

## Financial Workshop Series: Investment 101

### Investing & Retirement Planning

Too many women do not feel comfortable managing their money or they leave it to others. There is no reason for that. Financial independence should **EMPOWER** you! You can be rich at any income if you invest wisely. For example, a few years ago there was an article in *The Wall Street Journal* about a lady who cleaned houses for a living and who never earned more than \$22,000 a year was able to donate almost \$1million to a state school upon her death. **Financial independence happens step by step.** So, it's not how much you earn, it's how much you save and invest!

#### WHERE DO I START?

1. Prepare a budget to **SAVE** and know where your money goes. You should already be doing one.
2. Start a savings plan by paying yourself a set amount out of every paycheck before you pay any expenses or, even better, set up an automatic withdrawal to transfer money automatically into a savings account out of every paycheck. (Pay Yourself First).
3. **CONSISTENCY** is key – there is no such thing as a get rich scheme, but time is on your side.
4. Take advantage of **dollar cost averaging**. Dollar cost averaging occurs when one invests the same amount each time in an investment, but since the price of the mutual fund varies each time you contribute, so does the number of shares that you buy each time. For example, if you contribute \$50/month and in month #1 the cost of the mutual fund is \$25, you buy 2 shares. If in month #2, the cost of the mutual fund is \$22, you now own 2.27 shares. Over time, your cost basis (the average cost of all of your shares) will average out and you will not have to “time the market” or choose when to invest, based upon the prices at one point in time.

#### TYPES OF INVESTING

1. **Stocks/Securities:** (equity) where you own shares in a company.
2. **Bonds:** (fixed income) an investment that raises debt for a company, where the investor (you) receives interest on a regular basis (usually monthly) for a set period of time. A rule of thumb, as interest rates increase, bond prices decrease.
3. **Mutual funds:** an investment that invests in a variety of stocks and/or bonds, many times, with a particular investment focus. When you buy shares in a mutual fund, you are buying a small portion of every stock and/or bond that is in the mutual fund. It is not recommended to invest in individual stocks or bonds unless you have a strong understanding of investments.

#### HOW MUCH DO YOU NEED TO RETIRE?

Most people **underestimate** how much money they will need in retirement. According to a 2002 study by the Employee Benefit Research Institute (EBRI):

- Only 6% of all workers have accumulated \$250,000 or more for retirement;
- 47% have amassed less than \$50,000; and

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- 15% have saved **NOTHING** at all.

According to Charles Schwab research, you will need **about the same annual income in retirement as you did before retirement**. Most people neglect to factor in **inflation**, which makes items you buy in the future more costly than today. Look at what happened to the price of gasoline in the last 2 years. Additionally, no one can predict the future economic environment when we retire (such as high interest rates, high inflation, etc.)

**A Recent June 2006 Wall Street Journal article suggested that we should be saving MORE than originally thought – we should be saving 15% of your current income before taxes to prepare for retirement - assuming that you start saving in your 20’s. If you don’t start until later, you need to save more than 15%/year in order to maintain your lifestyle.**

**Another View is Charles Schwab’s Estimator:**

In order to have a beginning annual retirement income of **\$40,000 (\$3,333/month or 3.3 x 1,000)** that keeps pace with inflation, a moderate investor with a 30-year retirement time horizon (retire at age 60 and live until 90) would need to have approximately **\$1 million** (3.33 x 300,000) socked away. This translates into a withdrawal rate of roughly 4% of the portfolio’s value each year.

