

# 10 Commandments of Retirement Planning

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When it comes to retirement planning, sooner is always better than later.

Consider this illustration in the importance of time in retirement planning: a 25-year-old who saves \$5,000 every year for 40 years will retire with nearly \$1 million, assuming a 7 percent rate of return. A 35-year-old who begins saving \$5,000 annually will turn 65 with around \$472,000.

To get close to \$1 million in 30 years rather than 40, the 35-year-old would have to save twice as much as her younger counterpart.

Consistent saving as early as possible is key, but other factors will contribute to the success of your retirement plan. To ensure that you arrive at the promised land of retirement flush with cash, incorporate these 10 simple guidelines into your financial planning.

## 1. You shall get out of debt

Certain types of debt are toxic to building wealth. High-interest credit card debt can fester in your finances and cost more than can possibly be regained through saving and investing. Still, if you have access to a retirement account at work, take advantage of it. (See Rule 5.)

"If it's costing you a rate of interest and you're not getting a deduction for it, that would be the first order of business before you do any significant saving," says Brian Kuhn, Certified Financial Planner at Retirement Planning Services in Millersville, Md.

Mortgages and student loans score a pass due to the deductibility of the interest, but car loans and credit cards can sport interest rates well above yields on aggressive investments.

Pay off expensive debts and then accelerate retirement savings in earnest.

## 2. You shall have an emergency reserve

Getting out of debt and saving for retirement will be tough if you have to whip out a credit card to cover every crisis. That's why an emergency fund is the cornerstone of every financial plan. The general rule of thumb is to save three to six months' worth of living expenses, but that target can be hard to nail down, says Kuhn.

"We aim for a fixed dollar amount. The fixed dollar amount is whatever number you decide makes you comfortable, like \$10,000 cash in the bank," he says.

Pick an amount, save it up and then don't touch it -- until, of course, the inevitable emergency arises.



## 3. You shall have a budget

Budgets are not the most exciting topic in finance, but your budget will underlie all of your wealth-building efforts and keep you on track with everyday expenses and savings.

Just knowing the regular expenses and bills can help pin down where your money is going. There may be some fat that could be cut, which could translate to more savings.

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To further increase savings, pay yourself first. Savings, retirement and nonretirement, should be in the category of necessary expenses that must be paid every month, just like water and electricity.

"Our clients that chose to set themselves up with the checking account debits that automatically take money from checking to savings -- those people tend to always have more money," says Chris Reilly, Certified Financial Planner, senior vice president and retirement planning specialist at Firsttrust Financial Resources in Philadelphia.

"The people that choose to wait and see how much money they have left over at the end of the year -- the odds are not in their favor."

#### **4. You shall have a financial plan**

Your financial plan will be the road map to retirement.

Don't get overwhelmed, though. "Once you get through some of the basic variables in the beginning, it's really not that hard," Reilly says.

Some of the basic variables include the amount you currently have saved and how much money you'll need to retire.

A rule of thumb is to assume you'll need 80 percent of your current annual income in retirement. Subtract any known retirement income such as a pension or Social Security, and you have the amount you'll need per year in retirement.

According to the Social Security Administration, the normal retirement age is about 66 years. Many financial planners recommend running your financial plan to age 100, which means workers need to plan on financing about 34 years on average.

socking away money probably won't get you to retirement by itself. That's where wise investing comes in.

Use Bankrate's return on investment calculator to find the approximate rate of return your portfolio needs for you to reach your retirement goals.

The asset allocation of your portfolio will be based on rate of return as well as your time frame and risk tolerance.

#### **5. You shall use tax-favored retirement accounts**

The government encourages saving for retirement with special accounts that give you tax breaks.

Funds can be invested before taxes for investors who expect to pay a lower income tax in the future. Or money can be invested after taxes, as with a Roth account, where contributions and earnings can be taken out tax-free during retirement.

Investors can open an individual retirement account, or traditional IRA, or the Roth version. These accounts allow contributions of up to \$5,000 per year.

