9.5: Key Takeaways

Key Takeaways

Retirement planning is a major issue facing most people in the United States. Between the looming challenges facing Social Security (can you fix them?) and the decline in traditional defined-benefit pension plans, more individuals are going to need to save for their own retirement. While we have introduced the concepts of time value of money, bonds, stocks, and risk-and-return over previous chapters, the purpose of this chapter is to provide students with information on the principal tools available for meeting retirement goals – mutual funds, Individual Retirement Accounts, and 401(k) plans. Mutual funds provide a simple, potentially low-cost method for investors to easily invest their potential retirement savings. These can be used inside tax-advantaged retirement accounts (such as IRAs and 401(k) plans) or outside of tax-advantaged retirement accounts. IRAs and 401(k) plans are not investments, but tax shelters to protect investment income from taxes in order to help individuals better prepare for retirement. Unfortunately, the state of retirement savings in the US is in poor shape with the average (mean) retirement savings for families in the 56-61 age bracket being a mere $163,577 as of 2013. To put that in perspective, that would provide a couple with $956.25 per month in retirement income (or less than $12,000 per year) for 25 years if they could earn a 5% return over that 25 years. While that is not good, the picture is actually much worse. Because of the skewed nature of retirement wealth (if one family has $1,000,000 and 9 families have $70,000 each, that will provide a mean of $163,000 even though 90% of the families have less than half of the average amount), the mean likely overstates the retirement health of most families. If we instead turn to the median (half of the families have more and half have less) instead of the mean, half of families in the 56-61 age bracket have less than $17,000 saved for retirement. For the same 25 years with a 5% return, they would have just under $100 a month in retirement income. Using the tools covered in this chapter and the discipline to develop a savings plan, your chances of having a much healthier retirement is highly probable. Saving $200 per month and getting a $100 match from your employer from age 25 through age 64 (40 years) at 8%, will generate $1,047,302 available for retirement. This requires neither aggressive savings or unrealistic return assumptions.

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