CHAPTER 1

No One Will Reward You for a Job Well Done

There is a pretty good chance that you could die broke.

And there is even a pretty good chance that you could go broke long before you die.

There, I said it. Someone had to break it to you.

I'm no alarmist—far from it—I just know the facts. It's not easy to consider your retirement when you may have just started working, or even if you've barely hit the halfway point of your working life.

But no one is looking out for us, no matter what you've been led to believe about retirement.

No one will pick up the tab when you stop working.

No company. No government agency. No parent.

It is up to You to assume responsibility for You.

In theory, our parents and our grandparents had a simple formula for retirement: work at the same company for a number of years and accumulate a pension that would pay you a guaranteed and defined benefit for the rest of your life. You keep working, we'll manage a huge fund for you while you work, and then we will cut you a check when you retire. And not just a paltry couple of hundred bucks each month. How does the average salary for your last three years of work sound?

Sounds great.

How about we pay you that amount until you die?

Just show me where to sign.

For many, a pension agreement like this was a reward for being loyal. It was a competitive tool for recruiting new employees.

It was a standard, simple, and defined benefit that people could depend on to take care of the bill for life after work—not to mention that every month a check from Social Security would also show up in the mail to fill out the rest of their retirement income.

It was a promise that was the backbone for millions of people in their retirement. It was never a right—it was a privilege and, perhaps, the best benefit an employer could ever offer.

But you and I probably don't have that benefit. These types of traditional pensions are disappearing at a rapid rate. We likely won't have a guaranteed lifelong pension that our employers take care of while we pay them back with loyalty and hard work. Companies just can't afford it anymore. Either that or they just don't want to be saddled with a seemingly never-ending commitment.

But there is more to our retirement story.

During a time that fewer people are taking care of us, we are also taking care of more people.

We are living longer, the older population is growing rapidly, and the Baby Boomers are royally screwing us. They are going to take more than we can give. There are just too many retirees and we are not a large enough workforce to support them. More and more people are drawing on a limited pool of Social Security supported by us, the working population, while we are supposed to cross our fingers and hope that there is a little something left over for us in 30 or 40 years.

Even if the system is dripped dry, Social Security alone is still not enough to live a decent retired life on. The average Social Security check a retried person receives now is about $960 a month.[1] That's barely enough today—and what we get in 30 years and what it will buy us then is anybody's guess. There is even the possibility that Social Security, as we know it, may no longer exist by the time we are in our 50s and 60s.

Yet you and I will also probably live longer than previous generations. Our retirements may last for 20 to 30 years.

We will still have to battle inflation along the way, so even if we do save, we have no way of truly knowing if it will be enough to live comfortably.

Sound the alarm.

You and I will not be given anything.

We may have to work longer than our parents.

We may live longer than our parents.

Without some decent planning or a trust fund, there are only two simple solutions to our generation's potential retirement crisis:

- Work forever
- Die sooner

But we don't have to watch our golden years change to brass. We don't necessarily need to work into our 70s either. We just need to wake up. We need to plan a little earlier and plan a little more than our parents.

Most importantly, we need to recognize that we have some major advantages over previous generations:

- We have time.
- We have greater access to information.
- We have more options.

Companies can cut pensions and the Baby Boomers can suck up all of the Social Security, but the one thing that we have right now that no one can take away from us is *time.*

We just have to be aware—aware of the options that our employers give us, aware of just how important thinking about and planning for your retirement is right this second. We also need to be aware of the most considerable investment force of our youth: *the power of compounding.*

Albert Einstein was once quoted as saying, "The most powerful force in the universe is compound interest." So don't just take my word for it, Einstein was a pretty plugged-in guy.

"Compounding" doesn't sound that cool; but you need to know what it entitles you to if you start saving now, even if it definitely doesn't sound inviting or remotely interesting.

Compounding is simple. You make an investment. You make money off of an investment. Rather than spending what you have earned, you leave it alone and allow your initial investment, plus whatever you have just earned, to continue generating more investment income. Repeat.