Some employers also offer retirement plans. There are several types of employer-sponsored plans, but the most common is the 401(k) plan. It allows workers to save up to \$16,500 per year.

Some companies don't offer retirement plans. Workers do have other options.

"There are non-employer-sponsored retirement accounts, such as municipal bonds, Roth IRAs and annuities -- both variable and fixed," says Reilly.

A trusted financial adviser can tell you if a cash-value insurance policy would make sense for your situation. If you've maxed out all of your retirement-saving options, it may be a possibility.



## 6. You shall save

Retirement planning takes time. It takes a number of years to save a substantial sum and even more for the magic of compounding to become apparent.

Don't wait to begin saving for retirement. Save what you can now instead of waiting until you strike it rich or are magically motivated to learn about investing.

"Put \$50 a month into a 401(k) plan. That is better than doing nothing; it adds up," says Herbert Hopwood, president of Hopwood Financial Services in Great Falls, Va.

Retirement planning is not all or nothing. It's a process. The sooner you start, the less you have to save in the long run. Aggressive investing can amplify your savings, but it's not a miracle.

On that note ... see commandment VII.

## 7. You shall take on an appropriate amount of risk

Investing for retirement is a long-term proposition. That means investors can take on more risk as their investments have a longer period of time to recover from any market volatility.

But, even with 40 years or more to invest, not everyone is comfortable watching the value of their retirement account go up and down.

Investing conservatively is not without risk either. Giving up the possibility of higher returns is an opportunity cost that could result in less money at retirement.

As there's only a finite amount of time and money for most people, meeting retirement goals may require compromise.

"If somebody is going to run their plan out at 4.5 percent and it shows they're on pace to get 70 percent of their retirement objective, then they need to either save more money, work longer or retire on less," says Larry Rosenthal, Certified Financial Planner and president of Financial Planning Services in Manassas, Va. "Or take more risk. Those are the four choices. Usually it ends up being a combination of all four."

## 8. You shall set goals

To stay on track for retirement, set goals within your financial plan.

"As you're putting money away, it's hard to say I want my money to grow by 'X' amount because you don't know what the market is going to do," says Kuhn. "But you can take it in five-year increments -- in five years I'd like it to be worth 'X,' in another five years I'd like it to be this."

Monitoring annual returns will let you know if your investments meet the overarching goals laid out in the financial plan.

"If their financial plan says they need a 5 percent return, they have no business being in something that is going to give them the chance for 30 percent returns," Rosenthal says.

"Maybe a portion, but they need to monitor their portfolio to make sure it is on pace to their financial plan," he says. "The market is not the barometer. Their plan is the barometer. Are they consistently staying on pace with their financial goals on an after-tax basis?"



## 9. You shall minimize fees

The more an investor pays in fees, the less is available for investing and compounding over time. Investors can minimize fees by shopping for a low-cost custodian for their IRA and searching for low-cost investments.

When choosing mutual funds, be aware of the expense ratio, which encompasses all of the fees that will be scooped out of the fund's assets on a yearly basis. According to a September 2010 report from the mutual fund trade association Investment Company Institute, the average expense ratio paid by 401(k) investors in 2009 was 0.74 percent. The average expense ratio for stock mutual funds in general is 1.48 percent.

It sounds like a petty amount, but compounded over 40 years, those fractions of a percent make a big impact.

Whether you use an active or passive investing strategy, focusing on low-cost funds is the best place to begin. Research by Morningstar in 2010 found that expense ratios are the most reliable predictor of performance. Low-cost funds beat their pricey counterparts in every test.

Mutual funds can also come with a sales commission, or load, attached. Look for a no-load fund and avoid paying an unnecessary fee.

## 10. You shall insure your ability to make money

Going through the retirement-planning process can become moot if catastrophe interrupts your ability to make, and therefore save, money.

"Insure your life and your ability to earn a living through disability," Kuhn says.

The amount you'll pay for insurance will be based on your age, occupation and income, but you can buy as much or as little insurance as your budget will allow.

"If you have a budget, you'll know how much you can set aside. Whatever that buys you, it's better than not having anything at all," says Kuhn.

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