Financial Matters

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Savings Risk

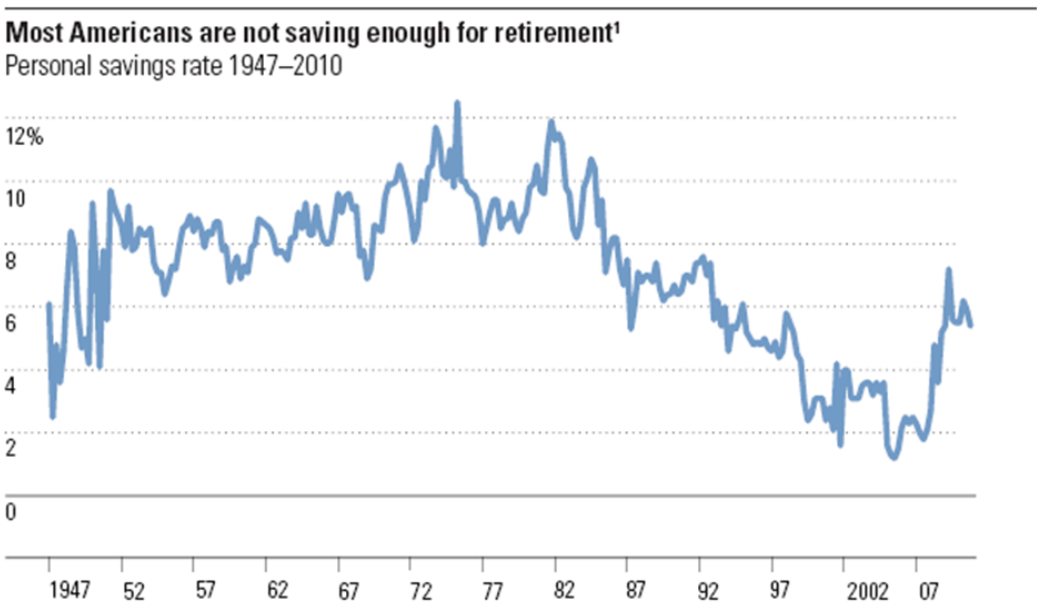
Steadfast Guidance Your Prosperity

Saving enough for retirement is up to you

Nowadays, the responsibility of saving for retirement rests squarely on your shoulders. This is a dramatic change compared to previous generations when employers established defined-benefit pension plans on behalf of employees. This type of plan utilized professional money managers and guaranteed retirees with income for life. How the world has changed. Today, people are responsible for building their own retirement accounts through defined contribution plans such as 401(k)s and 403(b)s. In these plans, investors make their own decisions on how much to save each month, how to allocate their savings, and how to take disbursements in retirement. Responsibility and risk for adequately preparing for retirement falls on the individual.

Most Americans aren't saving enough

The sad reality is that most Americans aren't saving enough for their retirement. The graph below shows that the U.S. savings rate has been falling for more than 20 years. However, this trend has recently reversed, as credit markets remain tight and consumers are uncertain about the future. According to Vanguard's 2006 Retirement Outlook study, which surveyed 1,049 workers over the age of 40, only 40% were considered "on track" for meeting their retirement goals, while 43% were considered "at risk." Many Americans run the risk of quickly depleting their assets in retirement and face the prospect of relying solely on Social Security or continuing to work in retirement. The long-term lack of savings is partly a cultural phenomenon. Baby boomers have a stronger sense of optimism than the World War II generation, and have not placed the same priority on saving. Worse, they have virtually



North Star Financial Group
101 Government Ave SW
Hickory, NC 28602
Website: www.northstarfg.com