It's the snowballing effect. Start with a small amount, and then just keep rolling. Consider the classic example: Would you rather have $100,000 cash right now or would you prefer to receive one penny today, and I will double what I give you every day, for the next 30 days? You can probably guess where this is going. Forget the $100,000. If you started with 1 penny and your pay was doubled every day, you would be earning $5.4 million after 30 days.

That's the power of compounding. As long as it keeps rolling, it will get larger and larger. It's a simple concept, but it could have an incredible effect on your life.

With your retirement savings, if you continue to contribute the same amount of money to the same investment every year, your potential to get a larger return will increase because you are continuously working off of a larger pool of capital (which is just another fancy way to say money).

Consider that if you put away $1,000 a year every year for the next 30 years, you won't just have $30,000 waiting in your account. You could accumulate almost $110,000 if your investments produce just average returns.

For us, this isn't about getting rich quick. It's just the opposite. The idea of getting rich slowly may not be that attractive, but it's secure. It gives us the freedom to take new jobs, to take stabs at entrepreneurial ventures, or maybe even retire a little earlier than our parents and grandparents.

If we learn to leave our money alone, or learn about the new ways to increase the amount of money we save, and if we learn how to take advantage of all of the different retirement options out there right now, we could be staring at retirements that are *even more stable* than previous generations.

It won't be easy, but it's also not that difficult either. You just have to do a little work to put yourself in a position to make it happen.

So would you rather have this proposition or the quasi-promise of an old school pension from people at your company who you have never met? People who don't have nearly as much of an interest in you as you . . .

Outside of understanding just how important it is to start thinking about your retirement right now, the power of compounding is the most critical thing you should take away from this book.

It's not just enough to understand how it works. It's only a powerful tool if you start to take advantage of it now. They younger you are when you start saving, the more you will have when you will need it most. Every day that you delay, you reduce your compounding power.

You can wait until you're 40 to start saving for retirement and you will end up with what seems like, on paper, a pretty decent haul when you approach the beginning of the end.

But the truth is it won't be nearly enough for you to retire for very long. If you wait until you are 40 to start saving for retirement, you will have to continue working longer than you expected, or you will have to find some form of work during your retirement years.

Or you will just have to play Mega Millions until you either hit the right numbers or die.

Because if you wait too long to save for your retirement, you will almost certainly outlive everything that you have put away in just a matter of years.

If, however, at the age of 30, you made the same commitment to start saving, you will be set for many more years after you retire.

But don't take my word for it; numbers never lie.

Say you're 40 years old, you make $50,000 a year, and you have no money saved for retirement right now. You want to retire at 65 and you can't live on less than $40,000 a year. If you put away 10 percent of your salary now until you turn 65, and you get pretty good returns on your investments (let's assume 9 percent), your retirement savings will run out at the age of 73 if you withdraw $40,000 each year after you have retired.

Eight solid years and then nothing.

Now look at the same scenario for a 30-year-old today with the same salary, same contribution to retirement, and same returns on investments. If the 30-year-old also retires at 65 and withdraws $40,000 a year for retirement, his savings will last him until he turns 84.

He put away 10 percent of his annual salary for 10 more years than his 40-year-old counterpart, and the 30-year-old can now *fully* support himself during retirement for *11 more years of his life.*

I told you that the numbers don't lie—your ability to turn small amounts of money into considerable amounts of wealth will never be greater. To get an idea exactly how much power you have at a young age, consider Figure 1.1. It illustrates how much $10,000 would be worth when you turn 65 if you put that money away when you are 25-, 30- , or 40-years old. (assuming 8 percent returns).

