

21st century retirement



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It's Never Too Late to Save for Retirement

If you lie awake nights worrying about whether you will ever be able to amass the jumbo-sized nest egg you will need to bankroll your retirement, you're hardly alone. Many Americans feel that their finances are depleted by mortgage payments, college tuition, or job loss, and they wonder how they will get by financially when the time comes to put their feet up for good.

The good news is that the federal government has recognized that most people—especially those over the age of 50—could use some additional help in saving for retirement. The tax incentives for retirement saving were enhanced considerably under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA). Contribution limits for the most widely used retirement accounts have increased and will continue to rise over the next few years.

So Many Tax Breaks, So Little Time...

You are probably aware that there are a number of options for tax-efficient retirement saving. You may be less certain, however, about which of the various accounts—or combination of several accounts—is best suited to you, given your current income and your expected circumstances in retirement.

If you are employed by a company that offers a retirement plan with matching contributions, it makes sense to take advantage of what is essentially free money by contributing at least enough to get the full match. In addition to lowering your current taxable income, your contributions have the potential for tax-deferred growth.

If your plan and personal circumstances allow, you will probably want to contribute to your account up to the maximum permitted by the federal government. For 2008, the annual limit for 401(k), 403(b), and 457 contributions is \$15,500, or \$20,500 for those aged 50 and over. If your employer offers a SIMPLE plan, you can contribute \$10,500, and those age 50 and older may contribute an additional \$2,500.

If you participate in a 401(k) or 403(b), consider a Roth option, if available. Offered in addition to your traditional plan, this option allows you to contribute after-tax dollars to a Roth account. Earnings grow tax deferred, and distributions are tax free, provided you have reached the age of 59½ and have owned the account for five years.

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Retirement Savings Worksheet

If you are approaching retirement age, or are just beginning to plan for it, you might be interested to learn that retirement may require 70%–90% of your current annual income in order for you to maintain the quality of life you presently enjoy (American Savings Education Council (ASEC), 2003). Setting goals—such as where you might like to live and the activities you plan to pursue—is an important factor in any savings plan. How do you determine the total amount needed for retirement and calculate the amount of savings you'll need to accrue each year? The worksheet below will help you answer these questions, based on calculations developed by the ASEC.

As an example to help you along the way, consider the hypothetical case of Henry Foster: At age 50, Henry earns \$50,000 per year. He estimates that during retirement he'll need 70% of his income (\$35,000 per year) to maintain his current standard of living. While he does not have a traditional employer pension, he does expect to earn \$5,000 annually as a part-time writer. In addition, he estimates he'll receive approximately \$14,500 annually from Social Security.

1. Required Income. How much money will you require per year in order to live the lifestyle to which you have grown accustomed? Enter 70% of your current annual income as a basic minimum.

2. Social Security. Project the amount you expect to receive from Social Security. Obtaining a Social Security statement from the Social Security Administration (SSA) will enable you to enter a more accurate estimate. You can obtain a statement by calling 800-772-1213 or on the web at www.ssa.gov. For a rough

estimate, enter \$8,000 if you earn less than \$25,000; \$12,000 if you earn between \$25,000–\$40,000; or \$14,500 if you earn \$40,000 or more. If you are married and earn less than your spouse, enter the greater of either your own benefit or 50% of your spouse's benefit.

3. Traditional Employer Pension. Enter the amount you expect to receive in today's dollars.

4. Earned Income. Enter your estimated annual part-time income.

5. Retirement Shortfall. Subtract lines 2, 3, and 4 from line 1. This is an estimate of the amount of money you'll need from savings each year, in addition to the above sources of income.

Now that you've determined the amount you'll need in retirement, as well as your shortfall, it's time to figure out how much you'll need to save. Assuming a 3% constant real rate of return after inflation, a life expectancy of age 87, and Social Security benefits beginning at age 65, performing the following calculations can help you estimate the total amount you'll need on your retirement day. These calculations do not represent the performance of any particular savings vehicle, and they are for illustrative purposes only. Bear in mind that the **full retirement age** (the age at which one is eligible to receive full Social Security benefits) is gradually increasing to age 67 for individuals born in 1960 and later.

For comparison purposes, let's return to Henry Foster, who plans on retiring in 15 years at age 65 and has managed to save \$45,000. Based on his income requirements and his income resources, Henry will need to save a total of \$254,200 by retirement, or \$9,474.40 per year.



6. To estimate how much you need to save, multiply line 5 (the amount of your retirement shortfall) by the appropriate factor below:

Anticipated retirement age:	Multiply by:
55	21.0
60	18.9
65	16.4
70	13.6

7. Enter the current total of your savings, including any funds in retirement plans such as a **401(k)** or **Individual Retirement Account (IRA)**.

8. Multiply line 7 by the appropriate factor:

Retiring in:	Multiply by:
10 years	1.3
15 years	1.6
20 years	1.8
25 years	2.1
30 years	2.4
35 years	2.8
40 years	3.3

9. Subtract line 8 from line 6 to reach the estimated amount of savings needed at retirement.

10. To estimate the amount you need to save each year, multiply line 9 by the appropriate figure:

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retirement savings worksheet

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Retiring in:	Multiply by:
10 years	.085
15 years	.052
20 years	.036
25 years	.027
30 years	.020
35 years	.016
40 years	.013

(Source: ASEC, 2003)

This worksheet is intended to be used as a starting point estimate of what you will need to save for a financially secure retirement. For specific guidance, consult a financial professional. Learning what you must save in order to reach your retirement goals is an important aspect of retirement planning, and the sooner you do so, the closer you will be to fulfilling your dreams. ■

Your Figures	Henry's Figures
1. \$ _____	\$ <u>35,000</u>
2. \$ _____	\$ <u>14,500</u>
3. \$ _____	\$ <u>0</u>
4. \$ _____	\$ <u>5,000</u>
5. \$ _____	\$ <u>15,500</u>
6. \$ _____	\$ <u>254,200</u>
7. \$ _____	\$ <u>45,000</u>
8. \$ _____	\$ <u>72,000</u>
9. \$ _____	\$ <u>182,200</u>
10. \$ _____	\$ <u>9,474.40</u>

Entrepreneurship and the New Retiree

For more and more retirees, retirement signals not the end of a career, but rather the beginning of a new phase—entrepreneurship. Many baby boomers view retirement as an opportunity to start a new chapter in life and hope to use their hard-earned skills and knowledge to create their own independent businesses.

