Maximize Your Retirement Investments

A step-by-step guide to building a secure nest egg through an employer-based plan or on your own.

In partnership with

By the Editors of
Kiplinger's Personal Finance

CONTENTS

About the Investor Protection Trust

The Investor Protection Trust (IPT) is a nonprofit organization devoted to investor education. More than half of all Americans are now invested in the securities markets, making investor education and protection vitally important. Since 1993 the Investor Protection Trust has worked with the States and at the national level to provide the independent, objective investor education needed by all Americans to make informed investment decisions. For additional information, visit www.investorprotection.org.

About the Investor Protection Institute

The Investor Protection Institute (IPI) is an independent nonprofit organization that advances investor protection by conducting and supporting unbiased research and groundbreaking education programs. IPI carries out its mission through investor education, protection and research programs delivered at the national and grassroots level in collaboration with state securities regulators and other strategic partners. IPI is dedicated to providing innovative investor protection programs that will make a meaningful difference in the financial lives of Americans in all walks of life and at all levels of sophistication about financial matters. For additional information, visit www.iInvest.org.

TABLE OF CONTENTS

1 Three key rules

3 Choosing the right investments

8 Investing on target

8 Best places to save

13 Getting the money out

14 Create an income stream

15 Protect your money: Check out a broker or adviser

17 Glossary of investing terms

Kiplinger's PERSONAL FINANCE MONEY SMART LIVING

© 2015 by The Kiplinger Washington Editors Inc. All rights reserved.

Saving today will improve retirement tomorrow

As American employers continue to abandon traditional pension plans in favor of more-flexible 401(k)s, individual workers are becoming increasingly responsible for their own retirement security. Although the government's Social Security program will provide you with some income, the quality of your retirement will depend largely on how you save and invest your money today.

When you're just starting to save for retirement, the bulk of your nest egg will come from your contributions, so it's important to make saving a habit. As time goes by and your nest egg grows, investment returns will represent a larger slice of your retirement savings. That's why it's so important to select the right investments to maximize your savings. Whether or not you have a retirement plan at work, you can save on your own in an individual retirement account (IRA).

Three Key Rules

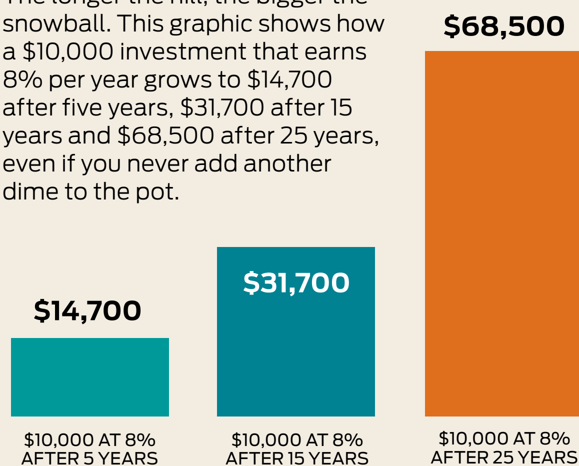
To put your retirement plan on track and keep it there, you need to master a few basic financial rules.

Rule #1: Time is on your side. Retirement is a long-term goal. Whether you're just starting your career or counting down your final years until retirement, one of your key investment allies is the "magic of compounding"—your interest earns interest and profits build on profits automatically. For example, let's say you invest $10,000 in an investment that pays an 8% annual return. You'll have $10,800 at the end of year one. After five years, your $10,000 will have grown to $14,700, $31,700 after 15 years and $68,500 after 25 years, even if you never add another dime to the pot.

But don't stop there. Your nest egg will grow more quickly if you continue to add to it year after year. Say you want to save enough to replace 80% or more of your preretirement income through a combination of Social Security benefits, personal savings and other sources of retirement income, such as a pension or a part-time job. To achieve that goal, you should start saving for retirement with your first job and ultimately aim to contribute 15% of your gross income—including any employer contributions. In the meantime, don't

THE MAGIC OF COMPOUNDING

Think of compounding as a snowball growing as it rolls down a hill. The longer the hill, the bigger the snowball. This graphic shows how a $10,000 investment that earns 8% per year grows to $14,700 after five years, $31,700 after 15 years and $68,500 after 25 years, even if you never add another dime to the pot.



Don't worry about ups and downs in the market

worry about the short-term ups and downs of the stock market—even huge swings, such as the massive downturn in the bear market that began in 2007 (and lasted through early 2009) and the remarkable rally that followed. You're a long-term investor who will benefit from putting time to work for you. And that means not cashing out your investments when the market tanks or borrowing from your retirement account to fund short-term needs. Your goal is to build as big a retirement kitty as possible—without taking unreasonable risks. The key word here is "unreasonable" and leads us to rule #2.

Rule #2: All investing involves some risk. Investing is a bundle of trade-offs between risk and reward. A willingness to take some risk with your money today provides you with the chance to earn a bigger return in the future.

