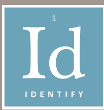
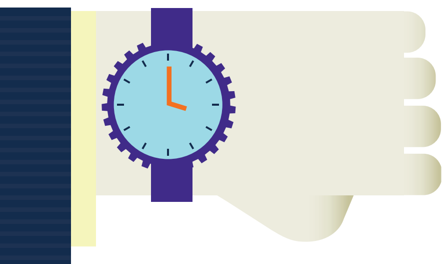


The elements of success

Saving early for retirement

There is no better time to put your money to work than when you are young. Learn how saving early can prevent future stress and keep more money in your pocket.

For many young adults, loan payments, credit card debt and living expenses seem to dissolve every paycheck. Putting money aside for retirement can seem impractical and almost impossible. Many individuals choose to delay saving for retirement because they feel it will be easier to do later in life. However, investments made shortly after college allow increased return and can greatly relieve pressure on future retirement planning.



Time and investment

Time is the fuel of investment growth; the more time you have, the better. An extra 10 years of investment growth can make a sizeable difference when it comes time for you to retire. Ideally, people would try to invest the majority of their money when they are young. Unfortunately, because young people earn less and need to accumulate property, that is usually unrealistic. Any money spared for investment, however, could easily pay for itself several times over in the future.

Consider an example of two identical retirement accounts that get funded over different periods of time. The owner of the first account saves $2,000 each year from ages 26-35 (10 years) and then stops contributing. The owner of the second account decides to start later but save longer; he saves $2,000 each year from age 36-65 (30 years). Both accounts grow tax-free and have an average annualized return of 7 percent.

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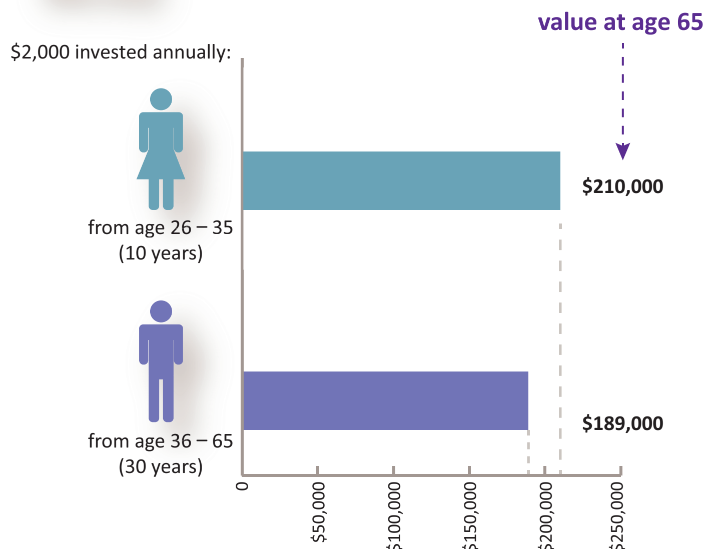
Two identical retirement accounts, each was funded over different periods of time.



When both owners reach retirement, what is the value of their accounts?

By age 65, the first account has grown to about $210,000, while the second has only grown to $189,000. Despite having put away three times as much money, the second individual still has less in his account. You must not underestimate the power of saving early.

Investment accounts

The easiest way to start investing is through a company-sponsored retirement plan. A 401(k) is a particularly powerful tool for young investors because contributions can be automatically withheld from a paycheck, and the account requires little management. Additionally, 401(k)s are government-sanctioned plans and are allowed to grow in a tax-deferred environment — so their value can compound much faster than taxable accounts.

If your employer matches 401(k) contributions, you should take full advantage of it. Matched 401(k) contributions are like getting a pay raise as a reward for retirement planning.

If your company does not offer a 401(k), you can consider setting up an individual retirement account (IRA) with a brokerage firm or a bank. An IRA is similar to a 401(k), but does not receive matched contributions and must be created outside of work. Since both accounts have contribution limits, people who max out their annual contributions to a 401(k) will often put any additional retirement money into an IRA.

IRA accounts come in two different varieties: traditional and "Roth." Contributions to traditional accounts are tax deductible, with their value getting taxed upon distribution. Roth accounts are the opposite: contributions are made after being taxed, but their distributions are made tax-free.

Risk and return

Nothing is certain with the market, and all investments take on some level of risk. The potential for return is typically proportional to the amount of risk of an investment. Younger investors have a long timeline and are usually willing to take on more risk. Even if their volatile investments suffer short-term losses, they have more time to recoup their losses than someone nearing retirement.

This changing level of "risk tolerance" is important to understand. Young adults who put off investing do not just miss time for their investments to grow, but potentially lose the most aggressive investment growth they could ever realize.

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