



# Insights The Challenge of Preparing for Retirement

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Most Americans look forward to a retirement that is fulfilling and financially comfortable. With longer life spans and better health care, retirees are enjoying active lives and second careers into their 60s, 70s, and beyond.

Financial experts estimate that, in order to maintain their preretirement standard of living, retirees should plan to replace 60% to 90% of their preretirement income once their paychecks stop. For example, someone earning \$50,000 a year before he or she retires would want approximately \$37,500 in the first year of retirement.

Financing a comfortable and enjoyable retirement is a central financial goal, and it is also a challenge. Most people can increase their chances for success by understanding what resources are available, setting realistic financial objectives, and developing an informed strategy for saving and investing.

## ■ A changing environment

In past generations, retirement was paid for largely by Social Security and company pensions. Employers sought to retain employees for the length of their careers and paid pensions to those with long-term service.

Today, the retirement picture is vastly different. Workers change jobs more frequently than in the past, and many companies have replaced traditional defined benefit pension plans with defined contribution plans such as 401(k)s.

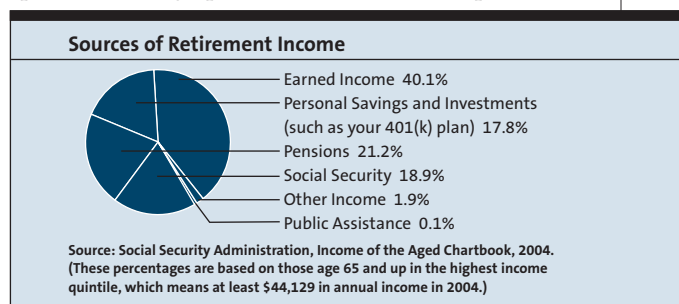
While this trend puts more of the burden of saving on employees, it also offers a level of freedom and flexibility that enables them to save and invest in a way that is more suited to their needs, risk tolerance, and timetable.

## ■ Sources of retirement income

Although many people think that Social Security will be their chief source of income in retirement, the reality is different.

- Social Security may pay only a fraction—less than 40%—of average retirees' former salaries.
- In addition, those making a high salary may get an even lower percentage of retirement income—less than 20%—covered by Social Security (see the following chart).
- The “baseline” amount of an individual's Social Security benefit assumes that benefits don't start until full retirement age, which is currently 66 years of age for someone born between 1943 and 1954, but rises for those born after that.

For the rest of your retirement income, you will need to look to other sources, such as part-time work, personal savings, pensions, and retirement plans.



## ■ What to do — and when

### 20s and 30s

Planning for retirement is not just a consideration for older people. The earlier you start planning for retirement, the better. Your savings and earnings can build on themselves (compounding), and that can give you a powerful advantage when you are saving and investing for the long term.

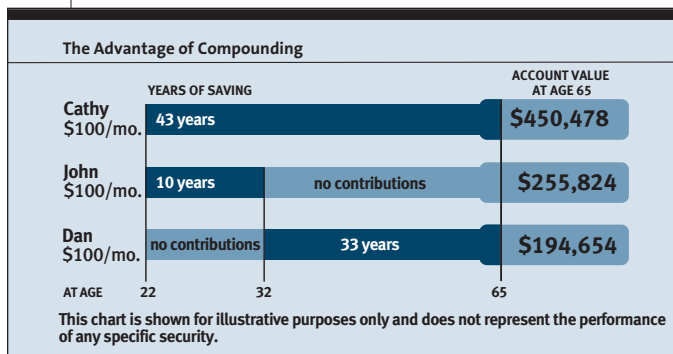
With that in mind, it makes sense to save as much as you can and increase your contribution to your retirement account with each pay raise, whether you're saving pretax through your employer's retirement plan or on your own through an individual retirement account (IRA).