In fact, the hidden risk of retirement investing comes from not taking enough risk. By stashing all of your money in supersafe investments, such as bank certificates of deposit and money-market funds, you forfeit your chance at bigger gains—and a more secure retirement. In effect, you swap one kind of risk—investment volatility—for two others: the risk that your nest-egg performance won't keep up with inflation or that you'll outlive your money.

Certainly, it can be nerve-racking to stick to your long-term investment goals during times of severe market volatility. But keep in mind that even if you retire tomorrow, you don't need *all* of your money tomorrow. And even in retirement, you're still a long-term investor, so you'll need to keep a portion of your assets invested for growth to carry you through a retirement that could last 20 years or more.

The real losers during the latest market meltdown were those who panicked and bailed out as the market fell, locking in losses. Those who continued to invest throughout the downturn were rewarded. They scooped up bargain-price shares that grew more valuable as the market rebounded. That's just one example why time in the market—and not trying to time the market by constantly buying and selling—is the best strategy for long-term investors.

The more time you have to reach your retirement goal, the more investment risk you can afford to take. The best approach is to start out with higher-risk investments, such as stocks or mutual funds that invest in stocks, when you're in your twenties, thirties and forties. Then, as you near retirement in your

The more time you have to reach your retirement goal, the more investment risk you can afford to take. Start with stocks, then move into bonds.

fifties and sixties, gradually reduce your risk level by shifting some of your money into more-conservative investments, such as bonds or bond funds.

If you are close to retirement and your savings haven't grown fast enough to meet your anticipated retirement-income needs, you might be tempted to increase your risk in hopes of achieving a higher return. Don't. A better solution is to delay retirement a few years until you've saved more and built the nest egg you need. And delaying retirement has a double-barreled financial benefit: The longer you wait to claim your Social Security benefits, the bigger they will be, until they reach the maximum value at age 70. Plus, the later you retire, the fewer years your nest egg will need to support you.

Rule #3: Diversification works. By dividing your retirement money among several types of investments—that is, diversifying your portfolio—you can reduce your risk and increase your opportunity for higher returns. Because no investment performs well all the time, when one is down, something else is likely to be up. (The stock market's 2007–09 collapse, coupled with an economy-wide credit crunch, created a rare perfect storm in which virtually every investment class declined. But by the end of 2009, many investors had recovered most of their losses.)

Choosing the Right Investments

Your investment choices fall into three broad categories: stocks, bonds and cash. You can buy individual stocks or bonds through a broker or gain instant diversification and professional management by selecting mutual funds that invest in stocks or bonds or some combination of the two. Cash generally refers to savings accounts, money-market funds and other low- or no-risk, easy-to-access investments.

If you're investing through your employer's retirement plan, you'll likely be offered a menu of mutual funds or an all-in-one target-date fund. Target-date funds combine a diversified portfolio of mutual funds that grows more conservative as you near your retirement date. IRA owners, who can set up an account with a traditional or online broker, mutual fund, bank or other third-party administrator, can choose from almost any kind of investments.

Stocks. In general, stocks have outperformed all other investments by a big margin over long periods of time. But the decade of 2000–09 was an exception. It was

Investment choices fall into three categories

the first time since the Great Depression that stocks lost money over a ten-year period, following double-digit annual returns during the 1980s and 1990s. Of course, not every investor lost money in the first decade of the new century. Those who diversified into other investments, particularly bonds and foreign stocks, generally earned positive returns, and those who invested in stocks gradually over the ten-year period exhibited better results than the overall market's performance suggested. At any rate, since 1926, the stocks of large companies have produced an average annual return of nearly 10% (including the lows during the Great Depression, the 2000–02 stock slide that followed the collapse of the Internet bubble and the financial crisis of 2007–09).

When you buy a stock, you are purchasing an ownership share in the company that issues it. If the company performs well, you reap the rewards as share prices increase. If the company performs poorly, the value of the stock declines. Some stocks pay dividends, which are profits the company distributes to its shareholders.

Stocks are divided into categories based on the size or type of company. Some are riskier than others.

Growth stocks. These include shares of companies with good prospects for growing faster than the overall economy or the stock market in general. Although their share prices are expected to go up over the long term, they may involve moderate-to-high risk in the short run.

Blue-chip stocks. Although you won't find an official blue-chip stock list, this category includes industry-leading companies (such as the 30 stocks that form the Dow Jones industrial average, a major performance measure of the U.S. stock market) that tend to have stable earnings, pay dividends and offer less risk than stocks of less-established companies. They should form the core of your retirement portfolio.

Income stocks. These companies pay out a larger portion of their profits in the form of quarterly dividends than other stocks. They tend to be mature, slower-growth companies. As long as the companies

keep up their distributions, the dividends paid to investors make these shares less risky to own than many other stock categories.

Cyclical stocks. The fortunes of these companies, which include such industries as airlines, home builders and chemical companies, tend to rise and fall with the economy, prospering when the economy is on the upswing and suffering in recessions.

