

info sheet

Nine retirement planning checkpoints

Genetics provide Paul Fama of San Francisco with the motivation to invest as much as he can for retirement. “My parents are still hale and hearty at 75,” says Paul. “My mom’s parents lived to 94 and 85, and my paternal grandparents lived to 97 and 95.

“If I’m lucky enough to live that long, I don’t want to end up having to sleep on a park bench.” Paul stepped up his retirement savings effort nine years ago, when he and his wife, Lili, turned 40. “We had some money saved, and we both have 401(k)s at work, but we still didn’t feel we had a game plan for retirement,” says Paul, a staff attorney for an insurance firm.

Paul and Lili turned to Loren Kayfetz, a Certified Financial Planner in San Ramon, California. Remembers Paul, “We told Loren, ‘Here’s what we have. What should we do?’”

Three words of advice

Kayfetz says his advice for the Famas was the same three words he shares with all clients: “Pay yourself first.”

Kayfetz encouraged Paul and Lili to contribute the maximum possible to their 401(k) plans and to invest additional amounts, outside of their plans, in mutual funds through automatic deductions from their checking account. Automatic investment plans offer an easy way to stick with a retirement investing program,¹ says Kayfetz. “They help people avoid any resistance they might have to writing a check each month to their investment accounts.” As Kayfetz notes, the money goes to investments before it can get spent on anything else.

Now, the Famas believe their retirement investment plan is on track. “Loren gives us figures for what we have to invest each year and a target for the wealth we need to accumulate to live comfortably when we retire,” says Paul. The Famas haven’t reached their target yet, but, Paul adds, “We’re getting there.”

Stay on course

If you’re worried that your retirement investment plan is adrift, your investment professional can help steer you in the right direction. Following are nine strategies investment professionals recommend for investors as they plot their way toward retirement. You can think of these tips as checkpoints or marker buoys. If you adhere to most of these guidelines, they should help you work toward your retirement goals.

1 - Don’t let today’s bills sink tomorrow’s needs.

When Carol Fleckenstein’s husband died at the age of 46, she had to raise three children on her own. Carol was left with a small Individual Retirement Account (IRA) and the proceeds from the sale of her husband’s auto-repair business. But those assets weren’t sufficient to meet the costs of supporting her family.

Carol, who lives in Colden, New York, went back to work at a bank. From the moment she resumed working, Carol maintained the family tradition of investing in IRAs.

¹Automatic investing does not guarantee a profit or protect against a loss in declining markets. You should consider your financial ability to continue to invest through periods of low prices.

It would have been easy for Carol to be overwhelmed by her current expenses, but she had her eyes on the future. “I knew nothing about investments, so I began working with a financial planner, Kevin Mahoney,” says Carol. “Kevin is a great teacher.”

Carol’s husband had put his IRA money in bank certificates of deposit. But Carol felt she needed to earn better returns. When the CDs matured, she transferred the money to mutual funds.² As she learned more about investing, with Kevin’s help, she started investing additional amounts outside of her IRA.

“After my husband died, I didn’t think I’d ever be able to afford to retire,” she says. At 66, Carol’s still at work in the bank, but she is planning to retire next year.

“Now I work because I want to, not because I have to,” she says.

2 - Put time on your side.

Kevin Mahoney, a Certified Financial Planner in Springville, New York, frequently teaches financial-planning courses at adult education centers. One of his biggest concerns with new students is that many have procrastinated with their retirement savings.

“I try to impress upon people the time value of money,” he says. As he explains, when you give your money more time to accumulate, the earnings on your investments — and the annual compounding of those earnings — can make a big difference in your final return.

Consider a hypothetical investor who saved \$2,000 per year for 10 years then didn’t add to her nest egg for the next 10 years. She has \$67,500 after 20 years, assuming she earned 8% annually in a tax-deferred account.³

Another hypothetical investor waited 10 years, then tried to make up for lost time by investing \$4,000 annually for the next 10 years. Even though he invests more — \$40,000 versus the early bird’s \$20,000 — he still ends up with a smaller nest egg. Assuming he too earns 8% per year, his final account value is only \$62,581. Most of the procrastinator’s nest egg — 63% — is the principal he invested. The majority of the early bird’s account — 70% — is earnings.

3 - Don’t count on Social Security.

“When projecting my clients’ sources of income in retirement, I discount Social Security if they’re under age 50,” says Kevin Mahoney. “It’s not that I think the program will go away. I just don’t think it will be available in its current form when people under 50 are ready to retire.”

Says Paul Fama, “My wife and I aren’t expecting to receive Social Security. We know it could be ‘means tested’ when we retire.” With means testing, benefits would be tied to retirees’ financial need. Those with incomes above certain limits might be denied benefits.

“I tell younger clients, ‘If you can collect Social Security, it’ll be a bonus,’” says Mahoney. “But I don’t want our projections to be based on something that may not be available to them.”

² CDs are FDIC insured and have principal and interest guarantees but offer no opportunity for growth of capital or income. The principal value and return of an investment in mutual funds will fluctuate with changes in market conditions, and shares, when redeemed, may be worth more or less than their original value.

