
Investing and Saving for Retirement
A SIMPLE GUIDE TO A COMPLEX SUBJECT
SEAN SEALES

Retirement

A Simple Guide to a Complex Subject

by

Sean Seales

This book is intended only as an introduction to the subject of investing and saving for retirement and not as financial advice. The author has no affiliation with the organizations mentioned in this book, but may own funds used as examples.

Feel free to write the author to provide your comments or suggestions at seanseales (at) outlook (dot) com.

Preface

This book is intended for those who need a very basic introduction to investing and saving for retirement. It's an intro to “financial literacy” in the area of investments, and is not intended to provide you with definitive advice, or delve deeply into the theories of finance. This book is intended to provide clear and concise information about this subject matter to normal people who want to retire one day. Being an introductory primer, this book focuses on investment funds, including actively managed mutual funds and exchange traded funds that track a stock index. It also emphasizes selecting a high quality and well diversified investment portfolio, i.e. not “putting all of your eggs in one basket.”

This book is short, by design, so that you don't feel like the financial firehose was just turned on you. Hopefully, you can quickly get moving in a positive direction to make some important decisions more quickly than with a 300 page book. Sometimes these subjects can be confusing and intimidating, but this can be avoided through learning some of the basics of investing that the investment companies won't necessarily offer up front.

The book focuses in on some key information that you can use to quickly begin deciding how you will plan to retire. The most vital information that you can use to get started is presented first. Later chapters provide additional information that you may find more useful if you want to do your own investment research. Where indicated, portions of this book are reprinted from government sources providing some good information regarding investing.

While not specifically stated in each chapter, if you are seeking to make an investment decision in the near future and have questions about what to do, it's usually a good idea to seek out the advice of a professional. This may be Certified Financial Planner, Registered Investment Advisor, attorney, or accountant knowledgable of these topics. Other types of investment professionals who're paid based on their sales can also provide useful information, but are not usually required to point out better alternatives to what they're offering you.

This book is provided free of charge for personal, non-profit or educational use, and is not permitted to be sold for any purpose by other parties. Feel free to redistribute information in this book to your friends and relatives, and please consider making a $5 donation or more to one of the charities listed below:

- American Red Cross
- Catholic Charities
- UNHCR (UN Refugees)
- UNICEF

Contents

1

Saving Money for a Rainy Day

One of the first things you should consider before you invest is “What would I do if I lost my current source of income?” How would you survive for the first six to 12 months of unemployment or the loss of your current income source? Unless you have a good answer for that, then you should consider the amount of savings you currently have in the bank. When it comes to emergency funds, it's best to have a source of money that is readily available and not subject to market downswings. Usually this means having money in a cash account. Some stock brokerages provide cash accounts, and some are even accessibly through ATM cards. While this may be changing, most people are more comfortable doing their banking in person with a bank down the street. Some other benefits to this is having a local place to go when you need a loan or when things go wrong with your account. Another important consideration is the ability of your spouse or other dependents to access money in the account in the event of an emergency.

However, if you're comfortable with technology and remote customer service, some online banks offer significantly better interest rates for savings accounts. As of this writing, there were online savings accounts offering 1.25%, with few fees. If may make sense for you to have a local checking account linked to a higher interest online savings account, keeping at least enough money in checking to pay near term bills.

If you've provided for your dependents to have access to a second ATM card and your PIN in an emergency, then they would probably be able to access these funds in the short term. However, you may also want to discuss with the bank how you can put their names on the account to ensure they have access, or consult an attorney regarding estate planning.

Your emergency fund in your bank or credit union should be enough to take care of yourself and your dependents for at least six months, although some would suggest having as much as twelve months. In addition to that, it would be a good idea to have enough cash to cover your monthly bills.

Some institutions have better reputations or fee schedules than others. While this book will not attempt to tell you which ones are best, here are some sources of information to help you select one:

- Bankrate
- Forbes, America's Best and Worst Banks
- US News, 10 Best Banks
- Wallethub's credit union search tool

High banking and ATM fees can sometimes eat up your savings or checking account balance, which is why some people prefer online banks and credit unions to traditional banks. Take note of the bank's key terms of service, such as any restrictions as to how and when your money is available, or unusually high fees. Comparison shopping and reviewing online reviews is usually also a good idea.

Sometimes banks offer short-term bonuses of $50 to $500, depending on the amount you plan to transfer into a new account. There are usually rules regarding how long you must keep the money in the account, and sometimes the interest rates are fairly low. However, there are often ways to take advantages of these bonuses and come out ahead.