Phone: 828.323.8777
Toll Free: 877.323.8877
Fax: 828.323.1077 or 877.203.4250

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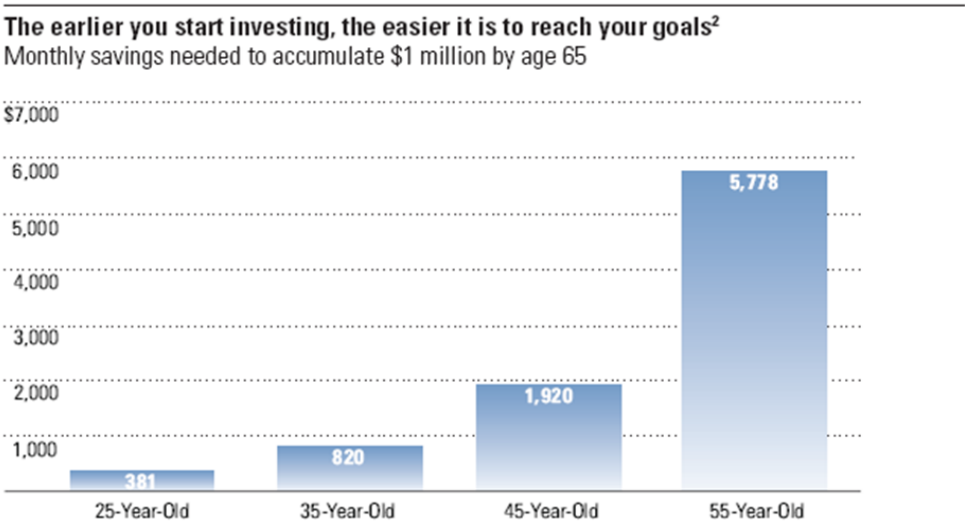
unlimited access to credit and a habit of spending beyond their means, regardless of how much money they make. This trend continues in subsequent generations.

You need to save a lot more than you think

It used to be a big deal to be a millionaire, but not anymore. Many financial advisors believe their clients can safely withdraw between 4%–5% each year from their portfolios in retirement. If you have a $1 million portfolio, a 4% withdrawal rate would produce only $40,000 in income in the first year. If you're trying to replace $100,000 in income and estimate you'll get $20,000 from Social Security, you'll probably need to save $2 million before you retire.

The image to the right illustrates roughly how much an investor needs to save monthly at various ages to reach $1 million at retirement. Clearly, the earlier you start saving, the easier it will be to attain your retirement goals. If you haven't saved enough, you may need to start an aggressive savings plan or postpone your retirement.



What is the ideal savings rate to meet my retirement needs?

There is no right or wrong answer to the ideal personal savings rate. However, many financial advisors suggest that individuals who are in their 20s, 30s, and 40s should be saving at least 10% of their income. If you are closer to retirement, don't have a pension plan, and haven't accumulated a significant retirement nest egg, you may need to save at a much higher rate. You should also think about the most effective savings vehicles. For example, many 401(k) plans provide an employer match, which is essentially "free money." Many financial advisors suggest you should contribute to your 401(k) at least to the level of the employer match. Savings vehicles such as 401(k)s, 403(b)s, and traditional IRAs can provide you with tax-deferred savings advantages. Roth IRAs and Roth 401(k)s can be funded with after-tax dollars, but investment gains grow tax-free, and your contributions and gains can be withdrawn tax-free. Another factor to consider is the amount of debt you are carrying, especially revolving credit-card balances and auto loans. Revolving debt can be thought of as "negative savings." We live in a society of indulgent consumerism and easy credit (at least we used to, until the recent crisis). As a result, many Americans find their biggest impediment to savings is their spending habits and debt levels. They simply don't have enough cash flow each month to save anything. If you have significant revolving debt, particularly debt carrying high interest rates, you might consider paying down your "negative savings" before you make other investments. Once you're ready to save and invest regularly, consider programs that "pay yourself first," such as payroll deductions or automatic monthly debits from your checking account. These provide savings discipline, which is half the battle.

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Questions to ask your advisor:

- How much income do I need in retirement? How big of a nest egg do I need?
- What is a safe withdrawal rate in retirement given my situation?
- If I haven't saved enough for retirement, what effect would retiring later or working part time have?
- What are the most effective retirement savings vehicles in my situation?
- Would it be beneficial for me to convert a traditional IRA into a Roth IRA?
- How can I make the most of IRA catch-up provisions or 401(k) matches from my employer?
- Is it better to allocate savings to investments or pay down my debts (especially credit-card debt)?
- What savings rate will help me attain my goals?
- How can I spend less today and save more for tomorrow?

Call North Star Financial Group at 877-323-8877 to speak with one of our financial advisors to assess your financial situation and assist you by creating a financial plan.

Disclosures:

The information provided is for illustrative and educational purposes only and is not intended to provide advice or recommendations to address your specific financial situation.

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