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Do You Know The Basics Of 401(k) Retirement

How much do you know about your 401(k) plan? Often, even though employer-sponsored retirement plans may make up the bulk of employees' retirement savings, participants understand less than they need to about how this savings vehicle works. Here's a primer covering 10 crucial facts:

1. You benefit from tax-favored treatment. For starters, contributions to your account are made on a pre-tax basis. For example, if you earn $100,000 a year and elect to defer $10,000 to the plan, you're taxed on only $90,000. What's more, the money you've contributed will grow, without taxes, inside the plan until you withdraw it.

2. There's an annual limit on how much you can contribute. The normal ceiling, adjusted each year for inflation, remains $17,500 for 2014. Plus, you can sock away an extra $5,500 a year (also adjusted for inflation) if you're age 50 or older. That adds up to as much as $23,000 for 2014. However, other tax law limits could affect your overall contribution.

3. Your employer may choose to match part of your contribution. Obviously, you're reducing your take-home pay when you defer part of your salary, but companies often help offset that deduction. You might get a matching contribution with your employer kicking in, say, 50 cents for each dollar you put in for up to 6% of your pay. If you earn $100,000 and contribute $10,000 annually, that could add an extra $3,000 to your account each year (half of the first 6% of salary that you contribute).

4. Participation may be automatic. Increasingly, employers use an automatic enrollment feature that adds you to its 401(k) plan unless you opt not to participate. That encourages you to save for retirement and helps companies avoid penalties that may be applied if too few lower-paid employees sign up. The initial default-deferred amount might be 3% of your salary, and some companies now add an "escalator clause" that automatically increases later deferrals.

5. You have a wide array of investment choices. How should you invest the funds in your 401(k)? You'll normally be able to choose from among a dozen or more standard options that may include several "target date" mutual funds, which adjust their allocations as you get nearer to retirement. If you don't make your own selections, a default option

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Simplicity And Sophistication

News is exciting when your firm's investment policy is recognized for a Nobel Prize in Economic Science. We are pleased to announce Dr. Eugene Fama has been awarded this prestigious award. He is the "father of modern finance," a professor at the University of Chicago and is a director and consultant to Dimensional Fund Advisors.

Professor Fama's groundbreaking work on asset pricing and markets inspired the founding of Dimensional.

His initial research and findings concluded that stock prices are extremely difficult to predict in the short run and that new information is incorporated very quickly into stock prices – known as the Efficient Market Hypothesis.

Dr. Fama's groundbreaking work on Efficient Market Hypothesis is the basis for the development of index funds.

This hypothesis has made a huge difference for prudent investors. This research has proven to be "time tested" as index funds routinely outperform approximately 70% of active mutual fund management or individual managers in any given year, more so over the time horizons that typical investors experience.

These assertions encourage investors to ignore the latest headlines and noise on the internet. Furthermore, they provide a clear path to reduce financial complexity and simplify the investment process.

Dr. Fama has given the investing public a superb reference point.