Similar to bank accounts, many credit cards are offered with points or cash bonuses for establishing a new account. While their relative benefits may fluctuate, the one common item to remember is that you should plan to pay them off every month, or begin incurring high interest rates and fees. Some card companies do offer temporary 0% interest periods of up to a year on balance transfer, which would make sense for someone having a balance. Paying off high interest debt before making any investments is a smart idea. You will be hard pressed to find a better return on investment through putting money into the stock market.

2

Simple and Quick Ways to Invest

This chapter is intended for those who don't want to spend a lot of time worrying about where to put their money for retirement. Assuming you've got an emergency fund established at the bank or credit union, there are many easy and quick options for retirement savings. We will review a few affordable “all-in-one” choices for retirement investing, and later the book will discuss some other investment options.

By “all-in-one,” I am referring to mutual funds having target dates: the year you plan to start drawing money to pay for your life in retirement. These funds split your lump sum into multiple types of investments, which are contained within the fund. You put money into this one target date fund, and they automatically diversify, or split up this this money, based on the risk level that your target date would normally call for.

Diversification is a topic that will be covered later in the book, in case you'd like to know more about what these funds are doing. For now, just remember that it's spreading the risk, on the premise that different parts of the market don't usually all go up or down at once, but generally go up in the long-term as a whole. It also involves dividing your money between lower risk and higher risk investments, depending on your individual needs.

Each year, the mix of investments is changed so that its less risky than in prior years. When the fund reaches the “target date,” or the year you need to start spending the money, then its underlying investments are put into stocks or bonds intended to generate income. If you're already retired and need income from your investments, then you would probably select a Retirement Income fund, rather than a target date fund.

Each mutual fund company has a different method for doing this, which means these types of funds may react somewhat differently to market events. The fund companies may have different philosophies regarding the best way to split up this money. Here is an example of how a family of target date funds might divide your money differently, depending on the year you select:

2040 fund:

- 19% in US Treasury bonds, 6% in corporate bonds, 38% in large company stocks, 16% in medium sized company stocks, and 21% in international stocks.

2030 fund:

- 29% in US Treasury bonds, 6% in corporate bonds, 34% in large company stocks, 12% in medium sized company stocks, and 19% in international stocks.

2020 fund:

- 44% in US Treasury bonds, 5% in corporate bonds, 27% in large company stocks, 8% in medium sized company stocks, and 15% in international stocks.

Retirement income fund (drawing money from it now):

- 74% in US Treasury bonds, 6% in corporate bonds, 12% in large company stocks, 3% in medium sized company stocks, and 5% in international stocks.

As you can see, the percentage going to very low risk investments, the US Treasury bonds, increases dramatically as you get closer to your target date. As the years go by, the 2030 fund will look a lot more like the 2020 fund, and then automatically turn into the Retirement Income fund. This all occurs without you having to move money between funds, which is a primary benefit of the target date funds. Having the low risk Retirement Income portfolio means you hopefully wouldn't lose too much principal to stay retired if the stock market goes down. By that time, the bulk of your money will be in low risk investments, just hoping to keep up with inflation rather than grow much more.

Some companies may also charge additional fees, having a higher than normal annual management fee or fees you're charged upon purchasing or selling shares. You will generally want to avoid these funds unless you've identified a compelling reason to invest in them. On the other hand, firms charging almost nothing are usually investing in stock index-based investments, rather than fund management staff screening and selling stocks on a continuous basis. Your investments would be on “automatic pilot” for the most part. Most active management fund managers have great difficulty beating the stock indices, but there are some standouts that you should consider before going for the one with the lowest management fee. Later in the book, I will describe how to research this.

In selecting a fund company, you will need to decide whether to use an investment firm that is only online, one that also has a branch office near your home, or a fund for which there is a stock brokerage that will buy and sell you shares at a reasonable cost. Some mutual fund companies, such as Fidelity and Schwab, have hundreds of offices across the country in case you'd rather not use their website to invest. I would personally avoid using a fund or brokerage requiring a transaction fee in order to purchase or sell shares in a fund. This can make a major dent in your investments over a long period of time. They are already earning their pay through the annual management fee, which should hopefully be less than 1% on domestic stock funds or below 1.5% for international funds. Some would say this is too high, but I'd also take into consideration how well the fund is doing relative to its peers and to the stock index it tracks. If its fee is 0.3% more than a low-cost fund, but consistently beating the cheaper fund by 3% high return each year, then I'm not as worried about the management fee.

