Today's nest egg affects your retirement years and what you'll be able to spend then, too

BUSINESS

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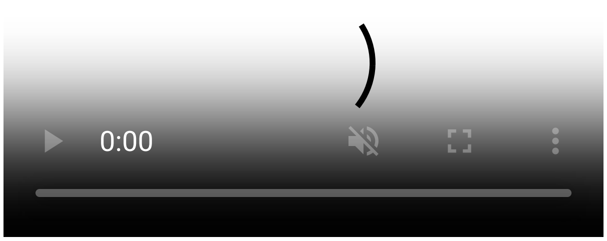
For FLORIDA TODAY



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Keep Watching

- The time value of money refers to the future worth of money when considering factors like inflation and earnings.
- A dollar today is typically worth more than a dollar in the future due to the effects of inflation.
- Saving a higher percentage of your income is more critical for retirement than the earnings on your investments.
- Saving more not only builds a larger nest egg but can also provide the financial freedom to retire earlier or change careers.

Q: I saw a reference to the time value of money and was wondering: What does that mean?

A: Ask a financial planner about “time and money” and you may get a discourse on the “time value” of money instead. This usually refers to the worth of money in the future, with the factors of inflation and earnings figured in. For example, if inflation is around 4% a year, a dollar in five years is worth less than 80 cents today in terms of what you can buy with it. As inflation is the norm, a dollar today is almost always worth more than a dollar in the future. Our investment portfolios should be designed to overcome that drag.

But let us talk about another time and money interaction. What time does your money buy?

I remember my first job in the 1970s was at the princely minimum wage of $1.10 an hour. I began to calculate just how many hours I had to work to buy gas or a movie. Suddenly, I had a gauge of value — how long I worked was directly proportional to how much I could spend. If something I wanted was even five more dollars than a comparable item, I would have to work at least five to six more hours (after taxes) for the more expensive choice.

As we save for retirement, the relationship between money and how much we save is similar but skewed more by the length of time we save, how much of our income we spend on lifestyle expenses, and how much we earn on our investments. Of these variables, how much we earn on our investments is the least important value, although it is often what we focus on the most. Saving a higher percentage of your income both increases the amount that you will ultimately have for retirement, while at the same time reducing how much you get used to spending each year. For example, a family that makes $150K per year and spends $140K will have a tough time saving enough (regardless of earnings on those savings) to build a nest egg that can provide a $140K income in retirement. Conversely, the same family saving one third of their income will most likely find it easy to retire financially in comfort.

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Spending in your retirement years: What's your goal?

Not only does saving more and spending less (at any given income level) provide for a safer retirement, it also provides for an earlier one. I’m not an advocate for early retirement for everyone — we may live too long to fill those days without productive efforts (paid or otherwise). But being “able” to retire early gives one the opportunity to change careers, to grow, and to take risks not otherwise possible. It “buys time” to do many things we want to do instead of working.

I will say that I work with many income earners who enjoy their work, and plan to continue so well past the “normal” retirement age. Good for them! They remain productive doing what they want. But sometimes in our youth, we don’t know how long we’ll enjoy doing our work and having some choices before it’s too late is nice. Give some thought with how much time you’d like to buy with your money!

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