What you may need for each \$1,000 of monthly income for approximately 90% confidence level:

Time in Retirement	ASSET ALLOCATION				
	Conservative	Moderately Conservative	<b>Moderate</b>	Moderately Aggressive	Aggressive
20 years	\$220,000	\$230,000	\$240,000	\$250,000	\$270,000
<b>30 years</b>	\$300,000	\$300,000	<b>\$300,000</b>	\$330,000	\$340,000
40 years	\$370,000	\$350,000	\$360,000	\$370,000	\$410,000

\*Moderate: 30% large-cap mutual funds, 15%mid/small-cap, 15% international, 30% bonds, 10% cash

Example: You earn \$24,000/year – that is \$2,000/month (24,000/12). The chart above is based upon each \$1,000 of monthly income, so divide: 2,000/1,000 = 2. So if you plan to be in retirement for 30 years (expect to retire at 60 years old and live until 90), and you invest with a moderate asset allocation, you will need \$300,000 x 2 = \$600,000 in retirement. (If Social Security is still available, it will help to contribute to the \$600,000 needed – but don’t count on it).

**Sample Retirement Saving Scenario:**

Scenario: I am 40 years old, earn \$40,000 per year, have NOT SAVED ANYTHING, but will collect \$8,000 per year in Social Security. If I plan to retire at age 65, I need to save **\$14,169 PER YEAR** for the next 25 years (**or work longer than age 65**). I will need \$525,000 in retirement (excluding Social Security). Assumptions: 3% inflation, live until 87 years old, will need \$40,000 in income at retirement.

You need to be saving 30-35% of your gross salary if you just start saving for retirement in your early 40's, in your 30's, focus on 25-30%.

## **SAVING FOR RETIREMENT: 401(K), 403(B), and IRAs**

1. Know if your company or organization offers a 401(K) or 403(B) retirement plan. **401(k)** is a plan that allows you to invest tax-deferred for retirement if you work for a for-profit corporation that offers a program. **403(b)** is a plan that allows you to invest tax-deferred for retirement if you work for a non-profit corporation/school that offers a program. An **IRA** is a structure that allows you to invest either tax-deferred or tax-free for retirement if you are self-employed or meet other requirements such as a maximum salary. **Tax-Free** means you never have to pay taxes on the investment. **Tax-deferred** means that you pay taxes upon withdrawal of the money at retirement, but the investment is allowed to grow without pay taxes for a set period of time before retirement.

Compounding illustrates that, the earlier you start to invest, the more your money works for you. For example, if each person invests \$3,000 per year for retirement, earns 6%/year, but you start at age 23, you will have \$560,000 in retirement. (\$126,000 of money you contributed, \$430,000 is interest you earned over time!!!) If you wait until age 30, you will only have \$354,000.

In this same way, an increase of just 1% of your salary invested for retirement can make a huge difference! If Jill and Jack are both age 25 and earn \$50,000 per year, with 8% paid on their investment, if Jill contributes 7% of her salary, while Jack contributes 6%, Jill will have \$140,000 MORE than Jack at age 65.

2. Understand that 401(k), 403(b), and any type of IRA is NOT the actual investment – you need to **CHOOSE the actual investment** (such as a mutual fund) in which you invest your retirement money.
3. Know the difference between **pre-tax versus post-tax investing and understand the effects of compound growth** with pre-tax deductions (see attached handout with graph). When you set up a 401(k)/403(b) retirement plan, the money is deducted pre-tax, so your taxable income is lowered by the full amount of your contribution. In addition, the investment is allowed to grow tax-deferred until retirement. For this reason, you will see the enormous impact of letting your money grow tax-deferred for years (this is called compounding) versus investing on an after-tax basis and having to pay taxes each year on the earnings.
4. If you are able, put the maximum amount in 401(K)/403(B) plans (**up to \$16,500/year in 2009**). If your company does not offer a 401(k) or 403(b) plan and you are a single person earning less than \$50,000/year, you may be eligible to open up your own IRA to save for retirement. Even if you or your spouse has an employer-sponsored retirement plan, you may have deductibility on a limited basis, depending upon income. There is a substantial penalty for early withdrawal of the money before retirement.
5. Open an IRA, if you are eligible. A **Traditional IRA** allows you to save up to \$5,000 for 2009 as an individual up to the age of 50 (plus an extra \$1,000 if you are over 50) on a **tax-deferred** basis or 100% of earned income. It is also 1. **FULLY tax-deductible if** neither you nor your spouse participates in an employer-sponsored retirement plan such as 401(k), 43(b) or pension plan or 2. fully tax deductible (the amount contributed is deducted from your taxable income) if your salary as a single is less than \$52,000 if single or \$83,000 married filing jointly where you participate and If you income exceeds this amount, you may be entitled to partial deductibility

