## CANBY

## Destination: Retirement

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## Questions?



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## The Power of Positive Compounding

It's certainly true that the way you allocate money in your 401(k) account among stock, bond and money market or stable value funds plays a critical role in determining its growth potential.

But two other factors are just as important: How much you contribute each month and how long you'll continue to save until you start taking withdrawals at retirement.

During your enrollment presentation you probably were shown a hypothetical illustration of how one employee who started contributing a small amount per month at a younger age ended up with more retirement savings at age 70 than another employee who contributed a higher monthly amount but didn't enroll in the plan until they were in their 40s.

Or you may have seen examples of how increasing your monthly contribution could theoretically result in a much larger nest egg later on.
These examples all illustrate the power of compounding interest.
Your online 401(k) account provider should have tools you can use to test out these scenarios, but if you want a simple way to do it you may want to check out the Compound Interest Calculator at Investor.gov. ${ }^{1}$

It's very simple. Enter an initial amount to invest, your monthly contributions, an annual interest rate, how often your interest compounds, and how many years you want to keep contributing and compounding.

You'll see the numerical result as well as a chart illustrating how compounding interest could theoretically increase your savings over time. Keep in mind that the amounts shown are in today's dollars.

Let's use the Calculator to see how contributing more could result in a larger nest egg later on. Say you started contributing $\$ 100$ every month to your plan at age 25 and plan to retire at age 70 . If your account earned $5 \%$ per year, compounded quarterly, it would be worth $\$ 201,487$ when you retired, as the chart on the next page illustrates.*
${ }^{1}$ https://www.investor.gov/financial-tools-calculators/calculators/compound-interestcalculator

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Now let's say that you doubled that monthly contribution, to \$200 a month. Using the same timeline and return assumptions as the first example, your account would hypothetically be worth $\$ 402,975$ when you retired.*


If you compare the two examples, you can see that the difference between the total contributions over that 45-year timespan isn't all that much - around $\$ 54,000$. The real growth comes from compounding interest. If you look closely, you'll notice that growth really accelerates after you've been contributing for 20 years. That's why it's so important to start saving as much as you can as early as possible.

Of course, in any given year investment returns will vary. In some years they'll be positive, in some years they'll be negative.
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One way to see how the investments you choose could theoretically impact the long-term value of your nest egg is to enter a value in the "interest rate variance" field of the Calculator. The resulting chart will show how your portfolio might have performed if compound interest rates were higher or lower than the original interest rate you entered.

Let's see how this works. Keeping the assumptions from the previous example, enter " 3 " in the interest rate variance field. The resulting chart will show you the theoretical growth of your account over time if it returned a low of $2 \%$ or a high of $8 \%$ in addition to the original $5 \%$ interest rate.


As you can see, if your portfolio returned $2 \%$ over that period it would have grown to around $\$ 175,000$. However, if it grew by $8 \%$ per year, your nest egg would be worth over $\$ 1$ million when you retired.*

This is where asset allocation comes in. If your portfolio is primarily invested in cash, annual returns may not be much higher than $2 \%$. However, if you invest in a moderate to aggressive mix of stock and bond funds, you may have a better chance of achieving $5 \%$ or higher annual returns during that timeframe, although you'll also be taking on greater risk.

That's why it's important to speak with a financial advisor or your retirement plan advisor to make sure that your contribution amount and investment mix are working together to maximize your retirement savings growth potential at a level of risk you're comfortable with.
*The hypothetical examples used in this article are for illustrative purposes only. No specific investments were used in these examples. Actual results will vary. Past performance does not guarantee future results.

## The Risks of Beneficiary-Naming Mistakes

Every year it's worth reviewing the beneficiaries you've assigned to your 401(k) plan accounts, IRAs, insurance policies and other financial accounts, especially if your marital or family situation changes. If you don't, problems could occur after you pass on.

For example, if you get divorced and don't remove your ex-spouse as the primary beneficiary, your ex could legally receive some or all of your retirement assets and death benefits after you pass on.

## Don't name your estate as IRA beneficiary

Many people consider naming their estate as a primary IRA or 401(k) plan beneficiary. But this could be a costly mistake.

An estate beneficiary has no age or life expectancy. This leads to fewer distribution options. For example, estates generally must distribute all funds within five years. If your estate is a primary IRA or $401(\mathrm{k})$ beneficiary, it would have to distribute assets in the account to your named heirs within five years. This could result in larger distributions and potentially higher tax burdens for them. In addition, since these assets would be included in your estate, they could be vulnerable to claims from creditors.

However, if family members are 401(k) or IRA beneficiaries, the distribution period could be much longer. Assets could be gradually distributed to your surviving spouse over the course of their lifetime. Children who inherit these assets would have ten years to fully deplete the account. And since these assets wouldn't be part of your estate, they would be shielded from creditors.

Still, adding or removing beneficiaries can be a confusing process. That's why you may want to speak to a financial advisor or attorney before making any changes.

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