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Retirement: Proceed With Caution Before Relying on General Rules

All investing involves risk, including the possible loss of principal, and there can be no assurance that any investment strategy will be successful.

Investments offering the potential for higher rates of return also involve higher risk.

When investing for retirement, you're likely to hear a lot of well-meaning guidance from family, friends, and others offering advice — even the media. As you weigh the potential benefits of any commonly cited investment rules, consider that most are designed for the average situation, which means they may be wrong as often as they're right. Although such guidance is usually based on sound principles and may indeed be a good starting point, be sure to think carefully about your own personal situation before taking any tips at face value.

Following are several general retirement investing rules and related points to consider.

Pay yourself first

It's hard to argue with this conventional wisdom, which helps make saving a habit. To determine how much you may be able to save and invest, develop a written budget. In this way, you can assess how much discretionary income is available after other necessary obligations are met.

If finding extra money to save is difficult, track every dollar you spend for a week or two to see where your money goes. You may surprise yourself by identifying several areas where you can cut spending.

Better yet, most work-based retirement savings plans help you pay yourself first through payroll deductions. This is perhaps the easiest way to save money. Having the money automatically deducted from your paycheck and invested in your plan eliminates the temptation to spend before you save.

Your stock allocation should equal 100 (or 120) minus your age

A widely accepted retirement savings principle states that the younger you are, the more money you should put in stocks. Though past performance is no guarantee of future results, stocks have typically provided higher returns over the long term than other commonly held securities. As you age, you have less time to recover from downturns in the stock market; therefore, the principle states, as you approach and enter retirement, you should invest some of your more volatile growth-oriented investments in fixed-income securities such as bonds.

A commonly cited guideline for determining an appropriate allocation of stocks in your retirement portfolio is to subtract your age from 100 (some iterations of this rule use 120). For example, if you followed this rule at age 40, you would invest 60% to 80% (100 or 120 minus 40) of your portfolio in stocks. However, a more thorough approach would likely account for a host of other factors, including your tolerance for risk, long-term savings goals, family situation, any assets you have already accumulated, whether you have access to a pension or other type of retirement income, and your overall health (and your spouse's, if married).

When it comes to investing, a "one formula fits all" strategy may be a good place to start, but be sure to also consider it in light of your own unique circumstances.

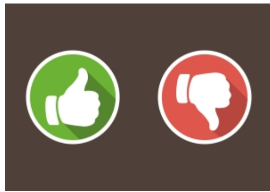
You will need 70% to 100% of your pre-retirement income

You've probably heard this many times before: that you should calculate a goal based on replacing at least 70% of your pre-retirement income each year during retirement. But this may not be very helpful because it doesn't take into consideration your individual needs, expectations, and goals.

Instead of basing an estimate of your annual income needs on a percentage of your current income, focus instead on your actual expenses today and think about whether they'll stay the same, increase, decrease, or even disappear by the time you retire.

While some expenses may disappear, others, such as health care, travel, and hobbies, may rise. You may also want to hire help for yard care, snow removal, or other home maintenance that you previously did yourself.

Focusing on your projected expenses can help you



Because work-based retirement savings plans benefit from tax deferral and are designated for retirement, certain rules apply. Distributions of tax-deferred contributions and earnings prior to age 59½ (55, or even younger, in some cases) will be subject to a 10% penalty tax, in addition to regular income taxes, unless an exception applies.

Asset allocation and diversification do not guarantee a profit or protect against investment loss. They are methods used to help manage investment risk.

determine a more realistic picture of how much annual income you'll need and help you hone in on a target accumulation amount.

Save 10%, 12%, or 15% of your current income for retirement

While the advice to contribute a certain percentage of your income to your retirement savings plan probably falls into the "smart rule" camp — particularly if the target rate is 10% or higher — it may not be appropriate for everyone.

For example, if you start saving for retirement in your 40s or 50s, you may need to shoot for the absolute maximum allowable amount (including catch-up contributions if you're age 50 or older) to make up for lost time. On the other hand, if you are in your 20s and facing a mountain of school loans, you may want to start at a lower percentage of pay — say 5% or 6% — and increase your contribution amount gradually as your income rises and your overall debt level decreases. Many work-based plans offer auto-escalation features that increase your contribution amount automatically over time.

Try to accumulate 20 times your current annual income

This alternative accumulation rule also doesn't take into account your age and personal circumstances. Although it be may helpful to keep a large ballpark total in mind, many other factors weigh into the equation. And let's face it: If all goes well, your annual income will likely rise through the years, so a total accumulation goal based on "current income" would therefore continue to be a moving target.

Contribute enough to receive the full employer match

Regardless of your age or financial situation, this tip has benefits that are hard to deny: If your work-based plan offers a match, contribute at least enough to receive the full amount. This is essentially free money that your employer gives you for your future. Don't neglect this potentially valuable opportunity to help build your retirement savings. (Note: Employer contributions are often subject to a vesting schedule, which means you earn rights to the contributions and any earnings on them over time.)

A "smart" withdrawal rate is 4%

If you're approaching retirement, an important consideration is how much you can withdraw from your account each year. The sustainability of your savings depends not only on your asset allocation and investment choices, but also on how quickly you draw down the account(s). Basically, you want to withdraw at least enough to provide the income you need, but not so much that you run out of money quickly, leaving nothing for later retirement years. The percentage you withdraw annually from your savings and investments is called your withdrawal rate. The maximum percentage that you can withdraw each year and still reasonably expect not to deplete your savings is referred to as your "sustainable withdrawal rate."

A common rule states that a withdrawal amount equal to 4% of your savings each year in retirement (adjusted for inflation) will be sustainable. However, this method has critics, and other strategies and models are used to calculate sustainable withdrawal rates. For example, alternatives include:

- withdrawing a lower or higher fixed percentage each year;
- using a rate based on your investment performance each year; or
- choosing a rate based on age.

Factors to consider include the value of your savings, the amount of income you need, your life expectancy, the expected rate of return on your investments, inflation, and taxes.

Determine which is right for you

The bottom line? Although all of these tips offer varying levels of retirement savings wisdom, think carefully about how they might apply to your personal needs, goals, and circumstances before making any decisions.

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