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Category: Retirement

The Best Time to Begin Retirement Savings

"A Gift of a Lifetime"

By: Doug Horn, CFP®

As most financial planning professionals would say, the best time to start funding a retirement is 'Now'. While it is true for all ages, for those in their 40's and 50's it is a matter of urgency; but for those high school and college students who worked this summer, starting their retirement now is not only smart but extremely beneficial.

As parents, there are many lessons which are taught to their children. How to count, their ABC's, and the Golden Rule to name just a few. Children learn many of life's lessons not only from family, but from Sunday school, school, sports, and lifelong friends. There is one area though which I believe is often overlooked. How do I know this? From the financial strength, or more accurately the lack of retirement readiness of many 40 and 50 year olds with whom we have visited. And, according to AARP and BTN Research forty-four percent (44%) of the private sector workforce are left to their own devices when it comes to retirement planning. Some have failed to even start. By the time most couples are in their 40's and 50's, the competition for each dollar of income grows. From expenses surrounding children, potential college costs, mortgages, travel, and car payments, not everyone has sufficient funds going into retirement to sustain the lifestyle they hope to have. Had they started investing early and were consistent with contributions, it might have been possible to create a retirement portfolio one might have only dreamed of having. Additionally, the amount needed to reach targeted retirement values is always less the earlier investing begins, leaving more dollars to use to meet other needs. Why not share the benefit of starting early with your working student?

A twenty year-old who has 'earned' income from working this summer could open and contribute to a retirement account. A single \$1,000 contribution could grow to \$72,890 by the time they reach age 65. Since most students work to create spending money or funds for their education, the contribution to their retirement account may be made by the parent or grandparent. For a child to contribute to a retirement account, they must have earned income in excess of the contribution and not contribute more than the annual limit of \$5,500.

Continuing the \$1,000 contribution annually could create retirement funds of \$720,000 or more. Since taxes can often be the thief which steals from everyone's retirement, managing the tax impact is important. By investing those funds in a Roth retirement account where the retirement distributions are tax free, the impact on retirement lifestyle can be very positive. For many, the marginal income tax rates range from 25% to as high as 39.6%. Depending upon a taxpayer's marginal tax rate, the amount of funds needed in a pre-tax account to have the same net after-tax benefit of \$720,000 in a Roth account is between \$958,000 to as high as \$1.18 million. To save the \$958,000 over the same time period in a pre-tax account, an investor would need to put back \$1,333 per year, or 33% more.

Insights Continued

While we have been discussing a college age contributor, what if a fifteen year was able to start a Roth account with a portion of their earnings or with their parent's assistance? The single contribution of $1,000 in this case could reach $117,490. While it is only five additional years of growth, it is 61% greater than the value for the twenty year-old illustration. A true example of *time value of money* and the impact of just a few more years of growth. After 50 years of contributions, the portfolio might reach $1,163,000.

In both of the above examples, it is assumed the contributions were never increased. What if at age 30 each were able to increase their annual contribution to $4,000? The potential retirement could be $1.531 million for the twenty year-old or $1.976 million for the fifteen year-old. To reach the same $1.976 million of tax-free funds for someone twenty years from retirement, even if they already have $50,000 saved, still requires $28,644 annually to be invested to reach the same value. Unfortunately, tax law does not permit this amount to be contributed to a Roth account. Which would you rather be contributing to retirement, $4,000 per year or $28,644?

Remember, teaching your child about *time value of money*, investing early, being consistent, and encouraging them to start a Roth retirement account is one of the best gifts you will ever give them.

(Note: All of the financial calculations assume the use of equities and a long term performance of 10%, the long term average of the S&P 500®. The 50 year average of this index generally ranges between 9 and 11%. Future returns are not guaranteed.)