Destination: Retirement

CANBY Financial Advisors

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Questions?

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Five Mistakes Retirement Savers Often Make

For most people, saving for retirement is one of their highest financial priorities. But once investors start participating in a 401(k) plan they sometimes make mistakes--either through action or inaction--that can throw their retirement strategy into disarray. Here are five common pitfalls—and how to avoid them.

1. Not contributing enough

One of the biggest mistakes many retirement investors make is not contributing enough to their accounts. The more money you regularly put in, the less pressure there will be on your investments to deliver the returns you need to reach your retirement savings goals.

If you're in a 401(k) plan and now contribute 3% per paycheck, see if you can increase it by at least 2% every year. Not only will you be giving your investments more capital to work with, but you'll be able to make these contributions on a pre-tax basis, which could make a difference between having to pay taxes or receiving a refund.

2. Not reviewing and modifying your investment mix

When you're young, investing a large percentage of your retirement assets in stock funds usually makes sense. Historically, stocks have performed better than bonds and cash over time, and if retirement is 25 to 30 years away you have time to ride out short-term dips in the market.

But when you're a few years away from retirement, that all-stock fund portfolio may be riskier that you want, especially if a market downturn hits when you really need that money to live on.

That's why it often makes sense to start shifting more of your portfolio from stocks to bonds and cash as you approach retirement. While bonds may not deliver the returns of stocks, the income they generate can help offset losses in your stock investments when the market hits a rough patch.

Authored by the Retirement Consulting Services team at Commonwealth Financial Network and Canby Financial Advisors.

If you don't feel comfortable adjusting your bond and stock allocations on your own, consider investing in a target date fund with a date that corresponds to the year you plan on retiring. These funds automatically invest your money in a mix of stock and bond funds. The further away the target date is, the larger the initial allocation will be to stocks. As the target date approaches, the fund gradually reduces the stock allocation and increases the bond and cash allocations to achieve a more appropriate balance of growth and capital preservation.

3. Leaving assets that are almost vested on the table

If your company's retirement plan has a vesting schedule, it's important to know when matching contributions or profit-sharing contributions will be fully yours. Some may vest right away, while others may take several years to fully vest.

Employer contributions can significantly boost the value of your account, so if you're looking for a new job and you're only a few months away from hitting a new vesting milestone, you might want to wait to make the switch until after you've completed that year of service. If you're not sure what your employer's vesting schedule is, contact your benefits administrator.

4. Losing track of retirement plan accounts at former employers

If you've changed jobs a number of times over the years, you may have assets remaining in one or more 401(k) plan accounts with your former employers. While there's nothing wrong with leaving them there, doing so often creates an "out-of-sight, out-of-mind" mentality.

When you're no longer actively participating in a plan, the recordkeeper may stop sending you quarterly statements or other plan-related communications. Unless you access your account online you won't know how much that account is worth or how it's performing.

That's why, at some point, you may want to consider moving old 401(k) plan assets into your new plan or roll them over into an IRA with a brokerage company. Not only will doing so allow you to consolidate your retirement assets, but you may have access to a greater variety of investment options.

5. Underestimating required minimum distributions

If you're age 72 and have to take annual Required Minimum Distributions (RMDs) from your 401(k) plan and/or IRA accounts, it's important to do it the right way since the rules aren't the same for all account types.

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A common mistake people make is assuming they can calculate an aggregated value of their yearly RMD amount and split these distributions among their different 401(k) and Traditional IRA accounts.

Unfortunately, this isn't true. You have to take a separate RMD for each of your 401(k) plan accounts. You can't choose to take more from one account and less from another.

The RMDs you take from 401(k) accounts don't reduce RMDs you have to take from your IRAs. The good news, however, is that if you have several IRAs you can choose to take more from one account and less from another—or take the whole RMD from one account.

This can be a complex set of calculations, and if you don't withdraw the correct amount you may face costly IRS penalties. That's another reason why it may make sense to consolidate your retirement plans into an IRA before you reach age 72. That way, you'll only need to deal with RMDs from your IRA accounts.

Getting back on track

If any of these situations sound familiar and you're not sure of the best way to resolve them, a financial advisor can help you get your retirement plan back on track.

All investing involves risk. Past performance is no guarantee of future results. Diversification, asset allocation, or any other investment strategy cannot assure a profit or protect against a loss in declining markets.

The Benefits of Compound Interest

A great—and simple—advantage of saving for retirement through a workplace retirement plan is the ability to take advantage of compound interest. Through the power of compounding, as your invested assets generate earnings, that money is continuously reinvested to potentially generate even more earnings. Those who start saving earlier have a distinct advantage over those who delay saving because their money has longer to earn interest. And, over time, this can snowball into a significant account balance. Let's look at a hypothetical example.

Alex, age 25, invests $3,000. With a 7 percent annual return, her investment would compound to $3,210 after the first year, $5,901 after the 10th year, $11,609 after the 20th year, and so on. When Alex retires at age 65, her original $3,000 investment would be worth $44,923.

Compare Alex's situation with that of Ann, who also invests $3,000 but doesn't do so until she is 40. When Ann is ready to retire at age 65, her $3,000 investment, after compounding for 25 years (and with the same 7 percent annual return), would be worth $16,282. By allowing her initial $3,000 to invest for an extra 15 years, Alex earned $28,641 more than Ann. Of course, the more you invest, and the more you can increase the amount you save each year, the better opportunity you will have to let compound interest take further effect and supercharge your retirement account balance. The sooner you get started, the better.

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