If you are at least 20 years from retirement, you may want to consider choosing a relatively aggressive portfolio, one that is composed primarily of stocks or stock funds. Stocks and stock funds historically have performed well over the long term, albeit with greater investment risk. Although past performance cannot guarantee future results, stocks and stock funds have the potential to provide returns that outpace the rate of inflation. Overinvesting in low risk/return funds at this stage can compromise your retirement goals if your returns do not keep pace with inflation over the years.

It's most important to keep your retirement money compounding in a tax-deferred account and not withdraw it for immediate cash needs. When you change jobs, you should move your retirement assets into an IRA, move them into your new employer's plan, or keep them in your current plan if permissible so they stay invested for your future.

Here's an example of how starting early—and keeping your money invested—can help you over the long term through compounding.

You can see by this example that although Dan puts in more money than John, his balance is less after 43 years because he got a late start. Cathy is



in the best position because she started contributing early and maintained her contributions throughout the 43-year period. (This chart assumes an 8% annual rate of return.)

### 40s and 50s

These ages are most people's peak earning years. If you have put off retirement planning, it's not too late to save a nest egg—especially if you contribute as much as you can to your employer's retirement plan or to an IRA.

Many who have started late or have not contributed enough over the years will find themselves behind in their savings goals for retirement. The Internal Revenue Service allows extra catch-up retirement contributions for those age 50 and older. The extra allowance for 401(k) contributions is \$5,000 over the regular retirement contribution limit in 2008 and \$5,500 in 2009; for IRAs, an additional \$1,000 contribution is allowed if you are age 50 or older in 2008 and 2009.

If you cannot afford to contribute the maximum to a retirement plan account, another option is to consider postponing retirement. Even a few more years on the job (along with saving and potential compounding) can boost your chances of having more money and not outliving your resources.

In addition, you may consider other aspects of your financial picture, such as the amount of equity in your home and your life and health insurance options. Consulting with a financial planner to review your specific situation can be a wise choice. Paying down debts can also help you prepare to enjoy more of your hard-earned retirement savings.

Wherever you are in your retirement strategy, you can always find opportunities to plan for a more comfortable financial future. Prompt action and a commitment to saving—as well as thoughtful, diversified investing—can improve your chances for securing the retirement you deserve.

### Resources

- Visit [troweprice.com/retirementplanning](http://troweprice.com/retirementplanning) to access the following:
  - Retirement Income Calculator
  - IRA Calculator

- Retirement Savings Guide
- Retirement Readiness Guide

• Call 1-800-638-5660 to learn more about the T. Rowe Price Retirement Funds—diversified portfolios managed to a target retirement date. You choose a fund with the date that's closest to the year you plan to retire, and we'll do the rest. As the target retirement date approaches, the portfolio manager adjusts the fund's investments to help provide greater stability and reduced investment risk. Important factors to consider when planning for retirement include your expected expenses, sources of income, and available assets. Before investing in one of these funds, weigh your objectives, time horizon, and risk tolerance. The funds invest in many underlying funds and are exposed to the risks of different areas of the market.

- Call T. Rowe Price at 1-800-638-5660 or visit [troweprice.com/advisoryservices](http://troweprice.com/advisoryservices) for information on T. Rowe Price Advisory Planning Services. These in-depth advisory services offer you personalized advice and solutions based on your specific financial goals. For a nominal one-time fee, you can enjoy the benefit of personal consultations with our advisory counselors; the expertise of our professional Advisory Planning Services team, including CERTIFIED FINANCIAL PLANNER™ practitioners; and ongoing advice through an Advisory Checkup.
- Go to [www.socialsecurity.gov/mystatement/](http://www.socialsecurity.gov/mystatement/) or call 1-800-772-1213 for information on receiving your Social Security benefits.
- Visit [www.medicare.gov](http://www.medicare.gov) for information on using Medicare and Medigap.

*Insights articles provide background information on many aspects of investing. Call 1-800-638-5660 to request a prospectus, which includes investment objectives, risks, fees, expenses, and other information that you should read and consider carefully before investing.*

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