turning 59½, though there are some exceptions.
- Withdrawals are normally required at retirement or after an investor turns 70½.
- Returns aren't guaranteed or insured, so even those who invest regularly may end up with less money than they need to live comfortably in retirement.

Taxable vs. Tax-deferred Accounts

While the investments in retirement accounts and non-retirement accounts may be the same—for example, a mutual fund—there is one major difference: the way that earnings in the accounts — and sometimes the contributions made to them — are taxed.

In a taxable account, income tax is due on all earnings in the year you receive them. For example, if you collect $100 in interest payments in a year, that $100 is added to your taxable income when you file your return for that year. As a result, your tax bill goes up, based on the tax rate you pay on your earned income.

In contrast, with a tax-deferred retirement account, income tax is not due on investment earnings until withdrawals are made from the account — typically over a period of years following retirement. If contributions made to the account were tax-deferred at the time they were made, as they would be with a 401(k) or 403(b), then tax is due on the contributions as well as the earnings at the taxpayer's ordinary income rate.

However, on withdrawals from certain retirement accounts, such as a tax-free Roth IRA, neither the earnings nor the contributions made to the account are taxable.

Annuities

Another possible source of tax-sheltered retirement income is an annuity, which is an insurance company contract intended to provide regular income payments, often for your lifetime. There are essentially two types of annuities:

- An immediate annuity can convert a sum of cash into a steady stream of income. You typically pay for an immediate annuity with a single, upfront payment before the payout phase begins.
- A deferred annuity is typically purchased by paying premiums to the issuing company during your working years. The accumulated value of your account provides a source of regular income after you retire. Any earnings in your account are tax deferred until you start withdrawals.

Annuities are complicated products with many different features and fees. While advocates point to the regular income that annuities guaranty, critics maintain that the costs eat into the benefits they provide. And there's always the risk that the company providing the annuity will be unable to meet its financial obligation to its contract holders.

Keep in Mind

If you're planning to purchase an annuity, you should speak with a knowledgeable, reliable financial professional to help you make appropriate decisions about annuities for your financial situation.

Annuities are generally regulated by the Texas Department of Insurance. Investors interested in annuities should at a minimum consult the consumer guide "Understanding Annuities"

401(K) PLANS

When you participate in a 401(k) plan, an account is set up in your name. You defer pre-tax earnings to your account every pay period, typically by designating a percentage of what you earn.

Advantages of 401(k) Plans

There are compelling reasons to contribute to a 401(k) plan:

- The money you put into the accounts is always yours, not the company's.
- Your employer may match a percentage of the money you contribute, perhaps even dollar for dollar, up to a certain limit. That's free money—always a good thing.
- The deferred earnings aren't included in the gross income your employer reports to the IRS, reducing the income tax you owe for the year.
- Investing regularly helps you build your account balance.
- Tax deferral on your contributions and earnings allows your savings to compound faster than they would in a taxable account since you don't have to withdraw money to pay taxes.

In addition, 401(k) plans allow the highest contributions you're eligible to make to a retirement savings plan. That's a major selling point, especially if you can afford to contribute the maximum.

401(k) Plan Basics

There is an annual cap on 401(k) contributions imposed by the federal government. The limit is $18,500 in 2018, plus a "catch up" contribution of $6,000 if you are 50 or older. You can usually contribute any amount up to the "max out" limit. Since the salary deferral is handled automatically, making the contribution is easy. The trade-off is a bit less take-home pay for more retirement savings for the future.

The harder part is selecting the investments for your account. Most employers provide a number of investment options, which are typically mutual funds or annuities, but may also include company stock. It's generally your responsibility to select from among those choices, which requires taking into account your investment strategy and the level of risk you are comfortable with.

Investing for Retirement

- Tax-Sheltered Accounts
- 401(k) Plans
- IRAs
- Comparing 401(k)s with IRAs

Keep in Mind

Before taking out a loan or a hardship withdrawal from your 401(k), consider your ability to repay the money without straining your family's budget.

Rolling over your 401(k) to a new employer is the best way to make sure your money continues to grow tax-deferred. Or, if you're comfortable with your former employer's plan, you may be able to keep your assets there. But cashing out your 401(k) will only damage your retirement savings.

IRAs (INDIVIDUAL RETIREMENT ACCOUNTS)

If you receive a salary, wages, commissions, or other income for work that you do, you can contribute to an individual retirement account, or IRA.

With an IRA, earnings in your account are tax deferred, and no tax is due as those earnings compound. You can buy and sell as often as you like without tax consequences, though you will pay trading costs.

Choosing an IRA Custodian

You choose your own custodian—a mutual fund company, bank, credit union, brokerage firm, or other financial services company—and then select investments from among those the custodian makes available. In fact, the types of retirement investments you want to make are an important factor in choosing where you open your IRA. You will want a custodian that offers the range of investments you're considering for your retirement portfolio.

