Financial Well-being

BASIC INVESTING AND RETIREMENT PLANNING

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You are well on your way toward managing your financial well-being and then someone asks you **"the question."** Do you think that you will have enough money for retirement? Maybe you haven't thought about it or maybe you don't have a good answer. How much is enough money? How much should I save each month?

In general, a couple of financial experts suggest you will need 17 times your current income or 25 times your expenses when you retire. The reality is that your needs will depend on your unique situation. You should estimate your need based on your own data. If you are just starting to think about your retirement or just starting to invest, it is stressful, complicated and you may have more questions than answers. You are not alone. This is a very complex topic and you will need to continue to educate yourself well beyond the basics.

To give you a starting point, let's cover the basics.

Let’s start

We will assume that you have a foundation in place – you have an emergency fund with 3-6 months of monthly expenses saved – and you are looking at investing for the long-term. You’re next step is to learn investment basics. Note: if you don’t have an emergency fund, review our Financial Well-being - Savings document to get started.

Let’s start investing:

1. Estimate how much money you will need to retire and live comfortably. There are a lot of different calculators to help you estimate how much money you will need at retirement. Your 401(k) or 403(b) plan most likely has a calculator that you can use to complete this calculation. Gather some basic information to get a more accurate estimate:

   a. Your annual income.
   b. Your current age and the age when you plan on retiring.
   c. The total amount of retirement savings you currently have. Note: Deduct any 401(k) loans that you have out of your current savings balance since there won’t be any return on that money.

d. The % of your income you will need post retirement. This percentage depends on your situation and the expenses that you have when you retire. If you pay off your mortgage before you retire, you may have fewer expenses when you retire and may be able to use a slightly lower percentage. If you want to travel or start another hobby when you retire, you will need to make sure you have money to cover your new plans. Most people will have a greater level of medical expenses later in their life so you may want to adjust your expenses in that area. Start with the % of income that you currently spend each month. Then adjust the percentage based on the changes that you expect to have during retirement. When in doubt, use a higher % such as 75-80%.

e. The number of years that you estimate you will need retirement income.

f. An estimated investment return rate. Note: many of the calculators will help you in this area.

g. Your retirement income sources – social security, retirement investment funds, and other sources.

2. Create a plan to address any shortages. You may need to save more money in your 401(k) or 403(b), pay off any 401K loans, and invest in a Roth IRA, Traditional IRA, and/or other investments.
3. Maximize your 401(k) or 403(b) contributions so that you have invested as much as you can up to the maximum amount allowed by the IRS. Your employer may match your contribution up to a certain limit – if they do, make sure you are contributing at least the minimum to earn all of your employers match money. After all, it is “free money.”

You may understand the basics, but the terminology can be confusing. We have defined some of the basic terms to help you start exploring your investment opportunities.

Investment Options

Types of Retirement Accounts

401(k) – an investment plan offered by for-profit employers. It allows an employee to save part of their earnings tax fee. Employers usually partially match the employee’s contribution up to a certain %.

The employee pays taxes on this investment when the employee's contributions and returns are paid out of the 401(k) plan. There are limits to the amount that you can contribute to the 401(k). Also, there is usually a period of time before you are "vested" with your 401(k). "Vesting" refers to the timing of when you are entitled to keep all of the employer's contributions to your 401(k), even if you leave the employer.

403(b) – an investment plan offered by non-profit employers (specifically public education, hospital services organizations, self-employed ministers, and some non-profit employers). It allows an employee to save a portion of their earnings tax fee. Employers may partially match the employee's contribution up to a certain %. The employee pays taxes on this investment when the employee's contributions and returns are paid out of the 403(b) plan. Employers may also provide a designated Roth IRA option with their 403(b). There are limits to the amount that you can contribute to the 403(b) and the designated Roth IRA. If you are eligible to participate in a 403(b), talk with your employer to learn more about the investment options and vesting requirements associated with your 403(b).

Roth IRA – an individual retirement account (IRA) where you pay taxes on the earnings prior to adding them to the account. The increase in value is not taxed and you don't pay any taxes when the funds are paid out of the account assuming that you follow the IRS rules. In most cases, Roth IRAs are considered to be a better investment option than a Traditional IRA because you don't pay taxes on the return on your investments. The theory is that your retirement income will be lower than your current income and therefore you will pay a lower amount of income taxes over your lifetime.