When you buy a stock, you are purchasing an ownership share in a company. Stocks are divided into categories based on the size or type of company.

Small-company stocks. Shares in stocks of small companies are riskier than blue-chip or income stocks. As a group, their long-term average returns have been high, but those long-term returns come at a price: short-term volatility.

Foreign stocks. Adding a dash of international flavor to your retirement portfolio through foreign-stock mutual funds can increase its diversification and returns because international markets tend to perform differently than the U.S. stock market. Foreign stocks are subdivided into developed markets, which are established and less risky, and emerging markets, which are faster-growing and more volatile.

Bonds. A bond is an IOU issued by a corporation or a government. When you buy a bond, you are making a loan to the issuer. In return, the company or government agrees to pay you a fixed amount of interest, usually twice a year, until the bond matures. At that point, you are paid the bond's face value. For example, let's say you buy a $10,000 bond with a 4% interest rate (called the coupon rate). Each year, you would receive $400 in interest, in two, $200 installments and, at maturity, you'd get back your $10,000. You can sell the bond to another investor before it matures.

But bonds aren't without risk—mainly from interest rates. The bond market thrives when interest rates fall. For example, a bond paying 5% interest that was issued last year will be more valuable today if new bonds are paying only 4%. So if you paid $1,000 for your bond, you could probably sell it at a premium. For example, your $1,000 bond might be worth $1,250 to another investor. That's because an investor would have to invest $1,250 at 4% to earn as much interest as you're earning on your $1,000 investment at 5%.

But the reverse is also true. When interest rates rise, bond values drop. You could lose money if you had to sell lower-yielding bonds. For example, if you bought a 30-year bond yielding 5% and new bonds jumped to

Bonds add safety but reduce your overall return

6%, your bond would be worth about $833. But if you held the bond to maturity, such price swings wouldn't matter. You'd still earn 5% annually and you would receive the full value of the bond when it comes due.

Over the long term, the performance of both corporate and government bonds has lagged the stock market. But if stocks are too unsettling for you, or if you have fewer than ten years until retirement, you may want to add modest amounts of bonds or other fixed-income vehicles to reduce the overall risk level of your portfolio. (Your employer-based retirement plan may offer a stable-value investment option, which acts like a bond but includes insurance to provide a guaranteed rate of return.)

Although investing a portion of your assets in bonds may reduce your overall rate of return, the additional diversification and safety will make for a smoother ride toward retirement.

Mutual funds. Mutual funds offer a combination of services that are ideal for retirement investors. They are especially well-suited for beginning investors who worry about their ability to select appropriate stocks or bonds and who could benefit most from this brand of professional management. But even experienced investors and those with large portfolios can benefit from what mutual funds have to offer: instant diversification, automatic reinvestment of earnings and easy-to-monitor performance.

A mutual fund pools money from many investors and buys a portfolio of stocks, bonds or a mix of both designed to achieve a specific investment goal. The fund might own a selection of well-established blue-chip stocks, small-company stocks, foreign stocks, foreign bonds, or a host of other investment types or combinations. Each fund's goals and other details are spelled out in its prospectus—a helpful document you should read before investing.

To find the right funds for your retirement portfolio, choose the fund types whose objectives and willingness to take risks match yours.

The categories used to describe mutual funds do a pretty good job of indicating the kinds of investments the funds make. To find the right funds for your retirement portfolio, concentrate on the fund types whose objectives and willingness to take risk match yours. For example, aggressive-growth funds take the biggest risk by purchasing shares of fast-growing companies, trading rapidly or engaging in other risky strategies; international funds invest in shares of companies based outside the U.S.; and balanced funds balance their portfolios between stocks and bonds.

Because the rate of return on your money needs to

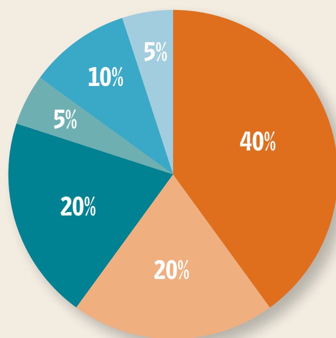
at least keep up with the rate of inflation before and after you retire, you should keep a significant amount of your retirement savings in stock funds. Just how much depends on how long you have until you retire and your appetite for risk.

Exchange-traded funds. Exchange-traded funds are a cross between index funds and stocks. Like index funds, ETFs hold baskets of securities that follow indexes. Unlike mutual funds, which are priced just once a day (at 4 P.M. eastern time), ETFs trade just like stocks throughout the trading day. Because you can buy as little as a single share of an ETF, the minimum for owning an ETF is typically far less than for owning a mutual fund (many ETFs trade for $10 a share or less).