³ The 8% return is for illustrative purposes only and is not intended to represent the performance of any MFS fund.

4 - Resist borrowing from your 401(k).

Loans are a popular feature of 401(k) plans. People like being able to get access to their money. But there are a number of reasons to think twice before taking a 401(k) loan.

First, explains Certified Financial Planner Roy J. Meyers of Bel Air, Maryland, “The money you have out on loan might not earn as much as it could if it remained invested.”

You may pay yourself interest of 7%, for example, on a 401(k) loan. That interest will get credited to your account when you repay the loan. As a result, 7% is effectively the return the money you borrowed will earn while it’s out on loan. But 7%, like most 401(k) loan interest rates, is a modest annual return. Your money could potentially earn a higher return if you left it invested in the financial markets.

While repaying a loan, you may also have trouble maintaining current contributions to your 401(k).

Switching jobs before a 401(k) loan is repaid can also bring unwanted tax consequences. You may be able to avoid them by paying off your loan or transferring the loan, with the rest of your 401(k) assets, to your new employer’s plan.

But if neither option is available to you, your loan balance will be considered a distribution from your plan. You’ll owe ordinary income taxes on the balance. In addition, you may be subject to a premature distribution penalty tax of 10% unless you meet one of the age or systematic payout method exemptions provided in the Internal Revenue Code.

Finally, loans are disadvantageous because the money you use to pay interest on your loan will be taxed twice. It will be taxed first when you’re repaying the loan. Even though you can contribute to 401(k)s with “pre-tax” dollars, you can’t do the same with loan payments. Your loan installments will be taken from your paycheck after taxes have already been withheld.

Your interest payments will be taxed a second time when you’re taking withdrawals from your account in retirement. Your loan interest is considered earnings on your account. It will be taxed, as other 401(k) earnings are, when you make withdrawals from your account in retirement.

Most investment professionals recommend clients consider borrowing from other sources, such as the equity in one’s home, before taking a 401(k) loan.

5 - Don’t “cash out” retirement plans when switching jobs.

When you leave a job, the vested benefits in your retirement plans are an enticing source of money. It may be difficult to resist the urge to take that money as cash, particularly if retirement is many years away.

“I discourage clients from doing that by telling them about the penalty,” says Roy Meyers. “They’ll generally have to pay federal income taxes, state income taxes, and a 10% penalty if they’re under age 55. In Maryland, with its 7.5% state income tax, someone in the 25% federal tax bracket would lose 42.5% of the amount they took.” (25% + 7.5% + 10% = 42.5%.)

When changing jobs, you generally have three options for leaving your retirement money invested. You can keep the money in your old employer’s plan, roll it over into an IRA, or transfer the money to your new employer’s plan if that plan accepts rollovers.

6 - Take advantage of your IRA options.

For the Kussrows of Fallston, Maryland, investing in the new Roth IRA is a family affair. Ron Kussrow has already accumulated a decent-sized nest egg, given his teacher's pension and regular contributions he's made to a 403(b) plan.⁴ Still, he and his wife, Carolyn, opened Roth IRAs when this type of IRA became available.

Their 21-year-old son, Adam, met with the family's financial planner, Roy Meyers, because he wanted to open a Roth IRA, too. Adam is in school, studying to be a chef, but he invests money earned from his part-time jobs. The Kussrows' 17-year-old daughter, Amanda, also plans to open a Roth IRA.

"We like the idea that you don't have to worry about taxes when you take money out of a Roth IRA in retirement," says Ron.

The Roth IRA has become popular across the country. But, as Loren Kayfetz notes, "Congress didn't invite everyone to the party."

You can invest to the maximum contribution limit in a Roth IRA each year only if your adjusted gross income is less than \$95,000 as a single tax filer, or \$150,000 if you're married and file a joint tax return.

Some investors qualify for both the Roth IRA and the traditional deductible IRA. They may still be able to deduct contributions to a traditional IRA because they're not eligible for a retirement plan at work or their income is below certain limits.

These investors will need to meet with their investment professional to determine which IRA better serves their needs. By deducting contributions to a traditional IRA, they can invest with pretax dollars and defer taxes on their principal investments and earnings until they begin making withdrawals in retirement. With a Roth IRA, they'd invest with "after-tax" dollars, but they could escape taxes on their earnings before retirement and after.⁵

For those investors who can't deduct contributions to a traditional IRA, but who are eligible for a Roth, the IRA choice is simple. They'll want to invest in a Roth IRA because it can let them escape taxes on their investment earnings.⁵

For distributions made after 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001 provides that distributions from qualified plans, 403(b) arrangements, and Section 457 plans may be rolled over to any of the other types of plans, including IRAs, that now accept such rollovers. The rollover restrictions previously imposed upon such plans have been eliminated. In addition, after-tax employee contributions, which in the past could not be rolled over, may now be rolled over to another retirement plan or traditional IRA as long as the accepting plan permits such rollovers. Plans are not required to accept rollovers. Given the complexity of the new rollover rules, you should seek the advice of your legal and tax advisers prior to requesting a rollover distribution from your employer's plan.

