SECURE MONEY
ADVISORS

Guide to Understanding Common Retirement Vehicles

The world of finance can seem far from intuitive.

The need to take a smart approach to retirement savings is practically universal, but the ability to understand financial language certainly is not. Even with the help of a financial planning professional, it is important to understand the sort of investment vehicles available to you to be sure you are making informed decisions. You may not need to comprehend every detail, but a basic understanding can go a long way.

That is why we have put together this beginner's guide to investment vehicles—we want you to feel confident that the choices you make to secure your financial future are the right solutions for you.

What is a 401(k)?

401(k)s are probably the mostly commonly cited type of investment vehicle in conversation, and if there is one type of retirement account you feel as though you comprehend, it is probably this one. Despite its cryptic-sounding name—"401(k)" is named after a line of a tough-to-decipher tax code—401(k)s are not too complicated, as investment vehicles go.

The first thing to know about 401(k)s is that they are "employer-sponsored" investment vehicles that allow employees to invest a piece of their paycheck into retirement funds pre-tax (with taxation happening upon withdrawal). These plans have been around since the 1980s, when a shift away from traditional pension plans prompted the government to form a new way for people to still prepare for

retirement. Today, pension plans (where employers invested in funds that paid out a steady income over the course of workers' retirements) are largely gone, replaced with 401(k)s except in heavily unionized industries or government jobs.

How do 401(k)s work?

With 401(k)s, you control (at least to an extent) how your money is invested, usually by choosing where to allocate your assets from a list of mutual funds. There is generally a variety of options available, from relatively reliable, but slow-growth bond funds to high-risk, high-reward small-cap stock funds...and everything in between. The simplest route to choose is often to invest in a "target retirement" fund that may initially contain aggressive growth holdings, but will gradually adjust to be more conservative as the target retirement date grows nearer. There is value in diversification, so you may also want to talk to a financial planning professional about how to properly distribute your money across the funds available to you.

One of the benefits of 401(k)s is that your employer may match your contributions to the account up to a specific percentage of your income, essentially doubling the value you gain from some of the contributions you make. If you contribute beyond the employer-match cap, that is fine; you just will not gain additional contributions from your company. How much the employer matches can vary significantly, so if you are not sure what the match percentage is, ask a benefits manager at work.

One thing to keep in mind, too, is that there may be a "vesting period" that governs how long you must work at the company before you can access any contributions your employer has made to your 401(k)—a caveat meant to prevent people from leaving the company.

Are their contribution limits?

Yes, though they are higher than with some other retirement accounts (such as IRAs). For 2016, 401(k) contributions are limited to $18,000 per year, with an additional employee catch-up contribution limit of $6,000 for those aged 50 or older by the year's end. There is an annual defined contribution limit from all sources of $53,000 (plus the additional $6,000 catch- up limit for those aged 50+) for those that may have numerous retirement accounts.

While there are contribution limits, there are no income limits to participate in 401(k)s, unlike some other retirement account types, making they compelling retirement savings vehicles no matter what your financial situation.

A few additional notes on 401(k)s

The 401(k) plan we have discussed thus far is a "traditional" 401(k) plan. There are also Roth 401(k) s, introduced in 2006, though they are still relatively uncommon. With Roth 401(k) plans, contributions are

made with after-tax dollars (instead of coming from your paycheck pre-tax), but withdrawals will not be taxed once you take your money out in retirement. Capital appreciation in the Roth 401(k) is also not taxed, making these compelling investment vehicles in some cases...if they are available to you.

Also, 401(k)s are not the only type of employer- sponsored retirement plans out there—there are also 403(b) plans offered to employees of tax-exempt or non-profit organizations, such as public schools, colleges, charities, churches, hospitals and libraries; 457 plans offered to state and local government employees, mostly; and Thrift Savings Plans offered to federal government and military members. There are some minor differences between these plans, but in general, the work much in the same way as 401(k)s. Any of these vehicles could be an equally important part of your investment strategy, depending on your circumstances and line of work.

What is an IRA?

An IRA, or Individual Retirement Account, is a tax- sheltered investment vehicle meant to allow you to begin securing your financial future yourself— whether you are employed or not. They serve the same general purpose as a 401(k)—to allow your money to grow tax-free for retirement—but IRAs are personal accounts that are not tied to your employer whatsoever.

What types of IRAs are available?

There two types of IRAs you will hear about most frequently: Traditional IRAs, which were created in 1974, and Roth IRAs, created as part of the Taxpayer Relief Act in 1997. While they both fit the definition of IRAs above, there are some fundamental differences in how they work, mainly with regard to taxes.

1. Traditional IRAs allow individuals to make tax-deductible contributions into the account. Distributions from traditional IRAs are taxed as ordinary income and, if taken before age 59½, may be subject to a 10% federal income tax penalty.
2. Roth IRAs work in an opposite manner: individuals can invest after-tax dollars into an IRA, knowing that they will eventually qualify for a tax- free and penalty-free withdrawal of earnings as long as distributions must meet a five-year holding requirement and occur after age 59½.

As a general rule, if you would rather use contributions to your IRA for a tax deduction now and pay taxes on it when you make a withdrawal, choose a traditional IRA. If you would rather forego the tax deduction now in favor of being able to withdraw your money later tax free, choose a Roth IRA. There are, as you may imagine, other factors to consider when making a choice like this, but this should at least help you get a feel for the differences in the account types.