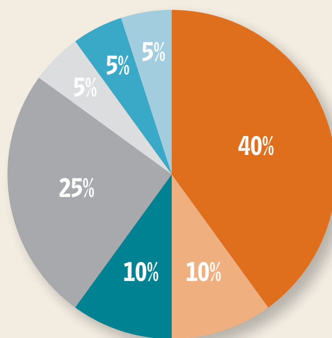
While ETFs make sense for individual investors, they have been slow to infiltrate the 401(k) market. Initially, retirement-plan administrators raised concerns that ETFs, with their all-day trading structure, would create a record-keeping nightmare. But their low cost is appealing, particularly to sponsors of small and midsize plans looking for ways to hold down expenses. They are less appealing to large plans that already benefit from rock-bottom fund fees due to their large volume and institutional pricing. So far, ETFs are the exception rather than the rule on most 401(k) investment menus, but that could change in the future.

GUIDELINES FOR YOUR RETIREMENT SAVINGS AT EVERY STAGE

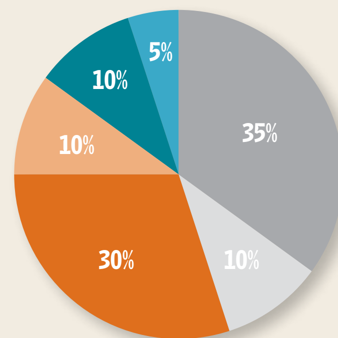
If you're more than 10 years from retirement



If you're 10 years or less from retirement



If you're in retirement



Large-company U.S. stocks
Small-company U.S. stocks
Developed-markets foreign stocks
Emerging-markets foreign stocks
Real estate stocks
Natural-resources stocks
Domestic bonds
Cash and equivalents

Target-date funds play a large and growing role

Investing on Target

In recent years, a new, easier way to invest for retirement has emerged: target-date retirement funds. You pick a fund with a name that includes a year close to the year you plan to retire. As the date approaches, the fund automatically adjusts the proportions of the stocks and bonds in the portfolio to become more conservative and protect your nest egg.

These all-in-one funds are designed as a turnkey investment option: In theory, you invest all your retirement savings in a single, professionally managed fund and you end up with a well-diversified portfolio appropriate to your age and retirement timeline. But the theory was put to the test when many 2010 target-date funds, designed for investors nearing retirement, lost 30% or more during the 2007–09 bear market. While that performance was better than the 55% drop in Standard & Poor's 500-stock index (a basket of stocks that is a widely followed benchmark of the overall U.S. stock market), it was cold comfort for workers forced to delay retirement or retirees who had to scale back their withdrawals to preserve their shrunken account balances.

The situation sparked outrage among some investors and triggered congressional hearings about the future of target-date funds. The upshot: The Securities and Exchange Commission tinkered with the rules to rein in some outliers and require better disclosure to investors.

Part of the problem with target-date funds is their name. The debate continues to rage over whether the funds should be invested "to" the retirement date in the label or "through" a retirement that could last 20 or 30 years beyond that. Most target-date funds continue to invest for long-term growth well beyond the retirement date.

Despite these concerns, target-date funds play a large and growing role in retirement investing. If your retirement account represents the bulk of your investment portfolio and you're looking for a fix-it-and-forget option, these funds may be right on target for you.

> Target-date funds are a turnkey investment option that allow you to invest all your retirement savings in a single fund.

Best Places to Save

The key to a successful retirement-investment plan lies not only in choosing the right investments but also in choosing the right place to keep them. Over the years, Congress has created numerous ways for retirement investors to shelter their dollars during their working years, allowing their savings to grow unfettered by taxes until withdrawn in retirement.

In recent years, that save-now-tax-later model has been turned on its head with the Roth IRA and Roth 401(k) options, which offer no upfront tax break but provide tax-free income in retirement. Now you can choose which account or combination of accounts best suits your retirement goals.

In addition to IRAs for individual investors, there are a variety of workplace-based accounts: 401(k) plans, used by private employers; 403(b) plans, used by schools, hospitals and other nonprofit organizations; 457 plans, used by state and local governments; and the Thrift Savings Plan, for federal workers. Self-employed individuals can put away more than twice as much as the average employee each year using special retirement accounts, including Simplified Employee Pensions and solo 401(k) plans.

Collectively, these workplace-based retirement accounts are referred to as "defined contribution" plans. Employees are responsible for contributing to their own accounts (sometimes supplemented by employer contributions) and deciding how to invest the money. With traditional pension plans, employers shoulder the burden for funding and investing pension funds on behalf of employees. Eligible retirees can count on a regular monthly pension benefit or a lump-sum payout from these defined-benefit plans.

Traditional IRAs. Anyone who has earned income from a job and who is younger than 70½ can contribute to a traditional IRA. You may set aside up to $5,500 of your earnings in an IRA for 2014. And if you are age 50 or older by the end of the year, you can add an extra $1,000 in "catch up" contributions, for a total of $6,500. (The contribution limits may increase in the future.) In most cases, you can deduct your IRA contribution if you are not covered by a retirement plan at work.

If you have an employer-provided plan, the deductibility of your contribution hinges on your income. You can deduct your full IRA deposit if you are married and your adjusted gross income doesn't top $96,000 in 2014, or if you are single and your income doesn't exceed $60,000. The deduction phases out above those income levels. (Income-eligibility limits will increase in future years to keep pace with inflation.)