Once you decide the year of your retirement, or “the target date,” how do you figure out what the best target date fund is for you? Some of the top names in the target date mutual fund business are American Funds, Fidelity, T. Rowe Price, and Vanguard. As with banks, the internet has lots of information available to help you decide which fund is right for you. Here is a comparison of the “target date 2030” funds from these four companies:

- American Funds

- 2030 Target Date Retirement (REETX)
- Minimum investment: $250 ($25 for IRAs)
- Annual fee: $46 for every $10,000 invested
- This fund was less than 10 years old as of 2015.
- A $10,000 investment made in 2010 was worth about $16,000 in 2015.
- Its underlying investments are actively managed, rather than being tied to stock indices.

* Fidelity
  - Freedom Index 2030 (FXIFX)
  - Minimum investment: $2,500
  - Annual fee: $16 for every $10,000
  - This fund was less than 10 years old as of 2015.
  - A $10,000 investment made in 2010 was worth about $16,000 in 2015.
  - Its underlying investments are tied to stock indices.
* T. Rowe Price
  - Retirement 2030 (TRRCX)
  - Minimum investment: $2,500
  - Annual fee: $73 for every $10,000 invested
  - A $10,000 investment made in 2005 was worth

about $20,000 in 2015.

    - A $10,000 investment made in 2010 was worth about $18,000 in 2015.
    - Its underlying investments are actively managed, rather than being tied to stock indices.
- Vanguard
    - Target Retirement 2030 (VTHRX)
    - Minimum investment: $1,000
    - Annual fee: $17 for every $10,000 invested
    - This fund was less than 10 years old as of 2015.
    - A $10,000 investment made in 2010 was worth about $17,000 in 2015.
    - Its underlying investments are tied to stock indices.

Beyond the differences shown above, they each differ in regards to the types and amounts of investments make over their lifetimes and other important areas. People who're concerned about their portfolio being too risky may want to consider the amount being put into stocks versus government bonds and high grade corporate bonds. You can compare them using any of the free stock information websites discussed later in chapter 4 and by reviewing their prospectus. Another option is to diversify your investments between two, three, or four funds having the same target date, rather than putting everything with one fund company. There are differing opinions on the use of target date funds, but they can provide a diversified, simple and relatively low cost way of investing for retirement.

If your employer has established a 401k plan or other tax-deferred retirement plan offering access to target date funds, then you should review the fees associated with these funds, and the benefits of investing in them. Sometimes it makes sense to invest in your employer's plan if they offer to match your contribution. In other cases, the fees can be much more costly than what's available from a different mutual fund company. These 401k plans usually offer a higher amount of tax deferred savings than what's available from Individual Retirement Accounts (also called “Arrangements”) at a mutual fund company, which is one of their main benefits.

The rules for contributing to workplace employment plans and IRAs can be complex if your income exceeds certain thresholds. You may want to consult the Internal Revenue Service's website or your tax professional before contributing to both. Generally speaking, you may contribute up to $18,000 in tax deferred income to your employer's 401k plan. This money goes in without taxes being taken out, but you pay income taxes on any withdrawals after you retire.

On top of this $18,000, most people earning less than $118,000 per year may also contribute $5,000 in post-tax income to a Roth IRA. This type of IRA allows for the tax-free growth of this money after you pay taxes on the principal.

You may also contribute as much as you can afford to taxable accounts, where the invested amount is post-tax dollars and you also pay taxes on dividends, capital gains, and other earnings. Funds can sometimes generate capital gains in a taxable account, even if you haven't sold any shares of the fund, but most capital gains taxes will be due after you've sold shares at a profit.

If you're investing in target date funds for the long-term, with the goal of living off this money in retirement, then “Dollar cost averaging” is a good idea. This means putting in regular amounts every month, depending on what you can afford and also depending on your retirement plans. There are many online investment calculators that can give you an idea of how much money you'll need to save in the future to help meet your retirement objectives, such as:

- Vanguard's Retirement Nest Egg Calculator
- Bankrate's Retirement Planner

Generally speaking, if your financial situation allows, you should save or invest at least 10% of your income starting at a fairly early age. If you're getting a late start, then you may want to consider investing a larger percentage of your income. If you have a complex financial situation, then other considerations may need to be made, such as the amounts and types of insurance you have. A Certified Financial Planner or Registered Investment Advisor could provide independent advice to assist you with making your decisions. Another good resource is a financial literacy website created for the public by the American Institute of Certified Professional Accountants: http://www.feedthepig.org.