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O'KEEFE INVESTMENT MANAGEMENT

Saving for Retirement



Although most of us recognize the importance of sound retirement planning, few of us embrace the nitty-gritty work involved. With thousands of investment possibilities, complex rules governing retirement plans, and so on, most people don't even know where to begin. Here are some suggestions to help you get started.

Determine your retirement income needs

Some experts suggest that you need anywhere from 60% to 90% of your current income to enable you to maintain your current standard of living in retirement. But this is only a general guideline. To determine your specific needs, you may want to estimate your annual retirement expenses.

Use your current expenses as a starting point, but note that your expenses may change dramatically by the time you retire. If you're nearing retirement, the gap between your current expenses and your retirement expenses may be small. If retirement is many years away, the gap may be significant, and projecting your future expenses may be more difficult.

Remember to take inflation into account. The average annual rate of inflation over the past 20 years has been approximately 3%. (Source: Consumer price index (CPI-U) data published by the U.S. Department of Labor, 2010.) And keep in mind that your annual expenses may fluctuate throughout retirement. For instance, if you own a home and are paying a mortgage, your expenses will drop if the mortgage is paid off by the time you retire. Other expenses, such as health-related expenses, may increase in your later retirement years. A realistic estimate of your expenses will tell you about how much annual income you'll need to live comfortably.

Calculate the gap

Once you have estimated your retirement income needs, take stock of your estimated future assets and income. These may come from Social Security, a retirement plan at work, a part-time job, and other

sources. If estimates show that your future assets and income will fall short of what you need, the rest will have to come from additional personal retirement savings.

Figure out how much you'll need to save

By the time you retire, you'll need a nest egg that will provide you with enough income to fill the gap left by your other income sources. But exactly how much is enough? The following questions may help you find the answer:

- At what age do you plan to retire? The younger you retire, the longer your retirement will be, and the more money you'll need to carry you through it.
- What kind of lifestyle do you hope to maintain during your retirement years?
- What is your life expectancy? The longer you live, the more years of retirement you'll have to fund.
- What rate of growth can you expect from your savings now and during retirement? Be conservative when projecting rates of return.
- Do you expect to dip into your principal? If so, you may deplete your savings faster than if you just live off investment earnings. Build in a cushion to guard against these risks.

Build your retirement fund: Save, save, save

When you know roughly how much money you'll need, your next goal is to save that amount. First, you'll have to map out a savings plan that works for you. Assume a conservative rate of return (e.g., 5 to 6%), and then determine approximately how much you'll need to save every year between now and your retirement to reach your goal.

The next step is to put your savings plan into action. It's never too early to get started (ideally, begin saving in your 20s). To the extent possible, you may want to arrange to have certain amounts taken directly from



Distributions from retirement plans, IRAs, and annuities prior to age 59½ may be subject to a 10% penalty tax unless an exception applies.

your paycheck and automatically invested in accounts of your choice (e.g., 401(k) plans, payroll deduction savings). This arrangement reduces the risk of impulsive or unwise spending that will threaten your savings plan. If possible, save more than you think you'll need to provide a cushion.

Use the right savings tools

Employer-sponsored retirement plans like 401(k)s and 403(b)s are powerful savings tools. Your contributions come out of your salary as pretax contributions (reducing your current taxable income) and any investment earnings grow tax deferred until withdrawn. Some 401(k), 403(b), and 457(b) plans also allow employees to make after-tax "Roth" contributions. There's no up-front tax advantage, but qualified distributions are entirely free from federal income taxes. In addition, employer-sponsored plans often offer matching contributions, and may be your best option when it comes to saving for retirement.

IRAs also feature tax-deferred growth of earnings.

If you are eligible, traditional IRAs may enable you to lower your current taxable income through deductible contributions. Withdrawals, however, are taxable as ordinary income (except to the extent you've made nondeductible contributions).

Roth IRAs don't permit tax-deductible contributions but allow you to make completely tax-free withdrawals under certain conditions. With both types, you can typically choose from a wide range of investments to fund your IRA.

Annuities are generally funded with after-tax dollars, but their earnings grow tax deferred (you pay tax on the portion of distributions that represents earnings). There is also no annual limit on contributions to an annuity.

Note: *Distributions from retirement plans, IRAs, and annuities prior to age 59½ may be subject to a 10% penalty tax unless an exception applies.*

You have several options for saving for your retirement. How do you know what to do? Here's one common approach:

1 First contribute to employer-sponsored retirement plans, at least enough to get full company match

- Employer match is "free" money (you may forfeit match if you don't work for a given length of time)
- Dollars grow tax deferred until withdrawn
- Systematic payments from your paycheck--you'll hardly notice
- Most plans allow pretax contributions resulting in an immediate savings
- Certain plans may allow Roth contributions--tax free when withdrawn, earnings tax free if "qualified distribution"
- But, investment choices might be limited

2 Then contribute to IRAs

- Many investment options
- Traditional IRA contributions may or may not be tax deductible; Roth IRA contributions made with after-tax dollars
- Dollars grow tax deferred until withdrawn
- Roth IRA contributions tax free when withdrawn, earnings tax free if "qualified distribution"
- Can contribute up to \$5,000 in 2010 and 2011 (individuals age 50 and older may contribute an additional \$1,000)

3 Other options: annuities, stock plans, life insurance, other investments (e.g., stock, mutual funds), nonqualified deferred compensation, salary continuation plans

- Annuities, life insurance and other options have unique tax advantages
- Current lower capital gains tax rates make some equity investments more attractive for retirement planning
- Some options may be complex, and timing of taxable events may be difficult to control

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