If you are married and not covered by a retirement plan at work but your spouse is, you can deduct your full IRA contributions if your joint income doesn't exceed $181,000 in 2014. If you work but your mate doesn't, you can set up a spousal IRA for him or her

The real beauty of IRAs is tax-deferred earnings

and contribute the maximum $5,500 for 2014 or $6,500 if he or she is 50 or older.

You don't have to rush to contribute to your IRA by the end of the year. You have until April 15 of the following year—the day your tax return is due—to contribute. That gives you until April 15, 2015, for example, to make a tax-deductible IRA contribution for 2014 and deduct it on that year's return. If you're in the 25% bracket and contribute $5,500 to an IRA, it will save you $1,375 on your federal taxes (plus additional savings on your state income taxes).

The upfront tax deduction is nice, but the real beauty of an IRA is that your earnings accumulate tax-deferred, supercharging the already powerful effect of compounding. A yearly $5,500 IRA contribution earning 8% per year over 20 years will grow to almost $272,000, significantly more than if those savings were held in a taxable account (see box at right).

The tax deduction and deferral are the carrots. Here's the stick to enforce disciplined saving for retirement: Touch the money before you're 59½ years old and you'll be hit with a 10% penalty, on top of owing income tax on every dime you withdraw. (There are a few exceptions to the early-withdrawal penalty. It's waived, for example, if you use IRA funds to pay college expenses; use up to $10,000 to buy a first home for yourself or family members; or pay medical expenses in excess of 10% of your adjusted gross income, or 7.5% of AGI for IRA owners age 65 and older.)

Between ages 59½ and 70½, you can take as much or as little out of your IRA as you want without penalty. But the income-tax bill will still apply. Once you reach age 70½, you must take annual distributions based on your life expectancy. If you don't, you'll face a stiff penalty—50% of the amount you failed to withdraw.

Roth IRAs. Another way to save on your own for retirement is a Roth IRA. The contribution limits are the same as for traditional IRAs—$5,500 for most workers and their spouses and $6,500 for those who are 50 or older by the end of the year. The contribution deadline

TAX-DEFERRED SAVINGS BENEFIT

A yearly $5,500 IRA contribution earning 8% per year over 20 years will grow to almost $272,000. If those savings were held in a taxable account and taxed in the 25% tax bracket each year, the account would grow to only about $197,000.

(the April tax-filing deadline) is also the same.

But there are critical differences. There's no age 70½ cutoff for Roth contributions. As long as you have earnings from a job, you can shovel cash into your Roth. Unlike a traditional IRA, there is no upfront tax deduction for a Roth IRA, either. Instead, you make your contributions with after-tax money. While a Roth IRA grows tax-deferred, just like a traditional IRA, the big advantage comes at the end: Withdrawals are tax-free in retirement. That could be crucial if you think your tax rate may be higher in retirement.

> Thanks to a change in the rules that went into effect in 2010, anyone, regardless of income, can convert a traditional IRA to a Roth IRA.

Roth IRAs offer another advantage to retirees: There are no mandatory distribution rules. That means you don't have to tap your Roth IRA unless you want to. Another major departure from the traditional IRA is particularly important to your heirs. While funds withdrawn from an inherited traditional IRA are taxed, funds in a Roth go to heirs tax-free.

Roth IRAs are more flexible than traditional IRAs, too. Because the contributions are funded with after-tax dollars, you can withdraw your contributions (but not earnings) anytime tax-free and penalty-free. Once your turn 59½, you can even dip into earnings tax-free if the account has been open for at least five years.

Not everyone is eligible to contribute to a Roth IRA. To contribute the full $5,500 ($6,500 if you are 50 or older) in 2014, your income can't exceed $114,000 if you're single or $181,000 if you're married filing jointly. You can make a partial contribution if you're single and your income is between $114,000 and $129,000 ($181,000 and $191,000 if married filing jointly).

Thanks to a change in the rules that went into effect in 2010, anyone, regardless of income, can convert a traditional IRA to a Roth IRA. You must pay tax on the amount converted, but the switch means future earnings will be tax-free rather than simply tax-deferred.

Employer plans. About half of all workers have the opportunity to save for retirement through an employer-based plan. You simply sign up to steer part of your salary each pay period into the plan, reducing the amount of income that is taxed. In 2014, you can set aside up to $17,500 in your plan, plus an additional $5,500 in catch-up contributions for workers age 50 or older by the end of the year. Increasingly, employers are automatically enrolling employees in 401(k) and similar plans, and many also offer automatic escalation clauses that boost your annual contribution by one or two percentage points each year. (Employees may opt out of either automatic option.)

