Why You Should Max Out Your 401(k) Now for a Better Life Later

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Chelsea Batten September 7, 2018

Multiple news outlets have been writing stories about the “retirement crisis” currently facing millennials. Whether it’s a crisis or not can be debated. Whether or not millennials are saving enough for retirement cannot be debated. They’re not.

Most millennials (myself included) are far too occupied with the day-to-day hustle of paying rent, making student loan installments, and looking for affordable health insurance to have much bandwidth for retirement planning.

It’s not that we’re against planning for retirement, it’s that we don’t think it’s possible with our current income.

The truth is that the retirement crisis, while real, certainly isn’t relegated to millennials. The whole construct around long-term workplace benefits — the one that convinced your parents to forego their artistic dreams in favor of a steady job with a good benefits package — has been steadily unraveling before our eyes for the last two decades. The U.S. government is already removing benefits from people drawing Social Security today; a new study reported in the *Wall Street Journal* predicts that the system will be bankrupt by 2026. Meanwhile, the pension system is bankrupting states and municipalities. As a result, not only are pensions not being offered anymore, but people’s existing pensions are being taken away.

Many in our parents' generation are dealing with this reality now, some better than others. But for their children, the reaction to the situation vacillates between a ferocious espousal of socialistic government and a blank stare. Either we change the system, or there's nothing we can do. Both reactions end with a crossing of the fingers and a Voltairean return to the task at hand, i.e., getting through the work week.

All the while, ignoring a very powerful tool at our disposal, sitting right there among our work agreement and benefits statements.

That tool is the 401(k).

Don't Just Know Your Options — Use Them

If you work on a full-time basis just about anywhere, you probably have the option of a 401(k) account included in your benefits package. If you're like most millennials (again, myself included) you know just enough about this type of account to be dangerous .. .that is, dangerous to yourself. Because you (correctly) associate a 401(k) with retirement, you don't put much thought or effort into maintaining it. According to a Vanguard study, less than half of people who have a 401(k) option available are contributing to it at all. Those who do contribute tend to set and forget their contributions at the bare minimum amount.

Failing to max out your 401(k) means missing out on a huge opportunity, and the reason comes back to retirement.

Rethinking Retirement

It's time to stop thinking of retirement as this period where you turn in your hustler card, pass on all the creative dreams you haven't realized, and take up permanent residence on a front porch rocking chair. There's a reason people look forward to retirement: It's one of the most experience-rich, opportunity-rich times of your life. But only if you plan for it right.

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First of all, you need to be healthy in order to have an awesome retirement. And the reality is that no matter how many cold-pressed juices you've consumed or stair laps you've run in your prime working years, you're going to need a little more healthcare once you hit retirement age.

"Out-of-pocket medical expenses in retirement is an area where many people are significantly underestimating their costs," says Pamela Yellen, a financial investigator based in Santa Fe, New Mexico. According to her research, a 65-year-old couple retiring now will need $275,000 to cover out-of-pocket health care costs, according to a study by Fidelity, and that does not include nursing home or home health care. We know you don't want to hear about it, but it's worth noting that at least 70 percent of people over age 65 will require long-term care services, and more than 40 percent will need nursing home care, according to the U.S. Department of Health and Human Services — and Medicare doesn't cover those expenses. If Medicare's even around by the time we hit 65.

Second, you probably want to at least maintain your current lifestyle, if not improve it, during your retirement years. Think about what you'd like to do with all that free time, once you have it. Travel? Buy some land where you can raise llamas? Learn to play a 28-piece drum kit so you can back a Dave Matthews tribute band? Hell, maybe you want to be that awesome old person who puts surprise checks in the mail to their grandkids every couple of months.

Now consider whether you could afford to do any of that on your current income. And if you're not working, where is all that money supposed to come from?

So What Was That About the 401(k) Again?

Now that we've taken a hard look at the retirement situation, it's time to turn our attention to the secret weapon that can actually make it attainable: the 401(k). That little savings account looks pretty damn exciting right about now, doesn't it?

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The 401(k) account was originally designed by the government to help working stiffs like you and me plan for retirement. It's a special savings account that doesn't get taxed; in other words, you get to keep more of the money you save. The 401(k) is set up and maintained by your employer, with whatever monthly contribution amount that you decide. That amount is automatically withdrawn from your salary — it never gets as far as your paycheck — and deposited into the 401(k) account. And because you only get taxed on your take-home pay, the 401(k) offers the extra benefit of lowering your tax liability.

When people talk about “maxing out” your 401(k), what they mean is contributing the maximum amount allowed by law or by your workplace. As of 2018, the max federal contribution amount is $18,500. (It’ll increase each year with inflation.) For most workers, the maximum amount a company will let you contribute to your 401(k) is between 10 percent and 15 percent of your pay.

According to Rachel Podnos, a Washington, D.C.-based Certified Financial Planner, “Cash flow permitting, everyone should work their way up to maxing out their 401k. It might not be possible for everyone to max it out right away, but work your way up to it as your income increases.”

The best place to start is wherever you can, even if that means contributing the minimum amount for now. Then, every time you get a raise, put half the raise amount into your 401(k) contributions. Doing that every year, Podnos says, will make your account grow exponentially.

“Instead of getting a nicer apartment with every promotion, or spending more on vacations, stay at your current lifestyle and bump up your 401(k) contributions, until you’re maxing it out. Just by doing that, I’ve seen people really build wealth.”

Set It and Forget It

We all know we should be saving and investing money, but how many of us actually do it? Especially when it’s so, so easy to spend whatever we have left over after bills on a dope new pair of headphones, a swank weekend getaway or one too many rounds at the newest craft cocktail bar.

That’s the best part about the 401(k): It makes saving easy by making it mindless.

That’s the best part about the 401(k): It makes saving easy by making it mindless. The automatic deposit set-up means that the money intended for contribution never actually passes through your hands. By having it taken out of your pay ahead of time, you can effortlessly maintain a responsible lifestyle (e.g., living on less than you make) instead of “forgetting” (i.e., succumbing to temptation) and spending everything you make.

If there’s any downside to the 401(k), it’s that the money is locked up, so to speak. While there are certain 401(k) plans that allow you to take a “loan” out from yourself for specific purposes (like education or medical bills), the majority charge a penalty for withdrawing funds before you reach age 59. That’s because the whole point of this account is not just saving, but saving *for retirement*.

The good news is that by the time you retire, you’ll be in a lower tax bracket, partly as a result of the 401(k). Which means you’ll get to keep more of all this money you’ve saved.

Bottom line, there’s going to be a day when you want to stop working, or at least*having* to work. By maxing out your 401(k) now (or working your way up to it ASAP), you’re putting yourself in the ideal position to exit the working world in style. What you do after that is up to you.

Rachel Podnos, JDCFP is a Washington, D.C.-based financial planner for Wealthcare LLC. She’s currently writing a financial advice book for millennials — look for it in 2019. Pamela Yellen is a financial investigator, the founder of Bank On Yourself and the author of two New York Times best-selling books.

Editors' Recommendations

- What is Kombucha: Fermented Tea 101 with Matt Thomas, Founder of Brew Dr.

Kombucha

- You Can Retire and Live in Margaritaville (This is Not a Joke)
- How a Lamborghini Huracan Performante Helped Me Get Out Of My Head
- El Cosmico Campground Offers Unique Shelters for the Vagabond in Us All
- Could Harley Davidson’s New Motorcycles Signal the Brand’s Rebirth?