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Six ways to rev up your retirement savings

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The tax season often coincides with financial and retirement planning. This article explains effective strategies of a successful retirement plan that any investor — novice or experienced — can take advantage of.

Keep up with inflation

Have you ever wondered how prices seem to increase every year? What was the price of eggs, milk or other grocery store essentials five years ago? Or 20 years ago? This annual price increase is known as inflation. If your retirement plan is not at least keeping up with inflation, then it is time for a trip to your financial adviser to make serious changes.

Inflation varies, but it usually amounts to 3% to 4% per year. For example, a movie ticket costs $9 today but will jump to a whopping $22 in 30 years assuming 3% annual inflation. Similarly, an $1,800 round-trip airline ticket to Los Angeles will set you back $4,369 in 30 years. This slow creeping up of prices will erode your income as well as your nest egg unless you put away enough money to outpace inflation.

- Reality #1: Historically, stocks outperform other asset classes, such as bonds or money markets, and have therefore beat inflation.
- Reality #2: Stocks are riskier than bonds or money markets, are much more volatile and have a potential for greater losses. The old adage certainly rings true: More risk equals greater reward. As an investor, you must have the fortitude to withstand market fluctuations that go hand-in-hand with stock portfolios in order to beat inflation.

Match your investments to your time horizon

Your time horizon is how many years remain until you retire. The shorter the time horizon, the less risk you should have in your portfolio. The longer your time horizon, the greater risk you should have. If you are going to retire in one year, yet your portfolio is concentrated in stocks and the market declines, you could be facing severe losses and possible delayed retirement. Conversely, if your retirement is 30 years from now and you are not invested in stocks, as mentioned above, your portfolio will not be positioned to grow fast enough to outpace inflation. Matching your asset allocation to your time horizon is essential to retirement success.

Ulloa

Know your risk tolerance

Risk tolerance is affected by your financial strength and your emotions. Investors with large assets, income and a longer time horizon can withstand a temporary decline in their portfolio because they are financially strong. On the other hand, an investor with small assets, lower income and a shorter time horizon will not be suited for a high-risk portfolio. If the investment declines, they will suffer proportionately greater than the first investor.

The second component of risk tolerance is your emotions. Some investors worry or panic with every price fluctuation. Other investors calmly stay the course and continue investing or holding for the long term. If you are the first investor, consider rebalancing your portfolio and reducing your overall risk. Essentially this boils down to "Can I sleep at night?" since everyone's risk tolerance is as varied as their personalities.

Take a holistic approach to your financial plan

Saving for retirement is only one piece to the puzzle. At a minimum, a financial plan must address your current and future financial situations. In addition to retirement, what about paying off debt, life insurance, saving for your children's college education or having an emergency fund? These are just a few examples, and each need must be prioritized based on your ability to save. For instance, it may be beneficial to pay off high interest debt as quickly as you can, but the money you allocate toward these payments is money that can be used to save for any of these goals. Have an honest talk with your spouse and be realistic about your budget to maximize what you allocate toward each of these individual goals that comprise your overall financial plan.

Diversify

Diversification is crucial to minimizing losses. Risk comes in many forms: market risk, interest rate risk, political risk and more. You must spread your dollars across different investment classes and vehicles in order to spread out your risk. In other words, don't put all your eggs in one basket. One of the simplest and most efficient ways to do this is to invest in mutual funds. Consult with your financial adviser and do your own research to have a better understanding of the different types of risk before investing.

Utilize dollar cost averaging

Dollar cost averaging means investing a set dollar amount on a regular schedule. The advantage is you are not timing the market, which can be extremely risky. This technique averages out your cost basis, meaning when share prices are low, you obtain more shares. When share prices are high, you obtain less shares. A well-known example of this is when you save in your company retirement plan or IRA. Every pay period or month, you automatically set aside money into your 401k or IRA. This reduces your risk of having to arbitrarily choose the "best time" to enter the market.

The bottom line

Investing is complex and risky. But what's even riskier is underutilizing your money and losing out to inflation and taxes. The bottom line is to be smart about investing. Do your homework, consult with a licensed financial adviser and start. The sooner you get started the more time you have to take advantage of the power of compounding.

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