

## Ask the Key Questions

*Begin preparing for retirement at a young age*

Planning for a comfortable retirement takes thought and discipline. You can start the process by answering the following questions: How much money will I need for retirement? What will be my monthly and annual expenses? What will inflation do to my nest egg? How much money should I have when I retire? How much money will I get from Social Security and pensions plans from former employers? How much money will my own savings and investments have to provide? How can I ensure that I won't run out of money? These questions prompt another set of equally important questions that include: When should I start saving for my retirement? How much should I invest each year? What investments should I own?

## You Will Need Lots of Money

*You will need hundreds of thousands of dollar.*

To help ensure a comfortable financial secure retirement you need a large pile of money. But how large of a pile?

Here is an example. Suppose that after you add your Social Security and pension income (if you're fortunate enough to get a pension) you will need an additional \$20,000 for the first year of your retirement. This \$20,000 will come out of your own retirement savings. And further assume that

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Because it takes a huge pile of money to generate a stream of income year after year, it's very important to start saving and investing for your future retirement needs at the earliest possible age.

*“Begin you retirement planning now.”*

in each succeeding year your expenses will increase because of inflation. So the \$20,000 requirement becomes larger every year. Also assume you will live for 30 years after you retire.

Finally, if you assume an average inflation rate of 4% and an average rate of return of 6% on your investments during retirement, you will need to have accumulated \$436,000 by first year of your retirement.

*“Retirement requires lots of money.”*

## Invest at a Young Age

*Start saving and investing now – do not delay*

Suppose your goal is to have \$500,000 at the start of your retirement. How do you accumulate that amount of money? One way is to start investing at the earliest possible age. For example, if you start to invest 30 years before you retire and receive an average return of 6% on your investments, you need to invest \$498 each month for the 30 years, a total of \$179,191. If you wait until 20 years before retirement, your monthly tab is \$1,082. And if you wait until 10 years before your retirement, you must invest \$3,051 each month, or \$366,123 for the 10 years. If you want a \$1,000,000 nest egg, you must double the monthly investments. The conclusion is obvious – start saving and investing at the earliest possible age.

People who make systematic investments many years before they retire have time on their side to allow their investments to grow to very large amounts. But people who wait to invest until a few years before retirement have to play catch up and must invest very large amounts of money during their final years of working.

What does this simple example teach us? You need a **very large pile of money** for retirement and you should start saving and investing **many years before you retire**.

*“Save and invest before you spend your money”*

## Save and Invest Each Month

*Save and invest before you spend*

To ensure that you set aside enough money for your retirement make savings and investing your top priority. Save before you spend and start now.

At work contribute the maximum to your retirement plan and then save more in other accounts. Set up automatic transfers from your checking or savings account to your retirement accounts. Put your retirement savings and investing program on automatic pilot so your money gets allocated to the savings before for have a chance to spend it.

For example, investing \$500 each month at a six percent return for 30 years will result in a nest egg of over \$500,000.

The table shows how much money you can accumulate for different monthly contributions and accumulation periods.

<i>Future Value of Monthly Investments Rate of Return is 6%</i>			
Amount	10 Years	20 Years	30 Years
\$100	\$16,470	\$46,435	\$100,954
\$500	\$82,349	\$232,176	\$504,769
\$1,000	\$164,699	\$464,351	\$1,009,538
\$2,000	\$329,397	\$928,702	\$2,019,075

# You Have Many Investment Choices

## *Buy dividend-paying stocks and low-cost mutual funds*

You have thousands of investments from which to choose when building a retirement portfolio. Some popular options include: stocks, mutual funds, index funds, exchange-traded funds, certificates of deposits, bonds, bond funds, closed-end funds, real estate, commodities, annuities and many more.

***buyupside.com*** focuses on stocks, low-cost index funds and exchange-traded funds.

Stocks, particularly dividend-paying stocks, provide long-term investors the opportunity to achieve substantial gains through price appreciation and dividend reinvestment. Many companies offer low-cost dividend reinvestment plans. And companies like General Electric (GE) have increased their dividend regularly for many years and are excellent choices for a retirement portfolio.

An index fund is a collection of stocks that mirror stocks in a particular index. For example, the 500 Index Fund offered by the Vanguard Group and the Spartan 500 Index Fund from Fidelity Investments are index funds that include the 500 largest publicly-traded companies in the Standard & Poors 500 index. So when you own one or more shares of these funds you own a little bit of each company in the S&P 500. Because index funds do not have to select and buy and sell stocks, they do employ highly paid professionals and consultants for advice. Therefore, index funds charge very low annual fees so their performance is not significantly reduced by the amount of their fees. Thus, index funds are said to be low-cost alternatives to managed mutual funds.

