RETIREMENT PLANNING

6 Retirement Wealth Strategies to Start Young, Finish Strong

To build a nest egg that will see you through retirement, it helps to start young. Here are six steps to get going.

(Image credit: Getty Images)

When you are just starting off, it is hard to envision retirement. I remember earlier on in my career, before I got into wealth management myself, my financial adviser insisted on doing a financial plan for me and my husband that had us set retirement goals. I was resistant because with so many unknowns and such a long time horizon, I felt that any projected numbers would, by definition, be inaccurate.

Her response was, “Of course the numbers are not going to be right! What we’re looking for are directional trends. Without a plan, how are we going to have the framework to have any meaning financial discussions?”

I realized then that while I was very tuned into my monthly cashflows and savings, I did not have a long-term view. I had to push my view out by at least 30 more years. **This leads me to the first retirement lesson I’d share with my younger self:**

1. Never think you’re too young to need a financial plan

Any discussion about retirement has to come with a long view, where you set long-term goals with intermittent smaller goals in between. Without a financial plan, even at broad strokes, we make significant financial decisions based on a qualitative “gut” feel rather a quantitative analysis.

My advice: Work with a financial planner to put a retirement plan in place, even if it is full of estimates and assumptions. It will help you put a framework around where you are now and where you would like to end up. It will become your financial compass.

2. Cash in on the compounding effect of early investment

I cannot emphasize enough the power of investing early and the value of compounding. This may seem obvious, but you would be surprised how many people don't do this. Common roadblocks I hear are, "I don't know anything about the markets," "I don't have time," or "I would just have to pay taxes anyway." Yes, all of these are legitimate concerns, but they are not legitimate reasons to incur the opportunity cost associated with doing nothing.

Let's take a very simple example: Assume you have $100 each month that you can either save in an interest-bearing account or invest in a balanced equity portfolio. Under the current interest rate environment, and assuming modest portfolio growth, that $100/month over 30 years could yield $41,963 in a savings account or $83,226 in a balanced investment equity portfolio.*

Of course, there are always risks associated with investments and the returns may not be what you expect or there could be a market downturn. That is why it is important to get educated early on with investing. The answer to the unknown cannot be that you don't even try or avoid it altogether. Instead, the answer should be to get to a comfort zone by educating yourself and working with professionals who can guide you.

3. Contribute to a Roth IRA while you still can

The Roth IRA, named after Sen. William Roth, who sponsored the creation of the program in 1997, is a retirement savings strategy often overlooked by those while they are eligible. Unlike a traditional IRA, where you could get a tax deduction for the contribution to the account, contributions to a Roth IRA are *not* tax deductible. This is the key difference that allows for the back-end tax benefit of a Roth IRA, because while money distributed from a traditional IRA is taxable, money distributed from a Roth IRA can be tax free.

In essence, you are choosing the tax benefit on the back end when withdrawals are made during your retirement years. The important lesson here is that you may contribute to a Roth IRA only if your income level is under a certain threshold. In 2022, that limit is $144,000 for a single filer or $214,000 for those married filing jointly (contributions begin to phase out with lower income limits). Therefore, this is the type of tax-advantaged savings vehicle that you may be able to take advantage of earlier in your career, assuming that your income level may exceed the threshold amount later in life.

The common objection I hear is that you'd rather contribute to a traditional IRA and get the income tax deduction today, rather than waiting for a tax benefit many years from now. While I can certainly understand and appreciate the value of saving tax dollars currently, note that the tax rate is often lower for those at this lower income level and therefore, forgoing the income tax deduction today may be beneficial in the long run considering the years of compound growth that will ultimately be tax free, coupled with the fact that you may not be eligible for this program later on in life when your income is higher.

Also, you may contribute to *both* types of accounts! Even though the IRS' annual contribution limit for IRAs is an aggregate one (for both traditional and Roth IRAs). You can contribute a maximum total of $6,000 per year total (or $7,000 if you're 50 or older). So, if you have the liquidity, you can split up that $6,000 and contribute a portion to a traditional IRA (and get the tax deduction for that contribution) AND the rest a Roth IRA (and get the income tax benefits later in life).

I did that for a number of years earlier in my career and I am glad I did, as I now have both a traditional IRA and a Roth IRA. I not only diversified my investments, I have also diversified my tax-advantaged accounts. When deciding which type of IRA and how much to contribute, do be mindful of the rules around early withdrawals (for example, before age 59½, within first five years for Roth IRA) as it may result in taxes and penalties depending on the individual circumstances.

