Personal Finance 101

FINANCIAL E-BOOK

Retirement Planning

Types Of Retirement Investment Vehicles

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Types Of Retirement Investment Vehicles

Last week in Retirement Planning 101, we discussed what kind of assumptions you can use to figure out the island we call 'your number'. Once you figure out your number, there are really two very important ships that will get to that number. First, how much money do you need to save on a monthly basis to get to your number? Second, what rate of return on an after-tax basis do your assets need to earn to reach the retirement number?

This week, we will review some of the vehicles you can use to work toward your retirement goal.

1 Employer sponsored retirement plan (401(k), 403(b), 457)

Most employers whether they be companies, schools, hospitals, or government agencies will have a retirement plan they sponsor that allows you to save for retirement. The 401(k) plan is probably the most widely known of all of these plans. 401(k) plans allow employees to put away dollars on a pre-tax basis into an account that will grow tax-deferred for their retirement. Some employers will offer a matching program for employee contributions, and if you stay with your company for 5 or 6 years you will generally vest in the free contributions made by your employer. You will have a series of investment choices where you can invest it yourself or the investment company will have a pre-designed investment portfolio for you based upon your target retirement age or date. If you are under 50 years of age, you can put away up to $16,000 per year, and when you are over 50 years of age you can put away up to $22,000 year in the plan. For those just beginning, most plans will allow you to contribute as little as 1% of your gross income.

A new feature catching on in 401(k) plans is an option for a Roth 401(k) plan within the overall employer sponsored retirement plan. This feature allows you to put away dollars on an after-tax basis into the Roth 401(k) plan irrespective of your family's gross income. You can still grow the dollars tax-deferred, but the dollars will come out tax-free when you tax them out in retirement. With today's ever-changing tax environment, you should really consider strongly how you balance both pre-tax 401(k) and Roth 401(k) contributions.

2 IRA and Roth IRA plans

If you have no employer sponsored retirement plan, another option you have is to set up your own individual retirement account or Roth individual retirement account. For those under 50, you can generally put away up to $5,000. For those over the age of 50, you can generally put away up to $6,000. The traditional IRA contributions can be deductible if you do not have any employer sponsored retirement plan at all to contribute to during the year. If you do have a 401(k) plan, the contributions may or may not be deductible depending on your adjusted gross income. If you want to contribute to a Roth IRA, this will also depend on your adjusted gross income as well as to whether you can make yearly Roth contributions. The key with both the IRA and Roth IRA plans is the power of tax-deferral until you need the funds during retirement. Many people try to contribute to a Roth IRA as those contributions will be distributed tax-free during your retirement years.

3 Real Estate

Although many people recently saw the real estate bubble burst recently, real estate can be another investment vehicle to prepare for retirement. This can be true for both residential and commercial real estate. Beyond the hope of most investors that their real estate appreciates in value, some investors hope to rent their properties having a tenant pay off their mortgage before their retirement. This would allow the real estate to provide an additional income stream in retirement if it continues to be rented during retirement. It is important to consider your experience in buying real estate as well as the decision about being a landlord should you choose to use this vehicle for retirement savings.

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4 Stock Options, Restricted Stock, Deferred Compensation Plans, and other programs sponsored at work

The key here for most of you that are in these programs is to have a defined exit strategy out of these plans. Without setting a pre-determined exit price or stock option triggering strategy, you are not likely to be able to retire off of the options that management says is going to make you wealthy. In fact, many people spend the net cash earned from these options on buying a bigger primary residence, nice cars, or swanky vacation homes. It takes serious consideration in these types of vehicles to really 'earmark' what is actually going to be used for retirement.

5 Sale Of Your Business

We see many business owners today that put all of their eggs into the basket of selling their business. It is truly important to set up multiple strategies for your retirement vehicles, and not to banks solely on the sale of your business even for the best of business owners. Since in any business there can be regulatory change, industry change, or employee change, a business can go from being worth a lot of money to a little in a short period of time. Think about the tech bust and the real estate bust in the last 11 years that caused many businesses to be worth nothing.

6 Cash Value Life Insurance

One other option for those who max out their 401(k) and IRA/Roth IRA savings is overfunding a cash value life insurance policy. If these policies are funded and managed appropriately, it is possible to use these vehicles to grow after tax assets tax deferred and take those assets out on a tax-free basis down the road. It is important to understand that cash value must be managed correctly to work for the investor.

These vehicles are not an entire list, but will easily give you a great place to start when thinking about your retirement. No matter what vehicle(s) you use to fund your retirement, you will still need to figure out how much to save on a monthly basis and what rate of return your assets will need to earn to hit your number. Next week we will review investing within your retirement plans