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What Every Employee Needs to Know About 401(k) Savings

Are you familiar with 401(k) retirement funds?

More and more employers are offering 401(k) plans as an employee benefit, and if you have the option and are not currently taking advantage of it, it may be time to rethink your savings strategy. Not only do these popular plans offer the advantage of using pre-tax dollars (and thus lowering your taxable income each year), but they are also a simple way to ensure that you're putting away money regularly, without having to give it a thought once you've set up the plan.

Employers can sign you up automatically in the 401(k) plan that they offer, but even if you have to opt into a plan, once you've done so the amount that you've elected will automatically be deducted from your paycheck and deposited into your retirement savings account. All you have to do is decide how much you want to set aside each week. The answer to that question is entirely up to you and should be based on what your goals are, as well as variables like your living expenses and your age.

The closer you are to retirement age, the less time you have to save so you may want to bump up the amount that you deposit. Because the money that you invest will compound, the sooner you start investing the better. To give you an idea of how money can grow, consider the difference between investing $3,000 a year at an 8% annual return for 30 years – which would add up to $340,856 – versus only saving for 20 years, which would leave you with just $137,752. You also need to keep in mind that there is an annual maximum amount that you are permitted to contribute. Fortunately, that number increases each year. For 2022, the limit is $20,500.

You'll also want to consider whether your employer offers a match, and if so how much that match is. One of the advantages of the 401(k) type of account is that employers can match all or a portion of your contribution, but you need to make sure that you understand exactly how your individual program works. Some employers will only offer a match up to a certain point, and others will only match if you opt for a minimum percentage of your income. Most experts encourage employees to make sure that they are fully taking advantage of whatever match their employer is willing to contribute.

To give you a sense of how much the average American has in their 401(k) account, consider the results of a recent survey conducted by Vanguard. It showed that those between the ages of 45 and 54 have an average 401(k) balance of $161,079 (median $56,722), while those who are between the ages of 55 and 64 have saved an average of $232,379 (median $84,714). The group that is closest to retirement – those who are 65 and older – do not have that much more than the group closest to them in age: they have an average 401(k) balance of $255,151 with a median of $82,297.

When thinking about your retirement and how you'll fund your lifestyle, one of the most important questions you need to answer is exactly how you're hoping to spend your golden years. If you plan to spend your time at home with family, you will need less than someone who plans world travel.

If you don't have access to a 401(k) account, a Roth IRA is another good option. Though the contributions that you make come from after-tax dollars, you are able to withdraw them and their earnings tax-free at any point after you turn 59 ½. The annual limit that you can contribute to a Roth IRA is currently only $6,000, which is much lower than the $20,500 allowed each year for the 401(k) accounts.

It's never too early to start saving for retirement, and there are plenty of good options available. If you need guidance on how best to save, contact us today to set up a time to discuss your situation.