With an index fund you receive dividends that you can reinvest to buy more shares. And since index funds do not ordinarily buy and sell stocks, your tax liability is zero or nearly zero each year.

An exchange-traded fund (ETF) is a pre-packaged group of stocks that you buy and sell through a broker. ETFs are similar to index mutual funds in that both track an index and offer diversification at a low cost. But ETFs have many characteristics of individual stocks. For example, you can buy and sell an ETF at its current market price anytime during a trading session of a major stock exchange. Like stocks you pay a commission to your broker to buy and sell an ETF. With some ETFs you can reinvest dividends. Because ETFs are not managed, they have very low service fees.

If you are a buy-and-hold investor, buy an index fund to avoid the commissions required to buy an equivalent ETF. The fees for the index fund are less than the commissions and fees you'll pay for the ETF.

Pre-packaged funds with catchy names such as all-in-one, life style, life cycle and retirement target funds are designed for investors with different objectives. The funds designed for long-term investors who have many years before retirement are weighted toward stocks to ensure growth. The funds for investors who are about to retire are weighted heavily with bonds.

*“Everything else being equal always buy the mutual fund with the lowest fees.”*

## Getting Started

*Start with well known investments*

These ten well-known stocks are excellent candidates for a retirement portfolio of dividend-paying stocks: General Electric (GE), 3M (MMM), Public Service Enterprise Group (PEG), Southern Company (SO), Heinz (HNZ), Hershey Foods (HSY), Clorox Company (CLS), Procter & Gamble (PG), Illinois Toolworks (ITW) and Emerson Electric (EMR).

Two popular index funds that track the S&P 500 (the 500 largest publicly-traded companies in the Standard & Poors 500 index) are the 500 Index Fund offered by the Vanguard Group and the Spartan 500 Index Fund from Fidelity Investments. When you own one or more shares of these low-fee funds, you own a little bit of each company in the S&P 500.

Other popular index funds and what they track include: Vanguard Total Stock Market Index Fund tracks the largest 5,000 companies, Schwab 1000 Investor tracks the largest 1,000 companies, TIAA-CREF Equity Index tracks the largest 3,000 companies and the Fidelity Nasdaq Composite Index Fund tracks the 3,000 plus companies listed on the Nasdaq stock exchange.

Four popular U.S. market ETFs and what indices they track are: SPDRs, or Standard & Poors' Depository Receipts (SPY) track the S&P 500, Diamonds Trust Series (DIA) track the Dow Jones Industrial Average, QUBEs (QQQQ) track the Nasdaq-100 index and MidCap Spider (MDY) tracks the S&P MidCap 400, a group of mid-size stocks that offer good growth opportunities.

ishares from Barclays track major U.S. indices, some industry sectors and over twenty foreign countries.

PowerShares Capital Management offers a variety of industry exchange-traded funds (ETFs). These low-cost funds let you own diversified portfolios of stocks many industry sectors:

Then there are SPDRs (Spiders), Vipers, HOLDERS, streeTracks and BLDRS. These ETFs with funny sounding names are composed of groups of stocks from foreign countries, different market indices and about every industry sector imaginable.

The Vanguard Target Retirement 2005 (VTOVX), a life-cycle fund for retired or about to retire investors, includes four Vanguard funds: Total Bond Market Index, Total Stock Market Index, Inflation-Protected Securities, and Total Stock Market VIPERs. VTOVX has 35 percent stocks and 65 percent bonds.

The Vanguard Target Retirement 2045 (VTIVX), a life cycle fund for young investors, includes five Vanguard funds: Total Stock Market Index, European Stock Index, Total Bond Market Index, Pacific Stock Index and Total Stock Market VIPERs. The fund holds 10 percent bonds and 90 percent stocks.

## About the Author

Richard Howard maintains *buyupside.com*, a free site for individual investors. He has written numerous articles about investing and is the co-author of *Buy on the Upside*, a book which discusses the principles of investing. It is available from major Internet book sellers.

### More Information

For more information about investing see *buyupside.com* and other *buyupside.com* investing guides:

- *Beginner's Guide to Investing in Stocks*
- *Beginner's Guide for Young Investors*
- *Beginner's Guide to Dividend and Dividend Reinvestment*
- *Beginner's Guide to Index Funds and Exchange-Traded Funds*