(see schwab.com under Retirement for more details). You may contribute to this until age 70 ½. Withdrawals after age 59 ½ are penalty-free. Exceptions to penalty are higher education expenses for you or family members or first-time home purchase expenses (\$10,000 lifetime limit), death or full disability.

6. There is also a **Roth IRA** which uses post-tax dollars (so **no tax-deductibility**), but your investment earnings accumulate **tax-free**. Therefore, you never pay taxes on the investment, but you also never receive a tax deduction for the amount of investment. You are allowed full contribution when AGI (adjusted gross income) is less than \$101,000 (single person) or \$159,000 (married), and partial up to 116,000 and 169,000 respectively. There is no age limit. A **Keogh** is a tax-deferred, invested retirement account for self-employed individuals or employees of unincorporated businesses, who may contribute up to 25% of earned income for retirement. Remember, you must invest your IRA in something – an IRA is not the investment! (For more information, see attached “What Does I.R.A. Really Mean?”). There is no age limit with Roth.
7. Take advantage of **company matching**; this is free money and the money is growing tax-free. And, there is a good chance that your tax rate will be lower when you retire and have to withdraw.
8. You can create a **Rollover IRA** when you leave your employer and are required to move your 401(k)/403(b). It will probably remain tax-deferred, as long as you roll the entire amount into another retirement **INVESTMENT within 90 days**. Otherwise, there are **severe penalties and tax consequences**.
9. Be aware of substantial **penalties** (and any exceptions) for any retirement plan withdrawn before age 59 ½. You must start withdrawing by age 70 ½ and can not contribute after that age.

## **SOCIAL SECURITY: WHAT TO EXPECT**

First of all, you can only anticipate receiving money from Social Security if you have paid into “the system” for many years (i.e. you have been working and your employer has been withholding Social Security tax from each paycheck). If you have been paid “under the table” or you have NOT been paying taxes, then you will NOT be eligible. Both you and your employer must have been paying in on your behalf. Secondly, no one should rely on the Social Security system for their retirement, given its current state. It should merely be viewed as extra income for retirement.

You can contact Social Security to order a statement that shows the amount you will receive at retirement:

- [www.socialsecurity.gov/mystatement](http://www.socialsecurity.gov/mystatement); or
- call 800-772-1213; or
- write to: Social Security Administration, Office of Earnings Operations, PO Box 33026, Baltimore, MD 21290-3026.

## **RESOURCES**

- **Basic Information on Investing**

1. [www.schwab.com](http://www.schwab.com) – has quarterly review of mutual funds; Mutual Fund Select List – list of historically high-performing prescreened mutual funds

Bottomless Closet, 15 Penn Plaza, Level B, Suite 40, New York, NY 10001 [www.bottomlessclosetnyc.org](http://www.bottomlessclosetnyc.org)

2. Useful Retirement calculator: <http://www.bloomberg.com/analysis/calculators/retire.html>
  3. Smart Investor section on schwab.com– articles, etc.
  4. Free seminars on various topics – many are women-focused
  5. WIFE.org
  6. CNBC on TV
- **Advanced Information on Investing**
    1. Magazines: *Fortune*, *Business Week*, *Forbes*, *Money*
    2. Morningstar rates the mutual funds: [www.morningstar.com](http://www.morningstar.com)
    3. [www.thestreet.com](http://www.thestreet.com)
    4. Suze Orman books, tapes, videos, and television show
    5. The Wall Street Journal: C Section stock page
    6. For more information beyond this resource guide and series, consult Bottomless Closet’s resource library, read magazines, or go to your local branch of the New York Public Library.