12. Long-Term Financial Planning

You just graduated and are probably about twenty-two years old. Age sixty-five seems eons away, and retirement is something you’ll think about later. You have years to worry about that stuff, right? Wrong. The best time to think about retirement is now. Take a look at this example.

If a Yale graduate earns approximately $40,000 in his/her first job out of college and puts $400 per month into a retirement account beginning at age 22, by the time he/she reaches age 65 the investment of $206,400 ($4,800/year for 43 years) will have become $548,229 saved for retirement (numbers are based on the assumption that the investment will grow at a constant rate of 4% above inflation each year).* This growth in funds is the result of your investment compounding.

Now look at what happens when you wait until later to start saving. If you start the same retirement account at age 27, saving the same $400 each month, you’ll only have $427,282 saved by age 65.* That’s a loss of over 100 grand! Wait until you’re 35 to begin saving, and your retirement fund only has the chance to grow to $277,620.*

It’s hard to think about saving for retirement when you’re just out of college. Your income is usually just enough to cover expenses and repay loans, and you feel like you can wait until later. But as these examples show, even a small amount towards your retirement savings can add up enormously over decades. Opening a 401(k), IRA, or similar retirement account now is one of the most important steps you can take. You will thank yourself later.

How Your Job Can Help

The key is to start early, even if you are only putting away a small amount of money. Many companies and organizations will contribute a percentage of your salary or match a percentage of your monthly contributions to a
retirement fund—commonly referred to as a 401(k) or 403(b)—that you get to take with you when you leave if you meet vesting requirements.** When establishing a 401(k), make sure to talk with a financial advisor or company representative who specializes in retirement planning.

If your employer offers retirement contribution benefits, take advantage of it! Think of the money your employer contributes as an instant return on your investment. An added bonus is that money you contribute to any company-sponsored retirement fund is deducted from your paycheck on a pretax basis. That means that the salary you pay taxes on is lower, even though your salary remains the same, so your taxes are also lower.

Retirement benefits are a huge part of your total compensation package; be sure to find out what type of plan your company offers. Since many new grads don’t stay with the same company for more than a few years, there’s no guarantee that you can take all of your employer’s contributions with you if you leave, again depending on their vesting requirements**. But remember that whatever portion you personally contribute is always yours to keep.

**Going It Alone**

Perhaps you do not work for a company that contributes to your retirement, or you haven’t worked there long enough to participate in a plan (some businesses require a one- or two-year waiting period). Or maybe you are in graduate school and “401(k)” is not part of your vocabulary. You can still set up an Individual Retirement Fund (IRA) or a Roth IRA on your own through any commercial bank or Mutual Fund Company.

Like a 401(k), an IRA offers tax breaks. Traditional IRAs offer tax-deferred growth, which means that you only pay taxes on your investment gains when you withdraw money. Contributions to a traditional IRA also reduce your taxable income. In contrast, contributions to a Roth IRA are not tax deductible. With a Roth IRA, you do not pay taxes on the money when you withdraw your principal, or earnings. This type of IRA is limited to those who earn under a certain limit set by the IRS; check with your financial advisor for more information.

As of 2015, you may contribute a maximum of $5,500 per year to a traditional or Roth IRA (this number can change yearly). While it might be painful to write that $5,500 check each year, you will benefit later. Before you decide to set up an IRA, speak with a financial advisor to determine if an IRA is right for you and which type would be most beneficial.
“But what about social security?” you may ask. Anyone who has earned a paycheck feels some pain upon seeing that big chunk of change that gets deducted for social security on his/her pay stub. Social security was originally established to provide financial support for the nation’s retirees. The problem is that medical advancements and healthier lifestyles are extending the average life span. Therefore, more people will be drawing from the pot for longer periods of time. By the time you reach retirement, there’s no telling how much there will be to go around. Take matters into your own hands!

Yes, age 65 seems eons away — but if you play your cards right by investing now for retirement, you will be able to enjoy your golden years in comfort. Starting early is your key to success. Whether you plan to spend your retirement on the golf course, traveling the world, or on your porch reading good books, you are going to need money to do it. Failing to contribute to a retirement fund is only cheating yourself!

*Information obtained from the www.vanguard.com retirement calculator.

**Vesting is the period of time a person must remain employed by his/her employer before the company contributions to a retirement plan are the employee’s to keep. It’s not uncommon for companies to have a two- to five-year vesting period.