An Early Start on Saving for Retirement

Even if retirement is not for another 30 to 40 years, younger workers should start planning early for financial security during their golden years.

Preparing a savings plan in your 20s can help provide you with a comfortable retirement in your 60s. Although expenses such as a student loan, rent, utilities, and food can eat up a young adult’s budget, putting money aside for retirement has become an essential part of long-term financial planning.

Many say the average American will not be able to count on Social Security alone and that other savings tools, including 401(k) plans, can help people create a secure financial future.

“Young people need to start a 401(k) plan early and save if they plan on having a comfortable retirement,” says Dr. Jill Young, an instructor in South University’s College of Business. “Social Security is not enough money to maintain a reasonable standard of living. Furthermore, it was never meant to be a sole income for a retired person.”

A 401(k) is the most common employer-sponsored retirement plan and financial experts say it provides major advantages.

The contributions made to a 401(k) plan are tax-deferred, which means they are deducted from an employee’s paycheck before taxes are assessed.

An employer match is another incentive to participating in a 401(k). Many companies will also match the amount an employee puts into their plan up to a certain percentage of their salary.

It’s preferable to contribute the maximum amount the company will match. Otherwise, employees are passing up what amounts to free money from their employer. A recent report by investment company Financial Engines says many people, especially younger workers, are doing just that. According to the report , 39% of 401(k) participants are not saving enough to receive the full employer match and of the participants younger than 40, 47% failed to save enough to receive the match.

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While figuring out how much to save in a 401(k) can be difficult for some, Young says the portability of the retirement plan makes it easy for an employee to carry it throughout his or her career.

“A major advantage of a 401(k) plan is the ability to transfer funds from one plan to another,” she says. “A mobile employee can just roll over their funds into a new 401(k) plan from a previous employer’s 401(k) plan.”

When changing employers, many employees also have the option of leaving their assets in the old employer’s 401(k) retirement plan or completing a 401(k) rollover and moving the assets to an individual retirement account (IRA).

They also have the option of cashing out the assets — one of most common pitfalls of 401(k) plans.

http://cmsdeploy.content.edmc.edu/assets/marketing/Insite/INTEXT_401K.jpg

“There are situations where people might take a withdrawal rather than rolling their 401(k) over,” says Roger Wohlner, financial advisor with Retirement Fiduciary Advisors. “If you withdraw money before you are age 59 ½, you end up paying heavily on taxes and a 10% penalty. That’s why people should avoid taking any money out of their plan before retirement.”

In addition to the tax advantage, employer match programs, and flexibility, 401(k) plans can get young adults off to a good start when it comes to savings and investments.

“Since people will invest on a payroll deduction basis, this gets them into regular savings habits and provides them with structure,” Wohlner says. “Getting as early a start as possible will help people get to their goal even if they do not know what their actual goal is yet.”

Young people also have the benefit of time. If a person starts saving at age 25 and plans to retire at around 65, they have 40 years to experience the magic of compounding interest. They won’t have to put away a large amount of money each month to ensure they have enough for their retirement years.

“Even if a person starts with a small amount and increases their contribution by 1% each year or each time they receive a raise, they will have the power of continued savings over a long period of time,” Wohlner says.

Younger workers can also take more investment risks. In the beginning, their 401(k) portfolio is likely to be more heavily comprised of stocks and it will be risky.

“The important thing to remember for young investors is that the results of early investing could be very volatile,” Young says. “The key is not to panic and not to stop investing in the 401(k) program. Over time, the risk will decrease as the portfolio will move from more risky stocks to more conservative investments like bonds.”

If a person does not have access to an employer-sponsored retirement savings plan, they have the option of putting their money into an IRA.

“Assuming they are an employee, the best option is Roth IRA or IRA they can put in $5,000 if they are not covered by a plan,” Young says. “If they have a side business they can do a SIMPLE and SEP IRA and possibly a solo 401(k) plan.”