Robert Pyle & Sarah Heller

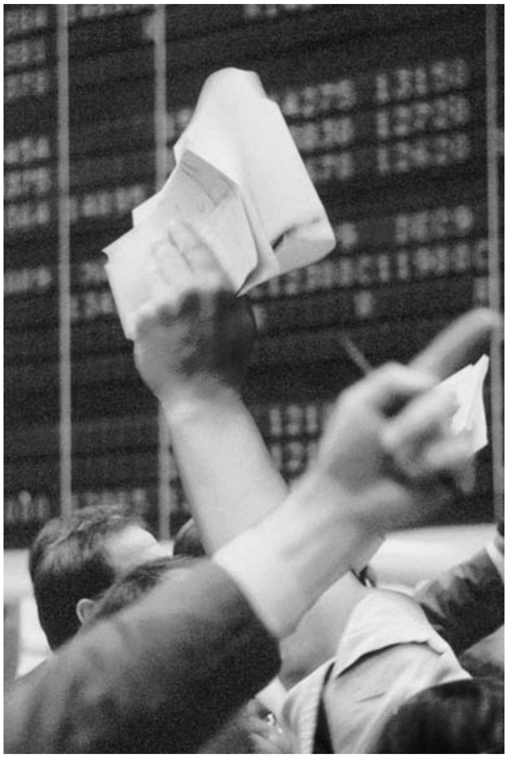
Don't Chase After The Market News

Did you read the newspaper today or check the news online? Invariably, the stock market will be heading up or down, with the movement triggered by anything from company earnings announcements to a change in economic indicators or even a political event such as the recent U.S. government shutdown. And, more often than not, financial pundits may respond by urging investors to buy or sell something.

But you can drive yourself crazy, if you haven't already, by making stock market decisions based on what just has occurred or what you think will happen next. In fact, chasing after the news is a common investment mistake. There are at least four good reasons to avoid this temptation like the plague:

1. The stock market usually moves ahead of the news.

There was no "all clear" signal that the severe stock market downturn of 2008-2009 had abated. But the market hit bottom on March 9, 2009, and embarked on a long, profitable climb even as other financial news remained dire. Typically, stocks move about six months ahead of economic developments, reflecting the collective knowledge, trends, and inclinations of investors. If you try to beat the market by reacting to the latest news, you'll probably be much too late to benefit.



2. You don't have all the necessary information.

Markets tend to move based on the decisions of mutual fund managers or professional analysts who monitor and interpret financial data for a living. They have a lot more information than you do, and they get it much sooner than you—and millions of others like you—who will hear it on television or find it on the Internet. That puts you at a decided disadvantage.

3. You can't believe all the hype.

In this electronic age, media reports are often prone to hyperbole, as the pressure to generate interest from a fickle public continues to increase. That could lead producers to overreact to news tidbits or sensationalize minor events. One small incident usually doesn't portend a complete economic collapse, so take reports of impending doom with a grain of salt. It isn't likely that the sky is falling!

4. Market timing is difficult, if not impossible.

To be successful at market timing, you have to be extremely skilled or lucky, or both. Over the long term, buying or selling based on what you hear or read almost never beats a consistent, methodical long-term approach. It's better to make investment decisions based on financial particulars rather than on instincts and hunches.

Building a diversified portfolio combining stocks, bonds, and other investments can help you progress toward your financial goals—and it can help you stop worrying about what you hear on the news. ●

Reminders On Your Beneficiary Choices

Quick: Who are the beneficiaries of your retirement plan, life insurance policies, and investment accounts? Many people don't remember whom they named as a beneficiary or are uncertain. But it's important to know, especially if your circumstances have changed since you completed the original paperwork.

You probably carefully considered whom to designate as beneficiaries of your financial accounts and life policies when you initially established them. But you may have shoved the documents into a drawer and forgotten all about them.

Suppose your family situation has changed. Maybe you have remarried and you have children from an earlier union. Do you still want your former spouse to inherit anything? Should your new spouse be named as a beneficiary? Aging, death, divorce, and other life-events, including the birth of a child or a job-switch, make it wise to periodically review beneficiary choices and ensure your assets go to the people you want to benefit most.

One reason it's so important to get beneficiary designations right is that when you name a beneficiary on your retirement accounts and life insurance policies, those assets will be transferred without going through probate or facing other complications. Moreover, the designations for financial accounts and insurance policies trump whatever it may say in your will. So, even if you change your will to cut out an estranged relative, that person still could benefit unless the beneficiary designations also are changed. And if there are discrepancies, the matter could end up in court—probably the last thing you would want.