There are other less-common forms of IRAs out there, such as a stretch-IRA (which allows you to structure the IRA to extend tax-deferred status across multiple generations) or a SEP-IRA (which is established by small

business owners in lieu of a 401(k)). While these accounts will not apply to most people, if they sound like they could be relevant to you, talk with your financial planning professional for more details. There is also a relatively new type of IRA called “myRA” established recently as a “simple, safe, affordable way to start saving for retirement” for workers that don’t have access to a retirement savings plan at work. For more detail on this type of plan, visit www. myra.gov.

Are there contribution limits?

Yes; a few. First of all, there are limits to how much income you can make and still get tax deductions from your traditional IRA.

- For individuals covered by a retirement plan at work, for example, the deduction for a traditional IRA in 2016 is phased out for incomes between $98,000 and $118,000 for married couples filing jointly, and between $61,000 and $71,000 for single filers.
- Contributions to a Roth IRA may also be limited depending on your income. For 2016, for instance, contributions to a Roth IRA are phased out between $184,000 and $194,000 for married couples filing jointly and between $117,000 and $132,000 for single filers.

There are also limits to how much you can contribute to either type of IRA in a given year, regardless of how much money you make. Usually you can make total contributions of $5,500 a year to IRAs, no matter how many accounts you have. If, say, you contributed $4,000 to your Roth IRA, you could only contribute $1,500 to your traditional IRA, for example. There is one exception: Individuals who reach age 50 or older by the end of the tax year can qualify for “catch-up” contributions, raising the yearly contribution limit to $6,500 to help them increase their retirement account balances.

What is an Annuity?

An annuity is a contract that is purchased from an insurance company. In exchange for premiums, the insurance company will make regular payments that can start immediately or at some date in the future. These payments can be made monthly, quarterly, annually, or as a single lump-sum, and annuity contract holders can opt to receive payments for the rest of their lives or for a set number of years. One of the largest benefits of investing in annuities is that invested funds grow tax-deferred. Upon withdrawal, the amount contributed to the annuity will not be taxed, but earnings will be. Unlike many other retirement vehicles, are not contribution limits for annuities.

Annuity contracts pass through two distinct phases: accumulation and payout. During the accumulation phase, premiums are paid and the funds accumulate until the annuity contract reaches its payout date. At that time, the total will either be paid out as a lump sum or as a series of payments over a period that can stretch as long as the account holder’s life.

What types of annuities are available?

There are two main types of annuities you will likely encounter: fixed annuities and variable annuities. Fixed annuities offer a guaranteed payout, typically in the form of a set dollar amount or a set percentage of the assets in the annuity.

Alternatively, variable annuities offer the possibility to allocate premiums between various subaccounts, giving the contract holder an opportunity to pursue potentially higher returns from the subaccounts, but also causing that the annuity account value to fluctuate. There are also specialized indexed annuities that have a rate of return based on the performance of an index during the accumulation period, though they are less common. Which kind of annuity is right for you depends on a number of factors that a knowledgeable financial planning professional can help you work through.

Beyond choosing which type of annuity you want, you will need to consider which sort of payout structure is right for your situation. Any annuity type may come in "immediate" or "deferred" variants:

- Immediate annuities are structured to provide current income, with payments starting either immediately or up to 12 months after the first premium is paid. Remaining funds in the contract accumulate on a tax-deferred basis, and only the portion of each payment attributable to interest is subject to tax, with the rest treated as a return on principal.
- Deferred annuities, alternatively, do not begin payouts until a specified date. Premiums paid accumulate interest during the accumulation phase, and you can determine the amount of payments and payment start dates based on your specific situation. Earnings credited to your contract are taxed upon withdrawal.

It is important to keep in mind that annuities have contract limitations, various fees and charges that could impact your returns. Most, for example, have surrender fees that are generally highest if you take out money sooner than later, and withdrawals made prior to age 59½ may incur a 10 percent federal income tax penalty. There are many other considerations, too, which are generally laid out in a detailed prospectus. Annuities can provide strong value—especially if chosen and managed carefully— but we encourage you to work with a financial planning professional to work through the details necessary to determine what sort of annuity contracts might be right for you, and how you can go about maximizing the value of your contracts.

What Sort of Retirement Accounts are Right for You?

There is no “magic bullet” solution when it comes to retirement planning; there are simply too many factors that can impact what sort of approach is right for you. As you can probably tell by reading about the investment vehicles above, there are advantages to different sorts of retirement accounts that must be weighed, and ultimately you are likely to end up with a mix of different account types tailored to your goals and circumstances. Your best bet for finding the ideal allocations for your assets is to work with someone who handles retirement investments for a living and possesses intimate knowledge of financial planning best practices.

Ready to start investigating how these sorts of retirement accounts (and others) can be harnessed to help you realize your retirement dreams? If you are contributing to your retirement using any of these accounts, do you have a plan to create a secure future for you and your family?

We want to be your partner in both understanding what retirement accounts you currently have as well as developing a holistic approach to protecting your wealth and living the life you’ve wanted to live in retirement.

Contact us today to get a conversation started.

Call: 724.382.1298
Click: www.securemoneyadvisors.com
Meet: 504 South Main Street, Suite 102, Zelienople, PA 16063