Start early to build a bigger nest egg

Whether your employer signs you up or you have to exert a little effort, don't pass up this opportunity to save inside a tax shelter. The earlier you start to save, the bigger your future nest egg will be. And it may cost you less than you think. If you're in the 25% federal tax bracket, your take-home pay will drop by just $75 for every $100 you put in the plan. (Actually, you'll lose less than $75 if your contribution also avoids state income tax.)

Many companies offer matching contributions, too. If yours does, try to contribute at least enough to capture the match. For example, say your company kicks in 50 cents for every dollar you contribute to your 401(k), up to 6% of pay. If you earn $50,000 a year, you need to contribute $3,000 to capture the full $1,500 match from your employer. That's a guaranteed 50% return on your money. Contribute less than your 6% share and you're walking away from free money.

Funding your retirement account is just the first step. The next decision is how to invest that money. Most employer-based retirement plans offer a menu of investment options, usually mutual funds that invest in a broad range of stocks and bonds. Many plans offer guidance on how to invest the money to meet your goals, whether it's in one-on-one counseling sessions, online or over the phone.

Be sure to review your account from time to time to make sure you're still on track. Most employer plans provide quarterly investment statements to help you chart your progress. And you may be able to sign up for automatic rebalancing to bring your investments back in line with your original asset allocation. Say your original plan called for 70% stocks and 30% bonds, and, due to strong market performance, your account is now split 80% stocks and 20% bonds. To get back to your original investment allocation, you have to sell investments that have performed better—in this case, stocks—and use the proceeds to buy those that have lagged—in this case, bonds. In effect, you'll be following the golden rule of investing: Buy low and sell high.

Review your retirement account from time to time to make sure you're still on track. You may be able to sign up for automatic rebalancing.

The Roth 401(k). Many employers are offering another option for saving for retirement: the Roth 401(k). Like a Roth IRA, pay-ins do not reduce taxable income because they are made with after-tax dollars. But you can contribute more to a Roth 401(k) than to a Roth IRA: $17,500 for workers under age 50 and $23,000 for those 50 and older by the end of the year.

For upper-income workers who have been barred

from contributing to Roth IRAs, Roth 401(k)s offer a nice feature: no income-eligibility limits. If your employer offers both traditional and Roth 401(k) options, you can split your contributions, but your combined total can't exceed the allowable maximums for the year. Contributions to and earnings on the Roth part of your account will be tax-free in retirement; pretax contributions and matching funds—and the earnings on them—will be taxed in retirement.

On your own. Self-employed individuals take a lot of risks investing in their own business and working hard to keep it going. Uncle Sam offers these entrepreneurs an extra incentive to save for retirement by allowing them to shield large chunks of money from taxes each year. The two most popular options are SEP IRAs and solo 401(k)s.

The SEP is easier. It's available through most mutual fund companies and brokerage firms, generally with the same range of investment choices as their IRAs. You can contribute up to 20% of your *net* business income (which is business income minus half of your self-employment tax), up to a maximum deposit of $52,000 in 2014. You have until April 15 of the following tax year to set up and fund a SEP IRA for the previous year.

If you want to shelter even more self-employment income from taxes and don't mind a little extra paperwork, consider opening a solo 401(k) plan. It has the same $52,000 maximum as a SEP, but because you fund your solo 401(k) as both an employer and an employee, you can reach the maximum contribution with a lower income than you can with a SEP.

With a solo 401(k), you can contribute up to $17,500 as an employee. Plus, you can kick in 20% of your business income with a maximum contribution of $52,000 in 2014. And if you're 50 or older by the end of the year, you can contribute an extra $5,500 in catch-up contributions, for a total of $57,500. (SEPs do not permit catch-up contributions.) You must establish a solo 401(k) by December 31 of the year for which you are claiming contributions, but you have until April 15 of the following year to fund it.

Getting the Money Out

Because the aim of 401(k) plans is to encourage saving for retirement, the IRS puts restrictions on taking the money out too soon. You generally can't have it back until you leave the company—or reach age 59½, if your plan allows "in service" distributions.

When you leave the job, how the money is treated depends on your age and what you do with it. You have four choices: leave it with your former employer; transfer it to your new employer's plan, if allowed; roll it over to an IRA; or cash it out. The first three choices have no immediate tax consequences. The last one does and it can be costly, both immediately and in the long run. You'll owe taxes on your distribution, plus a

There are penalties if you cash out early

10% penalty if you are younger than 55 in the year you leave your job. It could also take a big bite out of your future retirement nest egg.

You may be able to tap your employer-based retirement account early by taking a loan. If your plan permits it, you can borrow as much as half of your balance, up to a maximum of $50,000. (Solo 401(k) plans also allow loans; SEPs and IRAs do not.) You must repay the loan within five years unless you use the money to buy a home.

When you borrow from your 401(k) account, the plan will deduct the amount of the loan from your account balance and set up a repayment schedule at a specified rate of interest. As you repay, the money is added back to your balance. Because you are, in effect, borrowing from yourself and paying yourself interest, some plan participants think of 401(k) loans as "free money."