Furthermore, getting the beneficiaries right may affect estate taxes. For instance, if you name your spouse as the beneficiary of your 401(k) and IRAs, those accounts won't

Five Ways To Plan For The Long Haul

Maybe you're in the homestretch before retirement or perhaps you've already stopped working. If you've been diligent in setting aside funds to sustain you through your golden years, congratulations are in order, but you can't rest on your laurels. As life expectancies continue to increase, it's more important than ever to address concerns that you might outlast your money. As the rebound in the economy and stocks has demonstrated, you need to take steps to plan for the long haul and stick with that plan through downturns. Although there are no guarantees w hen it comes to investing, consider these five suggestions for planning for the long term:

1. Be able to ride out stock market downturns. Even if investing in equities helped get you where you are today, you may decide that the inherent volatility of the stock market means you should get out of it altogether during retirement. That might not be the best approach.

Instead, try to stay on a path for sustained growth that factors in your personal tolerance for risk. For instance, a conservative investor embarking on retirement might allocate 30% of a portfolio to equities and 70% to fixed-income investments. A more aggressive investor likely would choose a higher percentage—perhaps 40% or 50%—to keep in stocks. But the important thing is to find a balance between risk and reward that helps you meet your goals and that won't send you fleeing from stocks when they decline sharply.

2. Try to live off the income your investments generate. The longer you can go without tapping the principal of your savings, the better. But that doesn't mean that interest and dividends alone always can carry the day. Assume you have a $1-million portfolio that produces 3% in annual income ($30,000), plus you and your spouse receive Social Security benefits of $2,000 a month each. That gives the two of you a total of $78,000 annually before taxes, and that may not be enough to support the lifestyle you have in mind.

Depending on your situation, you could arrange to do some consulting work in retirement, wait until age 70 to begin drawing Social Security—a delay that will earn you a higher monthly benefit—or seek higher investment returns. In any event, look for ways to avoid drawing down your savings too quickly.

3. Weigh the 4% solution. That's a rule of thumb for the percentage of a nest egg you might withdraw annually to take income to fund a 30-year retirement. The idea is to take 4% of your total portfolio during the first year of your retirement and then to adjust that amount in subsequent years to account for inflation.

But like any rule of thumb, this doesn't factor in unusual circumstances, like the economic conditions you may face. You might decide a lower or higher percentage would be appropriate depending on your situation.

4. Let the IRS determine your income. Once you reach age 70½, you'll have to begin taking "required minimum distributions" from 401(k)s and other employer-sponsored plans (if you're no longer working) and IRAs. The size of each year's RMD depends on your account balances and your life expectancy. Another way to determine how much income to draw from your portfolio during retirement is to use the IRS calculation for your RMDs.

Suppose that you are age 70½ and have $500,000 in an IRA. The IRS says your first distribution would be about $18,800. Will that be sufficient to supplement your other sources of income? In some cases, such an approach might work well, but it doesn't take all of your personal circumstances into account.

5. Make a "bucket list." Another possible way to hedge your bets against market downturns and make your savings last is to divide your money into various "buckets." One bucket might be earmarked to supplement Social Security and other reliable income in covering your basic expenses, with the funds kept in conservative, liquid accounts. You could have a second bucket of money for discretionary expenses, such as travel, that you put into short- and intermediate-term bonds. The remainder could go into a third bucket, invested in a mix of stock and bond funds. As you rebalance the portfolio for the third bucket, you could use proceeds from investment sales to replenish the first two buckets.

All of these ideas are for illustrative purposes only. What you do will depend on your personal situation and goals. The important thing is to consider all of your options and come up with a plan that is realistic and based on the long haul. ●

be included in your taxable estate (although the assets eventually could be subject to estate tax when your spouse dies).

Another money-saving idea that might surface from reviewing your beneficiaries: If you have more than one child and intend to divide your IRA proceeds evenly, you may be able to reduce taxes owed by splitting your account. For example, if you have three children, you can split an IRA into three individual IRAs, naming one child as beneficiary of each new IRA. As a result, your children can take distributions from their inherited IRAs based on their longer individual life expectancies, not yours.

Finally, if you name a charity as an account beneficiary, the asset will pass to the charity tax-free. In addition, your estate will be entitled to a charitable deduction, which may reduce or eliminate tax liability.