Traditional IRA – an individual retirement account where you can contribute a portion of your earnings tax fee. There are limits on the annual contribution, and you pay taxes when the funds are paid out of the IRA. The advantage of a Traditional IRA vs. a Roth IRA over the short term is that you will pay less taxes in the current year when you contribute to a Traditional IRA, assuming that you meet the IRS tax requirements.

Investment Types

Stocks – you own a percentage of a company based on the number of shares you have. The value of your shares change as people decide on a daily basis how much they are willing to pay for each share. Some companies issue a dividend to the stockholders. A dividend is a periodic distribution of the company's earnings and makes the stock more attractive.

Bonds – these are issued when companies or governments borrow money. You are basically lending the issuer money and they pay that money back based on the terms (agreement) stated on the bond. There is usually a fixed borrowing period and interest rate on the bond.

Mutual Funds – these usually represent an investment in a group of stocks, bonds or a combination of both. An investment firm manages the fund and decides what investments are included. Mutual funds usually invest in certain types of stocks or bonds. They will describe their approach in their investment objectives. The fund itself holds the stocks, bonds, etc. and you own a portion of the fund. You pay a fee to the firm for the management services.

Additional Investment Terminology

When you enter into the investment world, you will see a variety of words used to describe different investment assets, what investors consider when they invest, and costs that offset the growth of your investments. We have included the basics below, but it is just a starting point. There is a lot to learn and when you are ready, we suggest that you start by reviewing your 401(k) or 403(b) website. You can also review some of the documents referenced below, or one of the many financial resources that are found online (Morningstar, The Motley Fool, WISEBREAD, INVESTOPEDIA, etc.).

Earnings Per Share – the company's profit divided by the number of shares of stock outstanding.

Plan Expenses – mutual funds charge an annual percentage based on the funds they manage. The fee (expense ratios) covers the funds costs and includes the fund manager's profit. In general, you want the lowest expense and the highest increase in value. If you can get a much higher return, you may more than offset the plan expense. Slightly higher than 1% is average for mutual funds.

Price to Earnings (P/E) Ratio – tells you how many years that it will take a company to pay back the price of one share of stock based on the current earnings and number of shares. If the company's profit is $1 per share and the stock price is $20, then the P/E ratio is 20 ($20 per share divided by $1 per share in earnings).

Market Capitalization – a company's market capitalization is based on the total number of outstanding shares that they have, usually calculated quarterly, and the current stock price.

Large Cap – "Larger Market Capitalization" includes bigger companies who are capitalized at a value of more than $5 billion dollars. Capitalization is based on the total number of shares of stock times the stock price. Larger companies with higher capitalization rates and a long track record of success are generally considered to be more conservative investments.

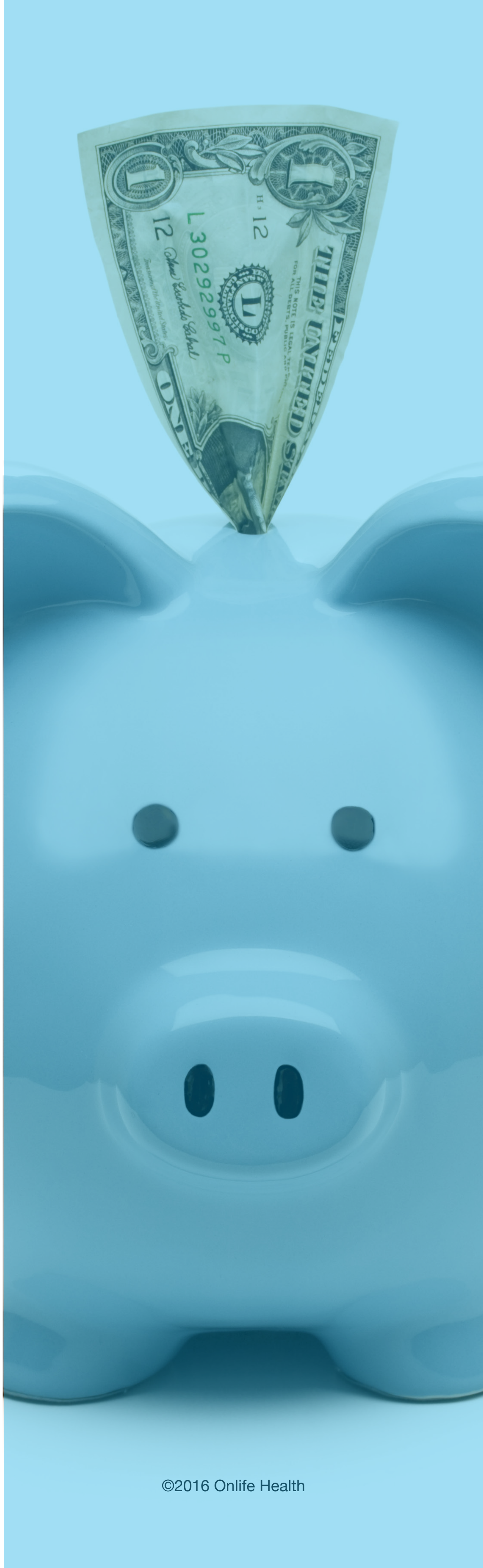
Small Cap – "Smaller Market Capitalization" includes smaller companies who are capitalized at a value less than $1 billion dollars. These companies are not small, but are smaller than the mid or large cap companies. Capitalization is based on the total number of shares of stock times the stock price. Smaller companies and companies with a shorter time in business are generally thought to be riskier and more likely to go bankrupt.