As you can see, there is no contest. When you turn 65, the value of $10,000 saved at the age of 25 will be more than *three times* the value of $10,000 saved at the age of 40. It's the same dollar amount saved, you are just allowing yourself 15 additional years to let the

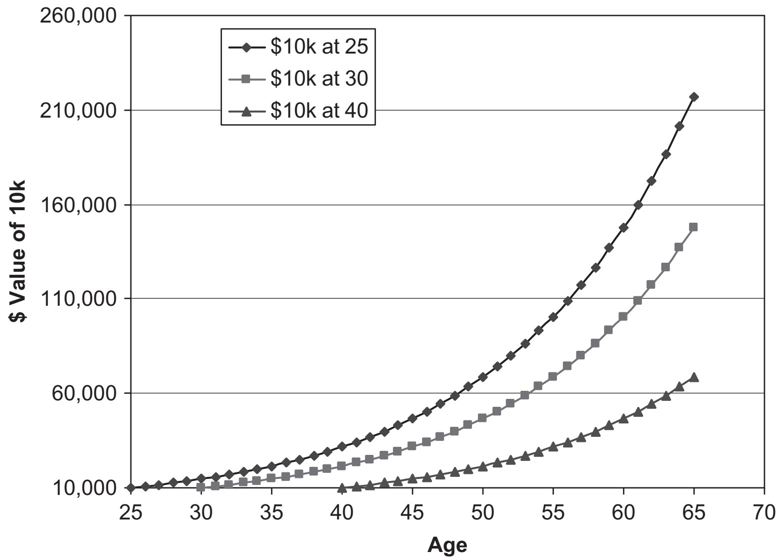

Figure 1.1 How much $10,000 would be worth when you turn 65

money go to work for you. And in the end, you will have $217,245 waiting for you, as opposed to $68,485.

As far as I can tell, there is only one downside here: It may not be as exciting as going to a casino with $10,000 in your pocket and turning it into $217,000 in one weekend. Saving your money is not instantly gratifying. It takes time and it is boring. But you need to know just how powerful you are right now—and how much you could be leaving on the table every year you wait.

You also need to be aware that no matter how much money you think you may inherit, or how much the house you don't own yet will be worth when you sell it in 30 years, you will not have nearly enough money to maintain your current lifestyle during retirement if you do not start saving now.

I talk to my friends and peers about retirement probably more than I should and definitely more than they want me to. Most, while they tend to acknowledge that their retirement is too far away to take seriously, have done some rough mental math about how much they may inherit from their parents and grandparents.

Many, if they haven't done any estimates of what their grandparents' condo in Florida will be worth one day, have at least considered that they're in somebody's will somewhere and should receive something at some point. That Money from Nowhere, I've been told, will probably help pay off mortgages or put kids through colleges, and maybe even help pay for parts of their own retirements.

They tell me that they have considered the future in some form, but just not in its entirety.

There may or may not be this Money from Nowhere as we move down the road. But there will certainly be an entirely new breed of Expenses from Everywhere that we can't even think about right now.

Besides paying for the basics such as food and shelter, you will also have to pay for your medical and health care expenses, which in and of itself could be enough to drip your savings dry. Just like many employers are cutting back on paying out lifelong pensions, fewer companies are offering health care and medical benefits to retirees.

While two out of every three large companies used to dish out health care benefits to retirees in 1998, that figure declined to one in three large companies by the end of 2005.[2]

And now for the kicker—for a person retiring right now, healthcare and medical expenses will add up to a total of $90,000 for men and $110,000 for women over the course of their retirement, according to a study from Fidelity Investments last year.[3]

Add another $200,000 to the retirement bill for any retired couple.

You don't have to be a victim. Life doesn't have to be as unfair as it may seem. What you do with your money now, in your 20s and 30s, will make the difference in the quality of the life of your future self. You just have to buy into your future and never look back.

You probably have other things on your mind right now besides retirement, as you should. If you just started working, it's probably impossible for you to conceive that you will be working for another 40 years, let alone how important it is to think about retirement. But you are not on your own here. If I didn't back my way into job writing about retirement and other people's money, it probably wouldn't have occurred to me either.