4. Maximize your employer-sponsored retirement benefits

If you're fortunate enough to work with an employer that provides a retirement savings plan, or better yet, one that matches your contributions, take full advantage of it. My first company had an employer match program and I ensured that, at the minimum, I contributed enough every month to my 401(k) plan so that I qualified for the match. Think of this as extra compensation that your employer gives you.

The company match is not taxable to you at the time the employer makes the contribution. It is taxable only upon withdrawal from the retirement account. Until that point, the money can be earning tax-deferred interest and growth for many years. Again, that investment compounding effect is significant over time.

Another thing to be mindful of is to revisit your contribution amount every year. Many people set their contribution rates and forget about them, but as IRS contribution limits for 401(k)s, 403(b)s, and other savings plans can change and the same with your earnings, it is important to check every year that the numbers are still working out as they should be. For example, many people set their contribution to a certain percentage of their salary each month. When the contribution limits increase, you may want to adjust your percentage contribution depending on whether your salary has changed as well.

Finally, many employers are now offering a Roth 401(k) option in their company retirement plans. The taxation of a Roth 401(k) is similar to that of a Roth IRA as discussed earlier. For younger, and even some experienced professionals, this option may be beneficial in the long term. While there is no current income tax benefit for contributions into a Roth 401(k), there can be significant tax benefits in your retirement years.

5. Consider HSAs – the 'hidden' retirement saving strategy

Another popular employer-offered vehicle that can be used during retirement is the health savings account (HSA), a type of savings account that's offered for those with a qualifying high-deductible health plan. Contributions to an HSA are tax deductible. The money grows inside the HSA tax-free. In addition, when distributions are made for qualifying medical expenses, there is no tax either. In essence, you are able save with pre-tax dollars, invest with tax-free growth, and use it later on in life to pay for medical expenses without any taxes.** The way I think about it is that the HSA is in essence a 401(k) for your medical expenses, except better because there is no tax upon withdrawal for qualified medical expenses.

Another flexibility is that you may withdraw out of an HSA after you turn 65 for *any reason* (not just medical ones) with no penalty. If it's for a non-medical expense, you will have to pay taxes on this withdrawal, but that's the same tax treatment with a 401(k) or traditional IRA. You would have still gotten the benefit of years of tax-free growth.

Note that this is different than a flexible spending account (FSA), a type of savings account whereby you make a contribution to it during the year, and by the end of the year, you may use that money for certain medical expenses. The money contributed and ultimately used for qualifying medical expenses will not be part of your taxable income. However, any money not used by the end of the year, and not eligible for any rollovers, would be lost. Therefore, while the FSA is a good income management vehicle related to yearly medical expenses, it is not a long-term retirement vehicle like the HSA.

6. Have a steady hand and recalibrate as needed

The road to retirement can be a long one, with many bumps in between. While executing on your financial plan, I would encourage you to resist the urge to make hasty decisions based on headline news or impulsive needs. Slow and steady wins the race.

That does not mean that you set your plan and forget it. I recommend that you recalibrate and revisit your financial plan at least once a year to account for any changes and whenever you experience a life event, like marriage or the birth of a child.

Your financial plan may be your compass, but that does not mean the journey is always a straight one. Periodic adjustments are needed to help ensure that your plan is fresh and up to date.

**Assumes savings account earning 1% annually, and investment portfolio earning 5% annually, with no sales or withdrawal and pre-taxed.*

***Note that taxation rules may vary at the state level.*

There is no assurance that any investment strategy will be successful. This article was written by and presents the views of our contributing adviser, not the Kiplinger editorial staff. You can check adviser records with the SEC or with FINRA

NYSUT NOTE: It's never too early to start saving for retirement and the NYSUT Member Benefits Corporation-endorsed Financial Counseling Program can help you get on track. This is your opportunity to talk to a Certified Financial Planner® who will provide personalized advice based on your situation. For more information or to take advantage of this program, visit the website or enroll today.

About the Author

Alvina Lo
Chief Wealth Strategist, Wilmington Trust
Alvina Lo is responsible for family office and strategic wealth planning at Wilmington Trust, part of M&T Bank. Alvina was previously with Citi Private Bank, Credit Suisse Private Wealth and a practicing attorney at Milbank, Tweed, Hadley & McCloy, LLC. She holds a B.S. in civil engineering from the University of Virginia and a JD from the University of Pennsylvania. She is a published author, frequent lecturer and has been quoted in major outlets such as "The New York Times."

Kiplinger