But these loans aren't free. The real cost consists of loan setup fees you pay, plus the lost earnings on the funds while they are out of your account. (Depending on your personal situation, however, taking a loan from a retirement account could be cheaper than other sources of borrowing, and there's no credit check to qualify.)

Create an Income Stream

Once you retire, you'll face a new challenge: transforming your lifetime of savings into a stream of income. One strategy to ensure you don't outlive your savings is to limit your initial withdrawals to 4% of your nest egg during your first year in retirement, and increase that amount slightly each year to keep pace with inflation. So if you've stockpiled $500,000 over your career, you could withdraw $20,000 the first year and slightly more in subsequent years. That should leave enough in your investment portfolio to weather the ups and downs of the market during a retirement that could last 20 years or more. But even that conservative drawdown strategy can be risky if your initial years in retirement coincide with a bear market, as happened to those who retired during the 2007–09 market meltdown.

Another option is to lock in guaranteed income by

using a portion of your assets to buy an immediate annuity. It works like this: You turn over a chunk of cash to an insurance company that promises to send you monthly payments for a set period of time—say, five or ten years—or the rest of your life, no matter how long you live. Because you pool your risk with other annuity holders, you receive larger monthly payouts than you could prudently afford to withdraw from your savings. The older you are, the bigger your annuity payouts. It can be a good way to stretch your retirement savings.

> Limit your initial withdrawals to 4% of your nest egg during your first year in retirement, and increase that amount to keep pace with inflation.

Protect Your Money: Check Out a Broker or Adviser

Securities laws require brokers and advisers and their firms to be licensed or registered, and to make important information public. But it's up to you to find that information and use it to protect your investment dollars. The good news is that this information is easy to obtain, and one phone call or a Web search may save you from sending your money to a con artist, a bad broker or a disreputable firm. That's important because if you do business with an unlicensed securities broker or a firm that later goes out of business, there may be no way for you to recover your money—even if an arbitrator or court rules in your favor.

Brokers and brokerage firms. The Central Registration Depository (CRD) is a computerized database that contains information about most brokers, their representatives and their firms. For instance, you can find out whether brokers are properly licensed in your state and whether they have had run-ins with regulators or received serious complaints from investors. You'll also find information about the brokers' educational backgrounds and where they've worked. You can ask either your State Securities Regulator or the Financial Industry Regulatory Authority (FINRA) to provide you with information from the CRD.

For contact information for state securities regulators, go to the North American Securities Administrators Association Web site (www.nasaa.org). To contact FINRA, go to www.finra.org or call 800-289-9999.

Investment advisers. People or firms that get paid to give advice about investing in securities must register with either the U.S. Securities and Exchange Commission (SEC) or the state securities regulator where they have their principal place of business. Investment advisers who manage $100 million or more in client assets generally must register with the SEC. If they

Brokers and advisers must be registered

STATE SECURITIES REGULATORS

State Securities Regulators have protected investors from fraud for more than 100 years. Securities markets are global, but securities are sold locally by professionals who are licensed in every state where they conduct business. State Securities Regulators work within your state government to protect investors and help maintain the integrity of the securities industry.

Your State Securities Regulator can:

- Verify that a broker-dealer or investment adviser is properly licensed;
- Provide information about prior run-ins with regulators that led to disciplinary or enforcement actions; serious complaints that may have been lodged against them; their educational background and previous work history;
- Provide a Web site, telephone number or address where you can file a complaint; and
- Provide noncommercial investor education and protection materials.

For contact information for your State Securities Regulator, visit the North American Securities Administrators Association (NASAA) Web site at www.nasaa.org and click on "Contact Your Regulator."

manage less than $100 million, they must register with the state securities regulator.

Some investment advisers employ investment-adviser representatives, the people who actually work with clients. In most cases, these people must be licensed or registered with your State Securities Regulator. So be sure to check out their registration form, called the Form ADV. It has two parts. Part 1 has information about the adviser's business and any problems with regulators or clients. Part 2 outlines the adviser's services, fees and strategies. Before you hire an investment adviser, always ask for and read both parts of the ADV. You can view an adviser's most recent Form ADV online at http://brokercheck.finra.org.

You can also get copies of Form ADV for individual advisers and firms from the investment adviser, your state securities regulator (see the box at left), or the SEC at www.adviserinfo.sec.gov.

Wrap up. So whether you are self-employed or work for someone else—or you're married to someone who has earned income—there is an investment vehicle that you can use to build a retirement nest egg. The key is to start early, contribute what you can now and strive to increase your contributions in the future. Select appropriate investments for your time horizon and risk level, and ask for help if you need it. Between the magic of compounding and the power of tax-deferred investing, you'll be on your way to a secure retirement. ■

GLOSSARY

Annuity. A lump sum invested with an insurance company in return for monthly payouts for a specific period or for the rest of your life, no matter how long you live.

Bond. An interest-bearing security that obligates the issuer to pay a specified amount of interest for a specified time (usually several years) and then repay the bondholder the face amount of the bond.