Risk vs. Reward

In general there is a trade-off between risk and reward, the higher the reward the greater the level of risk. If you are looking for less risk, you are most likely going to see lower returns. Risk tolerance is based on your personality, experience and age. Typically, you are less willing to take risk if you are older and have a shorter time to recover from your losses. Your risk not only relates to the earnings on your investments, but can apply to the loss of the money you contributed (principal) as well. You cannot totally avoid risk and have a reasonable return, but you can manage your risk.

Here are two areas to consider as you evaluate your investment risk:

1. **Your portfolio.** All of your investments combined should be diversified or spread across different types of assets (mutual funds holding stocks and bonds, or stocks and bonds directly). For most basic investors, you are most likely invested in mutual funds. The distribution of the assets held by your mutual funds overall should be consistent with your risk tolerance. If you have a low risk tolerance or are older, you will want to hold a higher % of bonds vs. stocks in your mutual funds.



If you are more risk tolerant or younger, you will want to have a more aggressive blend of stocks to bonds and invest more of your dollars in mutual funds investing in stocks vs. bonds. Note: some funds invest in stocks, bonds or are a mix of both. Your 401(k) provider and a variety of other resources, like your fund prospectus, are available from your broker, or 401(k) provider, or directly from the fund company. They can help you evaluate the types of assets that your fund is invested in (or the fund objectives and strategies) and calculate the right blend of stocks and bonds based on your situation.

Keep in mind, as the parts of your portfolio increase or decrease in value, you will need to adjust the % of your portfolio that you invest in each fund to retain the desired distribution (rebalance). If you are looking for an alternative to help you balance your portfolio risk, you may want to invest in "target date funds." Target date funds are funds that automatically shift their investment distribution based on the target date. The target date number is based on your expected retirement age. The closer the target date (year) is to the current year, the more conservative the distribution blend is in the fund.

2. Your fund's risk to return ratio – in general individual mutual funds with higher returns historically will also have higher levels of risk. You may have a limited number of fund options to choose from and may not be able to find funds with a lower risk to return ratio. In general you should review the risk ratio using a rating service or the data at your 401(k) site and look for funds with higher returns and a lower risk to return ratio.

Additional Information

Find more information about mutual funds at Investor.gov **https://www.investor.gov/investing-basics/investment-products/mutual-funds.**

Two commonly used rating services are Morningstar and Lipper Ratings. The ratings on these sites are based on historical performance, which is not necessarily an indicator of future success. These ratings are helpful when you are comparing multiple funds.

Looking for a financial planner?

Unfortunately there isn't a reliable rating service available for financial planners like there is for funds. Through **NAPFA.org** you can find fee-only, meaning you must pay

for these services, planners belonging to the National Association of Personal Financial Advisors.

Looking for help in evaluating your future financial advisor or planner?
Review the information provided by the Consumer Financial Protection Bureau at **Know your financial advisor**.

Since everyone's situation is different, if you need more information, find a financial planner in your area that you can trust to help you continue along your financial wellness journey.

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