With increased longevity, retirement often accounts for 25%–30% of a person's life. According to a study of those age 50 and older by the American Association of Retired Persons (AARP), of those surveyed, seven out of ten plan to work in retirement. Financial reasons for continuing to work are a primary consideration, but one in three report they intend to continue working for the enjoyment and “sense of purpose” work brings (AARP, 2003).

Regardless of personal motivation, there are many advantages that those age 50 and older possess when starting their own business ventures. By retirement, mortgages have often been paid and children have graduated

from college. With fewer financial obligations—and perhaps a cushion from a lifetime of saving—the retiree may have the opportunity to take his or her time in developing a strong business plan and concept. Retirees also have the ability to utilize the many business contacts and skills garnered over their working years to further product development, marketing, and sales. This can prove extremely useful for those who wish to use their experiences in a particular field to strike out on their own.

Many retirees find the opportunities of their dreams during their golden years. For example, prior to retirement, Bill and Helen Dawson (a hypothetical case) had thriving careers in accounting and travel services, respectively. After retiring, Bill and Helen quickly discovered they were not content to stay at home and felt that combining their skills would serve them well in their own business endeavor. Drawing upon Helen's years of customer service and Bill's book-keeping finesse, the couple opened

a bed and breakfast, which has allowed them to use their pre-existing expertise in a new and challenging way. If you want to use your years of wisdom to build *your own* company, here are some questions to consider:

1. Are you personally motivated?

Building a business requires intense dedication. You will need to develop your own ideas, set your own schedule, and manage a variety of responsibilities.

2. Are you a “people” person?

Running your own business will likely involve a great deal of interaction with various professionals and personality types. If you can harness the people skills you gained from four decades in the working world, you will be better prepared to handle difficult clients or professionals.

3. Do you have the ability to think quickly?

Representing your own company can mean that you will have to provide answers and decisions at a fast pace, and sometimes under pressure.

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it's never too late to save for retirement

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The IRA Alternative

You may also want to factor Individual Retirement Accounts (IRAs) into your savings plan. Generally, the tax-advantaged contribution limit for all types of IRAs is \$5,000 for 2008. Depending on your tax-filing status, your income, and whether or not you participate in a qualified employer-sponsored retirement plan, you may be able to take an income tax deduction for contributions to a traditional IRA. If, however, you participate in an employer-sponsored plan, income limits apply.

A Roth IRA may be a good choice if you participate in a qualified employer-sponsored retirement plan

and exceed the income limits for a deductible IRA, but do not exceed the higher limits set for Roth IRAs. As with the Roth 401(k), contributions to Roth IRA accounts can only be made with after-tax dollars, but distributions are tax free after the age of 59½, provided the account is at least five years old.

Roth IRAs also offer greater flexibility than traditional IRAs. The tax-free withdrawals from a Roth IRA could, for example, come in handy if income from a job, combined with forced distributions from tax-deferred plans, were to push you into a higher tax bracket in retirement. There are no mandatory distributions associated

with Roth IRAs, and penalty-free withdrawals are possible prior to retirement in certain situations.

If your high earnings make you ineligible for a traditional or a Roth IRA, you could consider contributing to a nondeductible IRA, which has no income restrictions. While it offers fewer tax advantages than other IRAs, your savings in a nondeductible account will still grow tax deferred.

Once you have exhausted your tax-advantaged options, you may also want to consider other savings vehicles. Your financial professional can advise you on which strategies are best suited to your individual situation. ■

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4. Do you have passion and stamina? It is often said that you must love what you do. Realize at the start of the enterprise that a good deal of time and effort may be required, but also know that the rewards can make your labors worthwhile.

5. Are you organized? Thorough organization and planning can lead to continued business success. Finances, invoices, and schedules are just a few of the tasks at which you must be or become proficient. According to the Small Business Administration (SBA), poor planning is responsible

for a majority of failed business attempts (SBA, 2003).

6. Is your motivation level high? A business requires a lot of work, and it can be physically and emotionally stressful. Those who are highly motivated often do well under stress because their "hunger" drives them forward.

7. Will your family be supportive? A new business can consume a lot of your time, mental energy, and sometimes, capital. Make sure to tell your family what they can realistically expect the experience to be like, and gain their support and trust.

There are many advantages to self-employment. The chance to be your own boss, experience the payoff of your own hard work, and harness the limitless financial and growth potential, all combine to make entrepreneurship an exciting and educational adventure. Interestingly, a lack of experience often accounts for many small business failures. Therefore, a lifetime of knowledge can put you far ahead of the game before it even begins, and many of today's retirees welcome the challenge. ■

The information provided is not written or intended as tax or legal advice and may not be relied on for purposes of avoiding any Federal tax penalties. Individuals involved in the estate planning process should work with an estate planning team, including their own personal legal or tax counsel.