Central Registration Depository (CRD). A computerized database that contains information about most brokers, their representatives and the firms they work for.

Certificate of deposit. Usually called a CD, this is a short- to medium-term instrument (one month to five years) issued by a bank or credit union that usually pays interest at a rate higher than that paid by a regular savings account.

Compound interest. This is really interest paid on interest. When interest is earned on an investment and added to the original amount of the investment, future interest payments are calculated on the new, higher balance.

Diversification. The method of balancing risk by investing in a variety of securities.

Dividends. Company earnings that are paid out to stockholders.

Exchange-traded funds (ETFs). Mutual funds that trade like stocks on the exchanges. Their portfolios generally track an index that represents a particular market or a slice of a market.

401(k) plan. An employer-sponsored retirement plan that permits employees to divert part of their pay tax-free into the plan. Money invested in the 401(k) may be matched by the employer, and earnings accumulate tax-deferred until they're withdrawn. Some companies offer a Roth 401(k) option that permits employees to invest after-tax money, the earnings on which are tax-free in retirement.

Individual retirement account (IRA). A tax-favored retirement plan. Contributions to a traditional IRA may be tax-deductible, depending on your income and whether you are covered by a retirement plan at work. Earnings grow tax-deferred, and withdrawals are taxable. Contributions to a Roth IRA are never deductible, but earnings accumulate tax-free and withdrawals are tax-free in retirement.

Money-market fund. A mutual fund that invests in short-term corporate and government debt and passes the interest payments on to shareholders.

Mutual fund. A professionally managed portfolio of stocks, bonds or other investments divided up into shares sold to investors.

North American Securities Administrators Association (NASAA). Membership organization for State Securities Regulators who work to protect investors' interests (www.nasaa.org).

Pension. An employer-provided retirement benefit paid to eligible workers based on salary and years of service. Pensions can be paid as a monthly benefit for life or as a lump sum.

Portfolio. The collection of all of your investments.

Prospectus. The document that describes a securities offering or the operations of a mutual fund, a limited partnership or other investment.

Risk tolerance. The degree to which you are willing to risk losing some (or all) of your investment in exchange for a chance to earn a higher rate of return. In general, the greater the potential gain from an investment, the greater the risk that you might lose money.

S&P 500 index. Standard & Poor's 500-stock index is a basket of stocks that is a widely followed benchmark of the overall U.S. stock-market performance.

State Securities Regulators. Agencies that work within state governments to protect investors and help maintain the integrity of the securities industry.

Stock. A share of stock represents ownership in the company that issues it. The price of the stock goes up and down, depending on how the company performs and how investors think the company will perform in the future.

Target-date fund. A mutual fund that invests in both stock funds and bond funds to create a diversified portfolio appropriate for your age and retirement timeline. The name contains a date, such as 2020 or 2030, that corresponds to your anticipated retirement date. The fund automatically adjusts the proportions of stocks and bonds in the portfolio to become more conservative, with the goal of protecting your nest egg as you near retirement.

Volatility. Price swings of a stock or mutual fund. In general, the more volatile the security, the riskier the investment.

WHERE TO FIND MORE FREE INFORMATION ABOUT INVESTING

The following booklets from the Editors of *Kiplinger's Personal Finance* magazine and the Investor Protection Trust are available at your library and offices of State Securities Regulators.

Five Keys to Investing Success
Make investing a habit
Set exciting goals
Don't take unnecessary risks
Keep time on your side
Diversify

The Basics for Investing in Stocks
Different flavors of stocks
The importance of diversification
How to pick and purchase stocks
Key measures of value and finding growth
When to sell
What's your return?
Consider mutual funds

A Primer for Investing in Bonds
How do bonds work, anyway?
How much does a bond really pay?
How to reduce the risks in bonds
Going the mutual fund route

Mutual Funds and ETFs: Maybe All You'll Ever Need
Mutual funds: The best investment
The different types of funds
How to choose funds and assemble a portfolio
Sources of mutual fund information
Where to buy funds

Getting Help With Your Investments
Do you need a financial adviser?
Who's who among financial advisers
How to choose an adviser
5 questions to ask before you hire an adviser
How to open an account
What can go wrong
How to complain

Maximize Your Retirement Investments
Three key rules
Creating the right investment mix
Guidelines for saving at every life stage
Investing on target
Best places to save
Getting the money out
Creating an income stream
Protect your money: Check out a broker or adviser

Where to Invest Your College Money
The basics of investing for college
Investing in a 529 savings plan
Locking in tuition with a prepaid plan
Other tax-favored ways to save
Tax credits for higher education
Save in your child's name?

1020 19th Street NW, Suite 890 Washington, DC 20036
www.investorprotection.org

Kiplinger's PERSONAL FINANCE MONEY SMART LIVING

1100 13th Street NW
Washington, DC 20005
www.kiplinger.com

A variety of noncommercial investor education and protection materials, including booklets, videos and curricula, are available and can be downloaded for educational purposes at www.investorprotection.org and www.iInvest.org.