The custodian keeps track of your account, sends you regular statements, and follows your instructions for investing your contributions.

Traditional IRA

In a traditional IRA, your earnings aren't taxed until you withdraw them from your account, usually after you retire. If you are at least 59½, there is no penalty for taking the money out, even if you are still working.

You may qualify to deduct your contribution to an IRA based on your modified adjusted gross income (MAGI). However, the deduction decreases as your MAGI goes higher, and your eligibility phases out altogether once your MAGI exceeds certain limits. You can check the current limits at www.irs.gov.

In years that you qualify, taking a deduction for your IRA contributions will reduce your taxable income. But remember, those contributions will be taxable, along with your IRA earnings, when you begin making withdrawals.

With a traditional IRA, you must begin to take required minimum distributions (RMDs) when you reach 70½, whether or not you need the money. You must also stop making IRA contributions at that age, even if you continue to earn income.

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Retirement Account Options

What you may not realize is that you can contribute to an IRA in addition to participating in a 401(k), 403(b), or other employer-sponsored retirement plan. Or you can choose an IRA instead of those plans.

IRA Deduction

Remember, you may also be eligible to deduct your contribution despite your MAGI if you are not covered by a retirement plan at work. However, there are limits if you're married, file a joint return, and either you or your spouse is covered by a plan even if the other person is not.

Roth IRA

A Roth IRA has the same contribution limits and provides the same tax-deferred earnings as a traditional IRA. But there are significant differences between the two.

With a Roth, you are not required to start making withdrawals at 70½ as you are with a traditional IRA. You can also continue to contribute as long as you have earned income, even if you're in your 90s.

Even better news is that you can withdraw your earnings tax free if you're at least 59½ and your account has been open at least five years. That's because your contributions to a Roth IRA are never deductible. They're always made with after-tax income.

There are eligibility requirements for contributing to a Roth IRA, based on your MAGI. You can check these requirements at www.irs.gov.

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Individual Retirement Accounts

IRAs	TRADITIONAL IRAs	ROTH IRAs
• Open to anyone with earned income • Tax-deferred earnings • Choose from investments offered by banks, mutual funds, brokerage firms • Annual limit on contributions, with catch-up	• Contribution may be deductible based on MAGI • Reduces current taxable income • Contributions and earnings taxed on withdrawal • Withdrawals mandatory after age 70½ • No contributions permitted after age 70½	• Eligibility to contribute based on MAGI • Contributions are never deductible • No mandatory withdrawals at age 70½ • Contributions permitted after age 70½ • Tax-free withdrawals if you are 59½ and account has been opened 5+ years

Contribution Limits

Like employer-sponsored plans, IRAs have an annual contribution limit: In 2018 it is $5,500. And like a 401(k), there is a catch-up provision—in this case, $1,000, for a total contribution limit of $6,500 if you are 50 or older.

You can make catch-up contributions from age 50 to age 70½, time enough to make up a lot of ground in saving for retirement.

COMPARING 401(K)s WITH IRAs

Saving for retirement, like everything in investing, is a matter of choice. You can choose to participate in a workplace plan such as a 401(k), or you can forgo the employer-sponsored plan and simply establish an IRA, either traditional or Roth.

An IRA is likely to have more investment choices than a 401(k), 403(b), or 457 plan, and IRA fees may be lower, based in large part on the investments you choose. And while traditional IRAs, like a 401(k), 403(b), or 457 plan, may require you to take withdrawals after you turn 70½, you may have more control over managing how you take those withdrawals with an IRA than you do with an employer-sponsored plan.

On the other hand, employer-sponsored plans have much higher contribution limits, which allow you to build your retirement savings f aster if you can contribute more than the cap on IRA contributions. Investing is probably easier with an employer-sponsored plan as well since all you need to do is sign up. Your contributions are automatically withheld from your pay and deposited directly into the investments you have chosen.

You have to do a little more upfront work with an IRA, including choosing a custodian, selecting investments, and arranging to have money from your paycheck or checking account transferred directly into your IRA on a regular basis.

Whichever retirement savings choice you make, you should not pass up this opportunity to save for retirement with tax-deferred earnings.

Investing for Retirement

Employer Plan or IRA?

	Employer Plan	IRA
Investment choices	Choices determined by plan	More, often better choices based on custodian
Fees	Generally higher	Generally lower, often significantly
Contribution limits	\$18,500 + \$6,000 catch-up	\$5,500 + \$1,000 catch-up
Withdrawal flexibility	Mandatory at retirement May roll over to IRA	Required after 70½ in traditional but not Roth IRA