⁴ Similar to 401(k)s, 403(b) plans are defined contribution retirement plans offered to employees of public or nonprofit institutions, such as schools.

⁵ To escape taxes on your Roth IRA earnings, you must meet certain requirements. Generally, you must be older than age 59½ when you begin withdrawals, and your account must have existed for at least five years.

7 - Compare the merits of the Roth IRA and a 401(k) plan.

The variety of retirement savings options available today is a boon for investors. But the range of choices can also be confusing.

Many investors now are trying to compare the potential advantages of the Roth IRA with their 401(k) or other type of defined contribution plan at work. The choice is especially difficult for those with limited budgets who can afford to invest in only one of the options.

If you're in that situation, you'll need to work with your investment professional to determine whether the Roth IRA or your 401(k) offers more advantages for you. The answer will depend on many factors, including how many years you have left until retirement, your tax bracket, and whether your employer matches contributions to your 401(k).

"If my clients' employers match contributions, I recommend that the clients first contribute to their 401(k), up to the limit of what their company will match," says Loren Kayfetz. "If they have more to invest, I recommend that they then put the money in a Roth IRA, up to the annual contribution limit."

Individuals who meet the income requirements for Roth IRA eligibility can contribute to a certain maximum annually:

- \$3,000 for each year 2002-2004
- \$4,000 for 2005-2007 and then
- \$5,000 in 2008

Thereafter, the maximum will be adjusted for inflation.

As with all IRAs, people at least 50-years old can make additional catch-up contributions of \$500 per year (in 2002-2005) and \$1,000 for 2006 and thereafter.

Clearly the increased maximum can help build an even bigger nest egg.

"If people have met their employer's 401(k) matching limit and have contributed the maximum to a Roth, and they still have more to invest, then I recommend they go back and contribute to their 401(k), up to the plan's yearly contribution limit." The dollar limit on an employee's annual contributions to a 401(k) is \$12,000 for 2003. This limit increases \$1,000 each year to reach \$15,000 in 2006.

8 - Don't try to time the stock market.

Some investors, even those for whom retirement is still many years away, frequently shift their money in and out of the stock market. They'll get out when they fear a crash and get back in when they expect a boom.

The problem with trying to time the market is that no one can consistently predict the short-term events that push the market up or down. Loren Kayfetz says, "Market timing is gambling. I tell my clients, if they need to gamble, they should earmark \$1,000 or more each year as 'Reno money' and go to Nevada and get the urge out of their systems."

9 - Maintain an asset allocation strategy appropriate for your age.

“I don’t recommend that my clients who are many years away from retirement put money in fixed accounts,” says Kevin Mahoney.

“People like the idea of getting a guaranteed return on their money,” he says. But fixed accounts generally pay low rates of return. If your returns don’t keep pace with inflation, your money could lose purchasing power each year.⁶

Because stocks historically have provided higher long-term returns than other investments, most investment professionals recommend investors keep a good portion of their assets in stocks.⁷ Many investment professionals adhere to that recommendation even when people are close to retirement. Their rationale isn’t just today’s longer life expectancies.

“I work with the assumption that my clients don’t want to exhaust their money,” says Loren Kayfetz. “I project what they’ll need to have accumulated by age 65 if they withdraw about 6.5% each year from their investments account.

“If we select investments that have the potential to earn better than a 6.5% annual return, then they won’t have to worry about outliving their money and they’ll have something to leave to their children.”

This material is not intended to replace the advice of a qualified attorney, tax consultant, or insurance agent. Before making any financial commitment regarding the issues discussed here, consult with the appropriate professional.

The testimonials provided by the investors in this article may not be representative of the experience of other clients. These testimonials are not indicative of the future performance or success of any MFS mutual fund.

Smooth sailing

If you can navigate around each of these marker buoys successfully, you’re to be commended for your skill. Your reward will likely be a smoother sail toward your retirement goals.

Resources for Further Information

Silver, Don. *Baby Boomer Retirement: 65 Simple Ways to Protect Your Future*. Adams Hall Publishing, 1998, 208 p., \$14.95.

Siegel, Alan M.; Morris, Virginia B.; and Morris, Kenneth M. *The Wall Street Journal Guide to Planning Your Financial Future: The Easy-to-Read Guide to Planning for Retirement*. Fireside, 1998, 187 p., \$15.95.

Hinden, Stan. *How to Retire Happy*. McGraw-Hill Trade, 2000, 224 p., \$14.95.

Smith, Mary Helen and Smith, Shuford. *101 Secrets for a Great Retirement*. McGraw-Hill/Contemporary Books, 2000, 160 p., \$12.95.

Contact your investment professional for more information or to construct a personalized Heritage PlanningSM Profile to help your parents, your children, or yourself.

⁶ Fixed accounts offer principal and interest guarantees but provide no opportunity for growth of capital or income. The principal value and return of an investment in mutual funds will fluctuate with changes in market conditions, shares, when redeemed, and may be worth more or less than their original value.

⁷ Source: Ibbotson Associates. Stocks are represented by the Standard & Poor’s 500 Stock Index, a commonly used measure of the broad stock market. It is not possible to invest directly in an index. Past performance is no guarantee of future results.



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