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Savings Risk

Saving enough for retirement is up to you

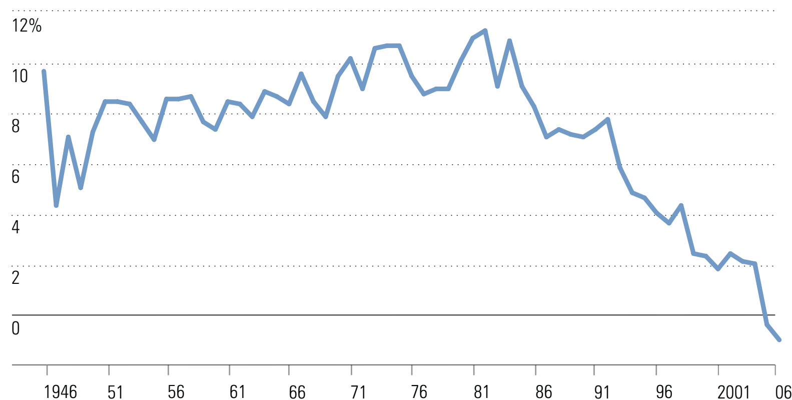
Like most baby boomers, the responsibility of saving for retirement rests squarely on your shoulders. This is a dramatic change compared to your parent's generation when employers established defined-benefit pension plans on behalf of employees. This type of plan utilized professional money managers and guaranteed retirees with income for life.

How the world has changed. Today, people are responsible for building their own retirement accounts through defined contribution plans such as 401(k)s and 403(b)s. In these plans, investors make their own decisions on how much to save each month, how to allocate their savings, and how to take disbursements in retirement. Responsibility and risk for adequately preparing for retirement falls on the individual.

Most Americans aren't saving enough

The sad reality is that most Americans aren't saving enough for their retirement. The graph below shows that the U.S. savings rate has been falling for more than 20 years. In fact, 2006 became the second consecutive year the national savings rate was negative since the Great Depression, at –1.0%.

Most Americans are not saving enough for retirement[1]
Personal savings rate 1946–2006



According to Vanguard's 2006 Retirement Outlook study, which surveyed 1,049 workers over the age of 40, only 40% were considered "on track" for meeting their retirement goals, while 43% were considered "at risk." Many Americans run the risk of quickly depleting their assets in retirement and face the prospect of relying solely on Social Security or continuing to work in retirement.

The recent lack of savings is partly a cultural phenomenon. Baby boomers have a stronger sense of optimism than the World War II generation, and have not placed the same priority on saving. Worse, they have virtually unlimited access to credit and a habit of spending beyond their means, regardless of how much money they make.

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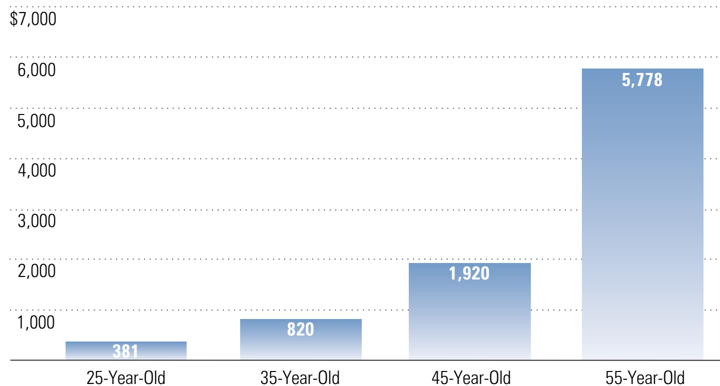
You need to save a lot more than you think

It used to be a big deal to be a millionaire, but not any more. Many financial advisors believe their clients can safely withdraw between 4%–5% each year from their portfolios in retirement. If you have a $1 million portfolio, a 4% withdrawal rate would produce only $40,000 in income in the first year. If you're trying to replace $100,000 in income and estimate you'll get $20,000 from Social Security, you'll probably need to save $2 million before you retire.

The image below illustrates roughly how much monthly savings an investor needs to save at various ages to reach $1 million at retirement. Clearly, the earlier you start saving, the easier it will be to attain your retirement goals. If you haven't saved enough, you may need to start an aggressive savings plan or postpone your retirement.

The earlier you start investing, the easier it is to reach your goals[2]
Monthly savings needed to accumulate $1 million by age 65



What is the ideal savings rate to meet my retirement needs?

There is no right or wrong answer to the ideal personal savings rate. However, many financial advisors suggest that individuals who are in their 20s, 30s, and 40s should be saving at least 10% of their income. If you are closer to retirement, don't have a pension plan, and haven't accumulated a significant retirement nest egg, you may need to save at a much higher rate.

You should also think about the most-effective savings vehicles. For example, many 401(k) plans provide an employer match, which is essentially "free money." Many financial advisors suggest you should contribute to your 401(k) at least to the level of the employer match. Savings vehicles such as 401(k)s, 403(b)s, and traditional IRAs can provide you with tax-deferred savings advantages. Roth IRAs and Roth 401(k)s can be funded with after-tax dollars, but investment gains grow tax-free, and your contributions and gains can be withdrawn tax-free.

Another factor to consider is the amount of debt you are carrying, especially revolving credit-card balances and auto loans. Revolving debt can be thought of as "negative savings." We live in a society

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Questions to ask your advisor:

- How much income do I need in retirement? How big a nest egg do I need?
- What is a safe withdrawal rate in retirement given my situation?
- If I haven't saved enough for retirement, what affect would retiring later or working part time have?
- What are the most effective retirement savings vehicles in my situation?
- How can I make the most of IRA catchup provisions or 401(k) matches from my employer?
- Is it better to allocate savings to investments or pay down my debts (especially credit-card debt)?
- What savings rate will help me attain my goals?
- How can I spend less today and save more for tomorrow?

of indulgent consumerism and easy credit. As a result, many Americans find their biggest impediment to savings is their spending habits and debt levels. They simply don't have enough cash flow each month to save anything. If you have significant revolving debt, particularly debt carrying high interest rates, you might consider paying down your "negative savings" before you make other investments.

Once you're ready to save and invest regularly, consider programs that "pay yourself first," such as payroll deductions or automatic monthly debits from your checking account. These provide savings discipline, which is half the battle.

[1]The personal savings rate is defined as a percentage of disposable personal income. Source: Bureau of Economic Analysis.

[2]Image represents monthly savings necessary using a 7% hypothetical rate of return. This is for illustrative purposes only and not indicative of any investment. The data assumes reinvestment of all income and does not account for taxes or transaction costs. Your results will vary as investing involves risk, fluctuating returns, and the possibility of loss.

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