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How To Be A 401(k) Millionaire

Melanie Hicken, CNN Money November 2013

You don't have to make millions to become a 401(k) millionaire.

Fidelity Investments analyzed the savings habits of roughly 1,100 401(k) investors who earned less than $150,000 a year and had accumulated more than $1 million in 401(k) savings to determine how they reached the million-dollar mark.

The retirement plan provider found these savers, who were an average age of 59, had some key behaviors in common: they started young, always took advantage of the company match, and saved a large chunk of their pay each year, a median of 14% (not counting the company match).

These workers put aside a median of $13,300 of their own cash each year and enjoyed a median employer contribution of $4,500, for a total of $17,800 in retirement savings each year.

As a result, the savers grew their median account balance from $426,000 in June 2000 to $1.2 million in June 2012.

"You have to start saving and start saving early," said Jeanne Thompson, Fidelity's vice president for market insights.

A 25-year-old earning $40,000 will need to save more than 20% of her salary each year to hit the million-dollar mark by age 67, assuming her salary grows by 1.5% a year and her investments gain 5.5% annually, according to Fidelity.

While saving $1 million may seem like hitting the retirement jackpot, you may want to hold off on booking that around-the-world cruise.

Take the widely used "4% rule" which dictates you withdraw 4% of your portfolio the first year of retirement and increase that amount each year by the rate of inflation over 30 years. Using that benchmark, a $1 million portfolio could provide about $40,000 a year in retirement income for 30 years -- not exactly enough for lavish lifestyle.

To get a basic idea of your savings needs, try a retirement calculator. Generally, you should assume you will need at least 70% of your pre-retirement income. If you were making $100,000 before retirement, for example, you will need at least $70,000 a year from your retirement savings and other income sources like Social Security.

Here are some more tips from the pros:

Start young: Thanks to compounding returns, the fact that your investments' returns will build upon themselves, the money you set aside in your 20s and 30s enjoys a snowball effect. For example, a single investment of $5,000 would grow to more than $50,000 in 40 years, assuming an average annual return of 6%.

Max out your savings: Most planners recommend socking away at least 10% to 15% of your salary each year. But if you can't afford to do that, make sure to contribute enough to receive your full company match, said Anton Bayer, founder and CEO of Up Capital Management, which works with dozens of 401(k) plans.

Don't be overly conservative: Sticking all your money in "safe" investments is a surefire way to stall your savings potential.

Financial planners say stocks are still the best bet for retirement savers. Bonds or savings accounts simply don't offer high enough returns to grow an adequate nest egg on their own. "If you're 25 years old [those investments] might not get you there, " said Patrick Chu, a Newport Beach, Calif.-based financial planner.

One common rule of thumb to help you determine the percentage of your investments that should be in stocks is to subtract your age from 120. For example, a 35-year-old should have up to 85% of his portfolio in stocks.

Fidelity found that the 401(k) millionaires in their 40s invested 70% of their savings in equities, and earned a median annual return of 4.8%.

Keep emotion out of it: Once you've figured out the asset allocation that makes sense for your age and risk tolerance, stick to it. This will keep you from gambling with your savings during market highs or from pulling out during market lows.
Watch out for fees: Over the course of a career, the fees you pay can mean a difference of more than $100,000 in savings.

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Work as long as you can: Staying on the job longer not only provides additional years to contribute and grow your investments, but it means your savings will need to sustain you through fewer years of retirement.

A 65-year-old with $1 million in his 401(k) can expect his nest egg to provide roughly $71,000 a year throughout a 25-year retirement if he retires at 65, according to Chu. But if he works five more years, investing just $4,000 more a year, and retires at the age of 70, he will be able to live on more than $100,000 a year until age 90, he said.

How To Rescue Your Retirement At 55

Elizabeth MacBride, CNBC   November 2013

So, retirement is right around the corner, and you're not prepared? Fear not -- you can still enjoy your golden years if you act fast.

If you're 55 and fearing that the only way to rescue your retirement is a time machine, you are not alone. You're also not out of options.