People much smarter than me, with much more money than me, helped me to recognize that if I fail to commit just a small portion of my income to retirement right now, I am essentially forfeiting the ability to have more money when I will need it most.

Without putting money in the right place right now, you and I are passing on the chance to have hundreds of thousands of dollars—our dollars—waiting for us when we are set to stop working.

You don't need to be an actuary to understand the new math that's at work here. A penny saved in your 20s is 14 pennies earned when you hit 60, and you don't have to watch *Mad Money* every night to get those types of returns.

You need to know that your job is probably offering you something that is not as simple or as clearly defined as your father's or your grandfather's pension plan, but that's okay. Many jobs give you the option to enroll in a retirement plan that could take a little time and effort to get going and maintain, but it could prove to have an even greater upside than a traditional pension if you start using it early enough. And it might even help you purchase your first home or put your kid through school if you need it. You just need to know what you can do with your retirement plans once you start saving.

You need to know that no matter how little you may be earning right now, you can still find money to put away for your retirement without cutting back on your Starbucks consumption. Not everything in life has to be an either-or proposition. You have the money. You just may not realize it yet.

You also need to know that no matter how *much* money you may be making right now, you should probably be putting away more for your retirement—not to mention that you could be making better decisions with your investments.

You need to know that, even though it requires you to take money out of every paycheck, you will actually have a good shot at increasing your take-home pay if you contribute. You use pretax dollars to contribute to a 401(k), for example, which means you lower your taxable income by saving for your retirement. In new math, that would be:

Larger contributions = Lower taxes

You need to understand the long-term power of your early retirement contributions, and the investment income your money will earn over 30 to 40 years.

You need to know that more and more companies are willing to match the money you donate to your future. You also need to know that more and more companies are going to be automatically enrolling you in 401(k) plans. But first you might need to know what a 401(k) plan is.

As if you needed more incentive to save for your retirement, many of your employers are giving you money to save.[4] Think of it as *free money* because that is exactly what it is. You need to know just how foolish you are if you don't take as much of their money as possible. Your job is paying you to save. You wouldn't turn down more money if they offered it to you up front. You'd take the money because it is why you get out of bed and go to work every single day. Instead of a signing bonus, consider it a leaving bonus.

"The truth is, with all of these options, people in their 20s and 30s are actually in a position to have greater security in their retirements than previous generations," says Dallas Salisbury, president and CEO of the Employee Benefits Research Institute in Washington D.C. "They can have it all."

You also need to know that there is no such thing as the Point of No Return. It is never too late to start learning and asking questions.

We are the information generation, a Google search away from every answer to every question we could ever ask.

It just has to occur to us to ask, even if it may seem like only the most basic of questions.

"So many people, when they get to a certain age, are embarrassed to ask simple questions about money and finance," says Mellody Hobson, president of Ariel Capital Management in Chicago, and a regular contributor for ABC's Good Morning America. "And they end up never asking and never learning the most basic things about money management because they are afraid of looking ignorant."

But you may be more than just a novice when it comes to finance. Even if you can describe the difference between a mutual fund and an exchange-traded-fund, there is probably a lot you don't know about some basic savings techniques that can net you huge gains over the course of the next thirty years.

Maybe you think you're okay because you have a 401(k) plan, but no IRA. Maybe you're like me and you've had four jobs in six years, which means you may also have multiple stagnant accounts that never vested.

Maybe you don't even know what "vested" means.

Maybe your new job won't let you participate in a retirement plan unless you spend at least a year at the company. Maybe you're at a job that doesn't even offer you any retirement benefits. There is plenty that you can do in the interim to create your own individual retirement account and start laying the foundation for your future financial security—because you don't have a choice.

No matter how little or how much you may earn during your working years, you can't afford to wait because you are not entitled to a retirement.

Fair or unfair, the burden of preparing for life after work ultimately falls on the individual, not your employer or the government. In other words: You.

