How Should I Save for Retirement?

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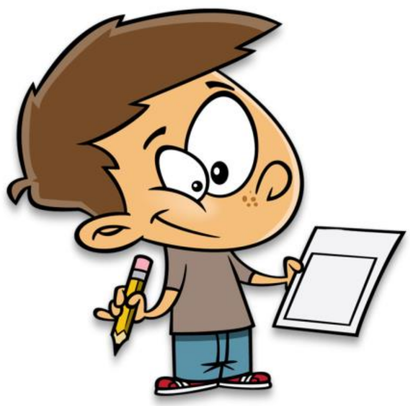

Throughout the years, retirement plans and strategies have changed drastically. Many employers have moved away from pensions and have embraced 401(k) retirement plans for employees. This move has taken much of the responsibility of saving for retirement out of the hands of employers and placed it in the hands of employees. By acknowledging how this change affects retirement planning, you can make the necessary adjustments to build a financially secure future.

Individuals often default to saving in two basic categories: their home and their retirement accounts. However, building equity in your home and only using your 401(k) allows for little flexibility in withdrawals and doesn't leave much room for tax strategies in retirement. To avoid this, we often recommend distributing savings amongst various account types with differing tax implications.

What Accounts Should I Focus On?

There are three types of accounts you should aim to contribute to for retirement:

> **Tax-deferred Accounts:** Commonly known as a 401(k) or a traditional IRA. These accounts are funded with pre-tax dollars. You pay income tax the year you withdraw the money.
>
> **Roth IRA:** Funded with after-tax dollars. Investment income and gains in the account are not taxable and withdrawals will be tax-free. Keep in mind, these accounts have income

limitations.

Taxable Investment Accounts: Funded with after-tax dollars. While withdrawals are not included in your taxable income, you will be required to pay annual taxes on dividends, interest, and gains from investments sold.

Even with diversified savings across accounts, you may want to split your contributions between Roth and pre-tax within your employer-sponsored plan. A diverse mixture of pre- and post-tax accounts and contributions grants more flexibility when you shift from being an accumulator of wealth to a consumer of your wealth.

For instance, married individuals filing joint tax returns must have an Adjusted Gross Income (AGI) of less than $89,450 in 2023 to stay in the 12% tax bracket. If you know you need at least $100,000 a year to live comfortably in retirement, you can pull $89,450 from your traditional IRA or 401(k) and supplement the rest with your taxable accounts. By using both accounts, you can use tax brackets to your advantage.

Can I Rely on Social Security?

Social Security is an important element when planning for retirement and can provide additional stability. However, you shouldn’t rely solely on Social Security for retirement income. Retirement strategies have changed tremendously throughout the years and like pensions, Social Security has not been immune to these changes. For those close to claiming or currently claiming, there will likely be minimal impact by future changes. However, those who are decades away may retire with a completely different Social Security benefit structure. Therefore, it’s important to consider, but not rely on Social Security when saving for retirement.

While Social Security is the most well-known guaranteed income stream, some still have pensions to supplement their retirement savings. If you feel the need to have an additional guaranteed income source, annuities are an option. Annuities are investments you can purchase that guarantee future income, like a pension. While these products are beneficial for some, they typically trade flexibility for stability.

What Else Can I Do to Prepare for Retirement?

The best thing you can do for yourself, and your future, is to develop healthy saving habits. Spend less than you make and live beneath your means. While it isn't sustainable to save every cent, you should strive to find a healthy balance between saving, maintaining your lifestyle, and having some fun with your hard-earned paycheck.

The moral of the story is to not fall victim to a lifestyle creep. More money shouldn’t always lead to more spending. The biggest problem with a gradual lifestyle creep is that many slowly increase their spending, but never increase their savings. Therefore, when you retire, you are accustomed to a completely different lifestyle than the one you saved for.

The Bottom Line

When saving for retirement, use more than just your 401(k). Diversifying contributions across accounts with different tax implications can open opportunities when it’s time to withdraw. Don’t paint yourself into a corner by only saving in one account.

For those who don’t qualify for a Roth account due to income limits, don’t worry. You may be able to do a backdoor Roth contribution. This method allows you to funnel money from your traditional IRA into a Roth account. Check out our free flowchart and see if you’re eligible for this loophole.