The typical household made up of Americans in the 55-to-64 age range has accumulated only enough retirement assets—$120,000—to produce $400 to $500 of income a month to add to Social Security payments, according to the Federal Reserve's Survey of Consumer Finances. If that sounds shockingly low, it is.

You've lost the advantage of time, which helps people in their 20s and 30s to use the power of compounding interest to reach their retirement goals, but you do have other financial tools at your disposal. The most powerful lever: capping or reducing consumption. Every dollar you don't spend in your 50s, after your kids fly the nest, pays you back twofold. Not only can you save it now, you won't feel the need of it later.

"You want to have a lifestyle you can maintain," said Alicia Munnell, director of the Center for Retirement Research at Boston College. "It's not saying you can't enjoy yourself. You can still travel, but go off season. Use Expedia."

In the first two-thirds of your life, your goal is simple and direct: accumulate assets. As you approach retirement, your goal becomes twofold: While looking to accumulate assets, you must also preserve them to ensure a sustainable monthly income—and consider how to reduce your monthly expenses.

Reduce your consumption

One of the biggest financial mistakes parents make is increasing spending after the kids finish college, and the mortgage declines. Research published in 2010 showed that households ramp up spending on things like food and travel by 51 percent on average when their children leave home.

Maintaining the frugal ways you adopted when raising your kids is a good idea. "People are surprised by how much of a difference it makes," said Steven Sass, program director of the Financial Security Project at the Center for Retirement Research.

Using a tool created by the Center for Retirement Research that shows how much of a difference spending decisions of today can make later in life. Consider, for instance, the following profile:

You are 55 and plan to retire at 62
Unmarried
Earning $100,000 a year
Setting aside $500/month in your 401k
Have $120,000 in retirement savings

The Center projects that, using the profile above, you will need a monthly income of $5,500 to maintain your lifestyle. But your investments and Social Security will only be producing $2,200. That's a gap of $3,300. Here's the trick: If you reduce your spending by an additional $500 a month now, you'll close the gap by $600 to $2,700, because you've reduced your needs by $500 and socked away enough to add $100 to your monthly income through investment gains. The biggest difference comes not from the investments you make but from the reduction in spending. (The tool's earnings assumption for a portfolio investing 50 percent in stocks and 50 percent in bonds is 4.5 percent a year).

Don't plan for retirement; plan to keep working

If you're in your mid-50s, you've probably started to consider when, exactly, you will retire. Working longer means you not only extend the years you are adding to your retirement savings, but it reduces the number of years you need your savings to support. In the example above, working in the same job for another three years, until you are 65, reduces your gap to $1,900 a month.

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What if you're burnt out? If you start planning now, you may be able to find a middle road, a second career into which you can transition in your early or mid-60s. In addition, if you delay taking Social Security, the government will increase your monthly benefit. If you are 55 (born in 1958), delaying retirement until age 70 will increase your monthly Social Security benefit by about a quarter, so if you were set to get $1,000 each month, you'll get $1,267 instead. Social Security offers a website to help you figure out how much of a difference delaying will make.

Stay in equities longer than you may think is safe

"Do not think you're going to invest your way out of this," said Harold Evensky, an investment advisor whose firm, Evensky & Katz LLC, is based in both Miami and Lubbock, Texas. But if you're shifting your planned retirement date, you also should extend the time frame of your investment portfolio. You can increase the chance that you'll earn a higher return by staying in equities for longer and in a greater proportion. Also, in this environment many experts say that bonds are a riskier investment than they usually are, because the government has been keeping interest rates artificially low.

In the post–World War II era, when interest rates rose after a long period of artificially low rates, bondholders lost money. "Since you will probably live to about 85, do not go into bonds until you are about 70 and then only gradually," said Charley Ellis, a consultant to governments and large institutions and a former board member of Malvern, Pa.–based Vanguard Group. (The average life expectancy for Americans is between 80 and 85).

Tap your house as an asset sooner rather than later

If you sell your house and downsize, you'll be able to use the proceeds to add to your retirement savings, tax rules permitting. You'll also be taking a huge step toward reducing your monthly expenses. Selling a house is an emotional decision for many. But if you believe you'll have to downsize eventually, the sooner you can practically make the move, the better off you will be.