



Commonwealth Sense

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Basics of Investing Continued ...

by

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Gene Perret, Comedy Writer on Retirement: "It's nice to get out of the rat race, but you have to learn to get along with less cheese."

As discussed in the two previous Commonwealth Sense articles, Basics of Investing I & II, investing starts with the creation of a plan. These days, the construction of a plan focused on saving for retirement has become increasingly important given that personal savings and investment will undoubtedly play a bigger role in funding one's retirement, coupled with the fact that both the costs and length of time an individual spends in retirement are likely to increase. This article will review some important questions related to retirement -- that set the stage for creating the right investment strategies -- and also highlight some of the attributes of popular investment vehicles used by individuals to save for retirement.

IMPORTANT RETIREMENT QUESTIONS

What kind of retirement do you want?

Some of us would like to travel extensively; others simply want to spend time watching the grass grow. Regardless of how you plan on spending your retirement years, one thing is certain; living in retirement costs money. And the simple fact is that most people are not saving enough to fund the type of retirement they want. Traditionally, Social Security and company pension plans were primarily depended upon to fund an individual's retirement. The current belief is that these established retirement income sources will no longer play as prominent a role going forward. Instead, personal savings are expected to play a much larger role funding future retirements.

The bottom line: The more you save, in tandem with the appropriate investment of your savings, the better your chances of enjoying the type of retirement you've always wanted!

How much should I plan to save for retirement?

Some individuals may be able to live on less during retirement, but others may find they need more -- just as during one's working years. Unfortunately, there is no magical formula or simple solution to this question. An assessment of an individual's essential versus lifestyle expenses in retirement is needed. As a general rule of thumb, amassing enough to replace at least 70 – 90% of your pre-retirement income is a good starting point.

Another way of addressing this question would be to understand what would be considered a reasonable, annual withdrawal rate from your retirement savings. Many financial planners believe an annual withdrawal rate of 4%–5% is reasonable and sustainable over a long retirement horizon of 25-30 years.

The bottom line: Don't put off planning and investing for retirement. The sooner you start, the longer your investments have to grow. Attempting to play "catch-up" later can be difficult and expensive.

When do you want to retire?

For some, an early retirement is the way to go; but for most, an early retirement may not be feasible. The earlier you plan on retiring, the shorter the period of time you have to accumulate funds and the longer those dollars will need to last and endure the effects of inflation and health care related expenses. The risk of retirees outliving the money in their portfolio is especially a concern for those taking advantage of early retirement or those who have a family history of longevity. Retirees need to consider how long they may possibly live. For a couple aged 65, there is a 25% chance that one of them will live to age 96—a 31-year retirement time horizon!

The bottom line: Both life expectancy and expenses during retirement are increasing, which may require most individuals to continue working for a longer period of time.

401(k) RETIREMENT SAVINGS PLANS

Introduced in 1978, the 401(k) is a popular and prudent investment vehicle that should be viewed as the primary investment vehicle to leverage when saving for retirement. A 401(k) is a retirement plan established by an employer which allows eligible employees to contribute a portion of their salary on a post-tax and/or pretax basis. Many employers offering 401(k) plans may also make matching or non-elective contributions to the plan on behalf of eligible employees.

Primary Benefits of 401(k) Plans:

- A 401(k) represents an opportunity to reduce your taxable income
 - » Traditional 401(k) contributions come out of your pay before taxes are withheld
 - » Roth 401(k) contributions are taxed prior to being invested in the plan
- Many plans include a matching contribution from the employer
- Plans typically offer a broad array of investment choices, which can be mixed to create a customized approach for each participant's unique investment profile based on risk tolerance, time horizon, etc.
- The money you save benefits from tax-deferred growth
 - » Traditional 401(k) - Dividend, interest, and capital gains are not taxed until they are disbursed
 - » Roth 401(k) - Withdrawals, including any earnings, are tax-free
 - » This lets your money compound more quickly than it would if it were taxed yearly

Types of 401(k) Plans:

Traditional 401(k) Plans:

- Currently allows you to defer up to \$16,500 of your annual compensation
- Presently individuals age 50 or older can make additional "catch-up" contributions of \$5,500 each year, and that is in addition to the \$16,500 mentioned above
- Invested funds can grow tax deferred until withdrawn
- Employer "Match" is free money
- Limited to investment options offered by plan
- Distributions made prior to age 59 ½ (Age 55 in some circumstances) are subject to additional 10% premature distribution tax

Roth 401(k) Plans:

- Contributions are after tax
- Funds grow tax deferred until withdrawn
- Currently total contributions (Roth and pretax) up to \$16,500 of your annual compensation, \$22,000 if age 50 or older
- Qualified distributions are federal income tax free
 - » 5-year holding period AND
 - » Either age 59 ½ or disabled
- Nonqualified distribution – both Federal income tax and a 10% premature distribution tax may apply to earnings portion

Whether your retirement plans are on the distant horizon or just right around the corner, you should seek the assistance from an experienced investment professional. If you are ready to learn more about what First Commonwealth Advisors can do for you, please contact one of our Financial Advisors to get the conversation started. You can reach them toll-free at 1-855-ASK-4-FCA or visit us on the web at fcbanking.com.

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