That version of your grandfather's guaranteed pension—the defined benefit plan—is not a dinosaur yet but it is in the fast lane to extinction. Just consider the numbers: In 1980, there were 30.1 million American workers in the private sector who were covered by these pension plans, according to the Department of Labor's Employee Benefits Security Administration.[5]

At the end of 2002, that number dropped more than 25 percent to 21.6 million. And it isn't that people are getting kicked out of these pension plans—some companies have terminated their pension plans altogether, while others are just closing their pensions to new workers. That's me and you.

It is important to note, however, that while millions of private sector employees have been covered by defined benefit plans, there were also millions more who were not. Without the promise of a pension for many, there was the belief that Social Security payments alone would be enough to see major portions of previous generations through their retirement.

Those who currently rely on Social Security alone are now living on less than $1,000 per month.

We should not be caught as unprepared.

We at least know that we are probably not going to be getting a guaranteed pension anytime soon. And we know that we will need more than just Social Security to maintain a reasonable version of our lifestyles when we retire.

In a way, this is perhaps the most distinct advantage we have over previous generations. We now *know* the burden of our retirements rests squarely on our shoulders. Because we can be free of illusions, we can, and should, know to start planning earlier.

It's not just about blindly saving pennies in a jar the day you start working. We have some newer, more sophisticated options in retirement savings that could provide us with a more stable retirement income than any other generation.

During the same period that these old school pensions became less prevalent, there was a substantial increase in the use of defined contribution plans. These are retirement plans like the 401(k) in which you are in control. If your employer is a public school or religious organization, your defined contribution plan may be a 403(b), while state and government employees will often have 457 plans. These types of defined contribution plans will all be referred to as 401(k)s throughout this book, otherwise it will seem like you are getting beaten over the head with a series of barcodes or gym locker combinations.

With these retirement plans, y*ou* now define how much or how little to contribute to your future—the old model merely fixed how much you got paid out during your retirement. With defined contribution plans, this is now entirely up to you. Your payout will be largely based on how much you put in. The more you contribute, save, and earn, the more you will be able to withdraw for your retirement.

Plans such as the 401(k) also allow you to decide how your money is invested. Previously, workers had no say in this part of the savings process. This can be a great advantage, if done properly. And lucky for you, some new developments in the investment management industry, coupled with some new legislation from the federal government, have made it easier on you to invest your retirement money more effectively and—this is the best part—without even really having to do much at all.

There is a pretty good chance that you have access to a 401(k) plan, even if you aren't aware of it right now. Almost 53 million private sector workers were covered by these defined contribution plans at the end of 2002, up roughly 270 percent from 14.4 million at the end of 2002.[6]

And the gap continues to widen between old school pensions and defined contribution plans, perhaps more dramatically in the last few years than ever. Pensions were almost never regular subjects covered in business sections of daily newspapers or magazines. Now it seems like you can't go a week without reading that some major company, or even state-run government entities, are closing their old pension plans to new workers and pointing us in a new direction. They're steering us to the 401(k) plan instead.

There will be employers, banks, brokers, books, websites, and friends to help you along the way as you save and invest towards your retirement. Part of the difficulty is that most of the information on retirement that is available is not geared towards people our age. You've seen the commercials: an older couple on a beach walking with their dog, the husband throwing a stick off into the horizon.

They don't have a worry in the world. They have more money than you and I do. And they will get more assistance than you and I will. Financial institutions want to help *them* because they have a deeper wallet, which means more of their wallet can be had. The more money you have, the more money banks, brokerages and fund companies can profit from you.

Most of the information out there right now is targeting these people—people who are closer to the end of working rather than the beginning. The economics just make more sense for those seeking profits.

This just means that you will often have to seek out the answers when you have questions. Again, nothing will be handed to you. Never be afraid to ask what you think is a dumb question. When it comes to your money and your future well-being, there are no dumb questions, only dumb decisions.

The questions you ask and the decisions you make in your 20s and 30s determine whether or not you will have to play catch-up for the rest of your life and, ultimately if you will live the life that you deserve to live once you stop working.

If you can stop working.