For these and other reasons, it's crucial to get beneficiary designations right, and to revise them when necessary as your circumstances change. Going to the trouble of regularly reviewing your designations could be time well spent. ●

How To Avoid Bad Surprises In Roth IRAs

If you've been tempted to contribute to a Roth IRA, or to convert some or all of the funds in your traditional IRAs into a Roth, it's likely you've been influenced by the lure of future tax-free payouts. However, be aware this tax-favored treatment isn't automatic, by any means. What's more, if you're below a certain age limit, you may be slapped with a tax penalty on top of the regular income tax you'll owe.

At the same time, though, even if the Roth IRA distributions are subject to tax, the impact may be negligible or nonexistent under special IRS "ordering rules." That means that even "taxable" Roth distributions may be effectively tax-free.

Here are the basic rules for Roth IRAs. You don't get any tax break now for contributing to a Roth. But "qualified" distributions from a Roth IRA that has been established for at least five years are 100% exempt from federal income tax. For this purpose, qualified distributions include those made:

- After you reach age 59 ½;
- Because of death or disability; or
- To pay for qualified home buyer expenses (up to a lifetime limit of $10,000).

The rule that often trips people up is the one requiring the Roth IRA to be in existence for at least five years. To compound matters, if you withdraw funds before five years have elapsed and you're under the magic age of 59 ½, you'll have to pay a 10% penalty on the distribution amount.

But here's the silver lining: Under IRS rules, the money you take from a Roth IRA is treated as being distributed in the following order:

1. Roth IRA contributions. That money went in without any tax advantage to you, and you can take it out, for whatever reason, without any penalty or taxes.

2. Contributions made when you converted a traditional IRA into Roth status. These may be withdrawn tax-free even if they are part of a nonqualified distribution, but the 10% penalty tax generally applies to withdrawals within five years, unless you're age 59 ½ or older.

3. Contributions made when you converted nontaxable traditional IRA balances into Roth IRA status. Such contributions also may be withdrawn on a tax-free basis subject to the 10% penalty.

4. Earnings within the Roth IRA. These amounts are taxable when withdrawn unless they meet the definition of qualified distributions. In addition, the 10% penalty tax applies to withdrawals made before age 59 ½.

As you can see, federal income tax on a distribution doesn't kick in until you've gone through the first three categories. For many people with a sizable amount in a Roth, distributions won't be taxable at all, even if funds are withdrawn within five years of setting up the account. ●

Do You Know The Basics?

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may be triggered.

6. You're penalized if you take out money early. You'll generally have to pay a 10% penalty on withdrawals you make prior to age 59½, unless a special tax law exception applies. That's in addition to the regular income tax that applies to all withdrawals.

7. You're penalized if you take out money too late. You must begin taking "required minimum distributions" (RMDs) from your 401(k), based on life expectancy tables, in the year after the year in which you turn age 70½. The penalty for not doing that is stiff—50% of the amount you should have taken. But you may be able to postpone RMDs if you're still working full-time and you own less than 5% of your employer.

8. You may be able to "Rothify." Some company plans now offer the opportunity to use a Roth 401(k). Just as with a Roth IRA, you make contributions on an after-tax basis, but withdrawals during retirement normally won't be taxed. At companies that offer this option, you can divide your contribution between regular and Roth accounts as you choose.

9. You have several options when you leave the company. When you leave your job, you can take a lump-sum payout from your account—which will trigger income tax and a penalty if you're under 59½—leave the money where it is, or roll it over to another company's plan or to an IRA. With a rollover, you won't owe any tax as long as the transfer is completed within 60 days of leaving. To avoid 10% withholding, make a trustee-to-trustee rollover.

10. You'll owe fees that may vary widely from plan to plan. If your 401(k) charges high administrative or investment management fees, those could siphon off a significant portion of your investment earnings. The lower the "expense ratio" of the mutual funds you select, the less you'll pay in fees. Index funds that passively track market benchmarks can be especially inexpensive.

Make sure you have all of the information you need to make smart choices about your account. ●

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