Saving Outside of Retirement Accounts

Experts suggest that you need 70–80% of your pre-retirement income level to live comfortably during retirement. Given that you are unlikely to be working in retirement – at least, not full-time – that money has to come from other sources. Outside of dedicated retirement accounts, pensions, and Social Security benefits, you have the option to invest on your own. There are multiple ways to invest.

First, understand the difference between retirement accounts and general investment accounts.

Retirement-specific accounts provide tax advantages when you save for retirement. However, if you withdraw money prior to age 59 ½, you may pay a 10% penalty and taxes – depending on the type of account. A Roth retirement account allows your investment to grow tax-free, while a traditional account allows your investment to grow tax-deferred. Retirement-specific accounts typically have contribution limits and may also have income restrictions.

You can also save money in general investment accounts. While these accounts may not have tax advantages, you can withdraw money prior to age 59 ½ without penalty and you generally have no contribution or income restrictions. Many people ultimately save for retirement utilizing both retirement-specific and general investing accounts. This article focuses on saving outside of traditional retirement-specific accounts.

Second, understand the difference between income assets and growth assets.

Income assets create income by loaning money to a bank, company, or government for their use. In exchange for your capital investment, they promise to repay your money with interest. Any return depends on the financial performance, strength, and resources of the borrower. Income assets are generally conservative and provide income in the form of interest, dividends, or capital gains.

> **When you loan your money to another entity, you are trusting that they will be able to repay you, on time and with interest.**

Growth assets create income by becoming more valuable over time, but you assume full responsibility for their market performance. You purchase a growth asset, like a house, gold, diamonds, mutual funds, or stock, with the primary goal of selling when its value has increased. As the owner, you receive the potential increase in value of your investment, but there are no guarantees that you will recoup the amount you paid when you originally purchased the asset. Depending on the market, you may make money on your investment, like selling a home for more than you bought it for, but you also may lose money if the asset's value declines, especially if you need to sell fast.

Mutual funds and stocks have fees that can affect your investment growth in the short term and even more significantly in the long term. Fees vary depending on the type of investment and the account manager. The law requires all fees to be clearly stated, so read the fine print before opening an investment account.

> **When you own an asset outright, its value is subject to market fluctuations and the principle of supply and demand.**

Third, consider your options.

Is your investment goal to continue to grow your assets, or to provide a regular income? Your goal determines the allocation of your assets (e.g., whether you choose to put more money into the stock market or into bonds). It's also important to consider your time horizon. If you will need retirement income in the near future, conservative income assets are likely to serve you well. If your retirement is further in the future, you may be able to afford the extra risk that comes with investing in growth assets.

Income Assets: Bonds

Bonds are debt securities sold by the government or a company to investors. The investor is promised a return of principal and periodic interest payments in exchange for their loan. The interest rate is determined by the length of the term – how long you are loaning your money for – and the credit rating of the issuer. The lower the credit rating of the issuer and the longer the length of term, the higher the risk of default, but the interest rates are higher as well. Conversely, the higher the credit rating and the shorter the term, the lower the interest rates.

Income Assets: Annuities

An **annuity** is a product sold by a life insurance company in which you deposit a sum of money – either as a lump sum or in installments – that then earns interest and is used to generate a guaranteed income payment in the future. While annuities are not investment accounts in the traditional sense, your premium deposits are invested by the insurer to increase the value of the annuity over time. The main benefit of annuities is the prospect of receiving a stream of income that cannot be outlived. There are three models for investing the principal:

1. **Fixed:** You deposit a sum of money with an insurance company and receive a guaranteed principal and interest payment in the future. Your principal deposit is guaranteed not to decrease. This type of annuity is low risk and often provides a higher interest rate than a savings account or CD.
2. **Variable:** You choose an underlying investment portfolio; the annuity's value will fluctuate with changes in market conditions. If the portfolio of investments performs well, your

returns may outperform those of a fixed annuity. However, if they do not perform well, your returns will decline and your principal is exposed to risk of loss.

3. **Indexed:** Like a fixed annuity, indexed annuities offer a guaranteed interest rate. However, they also offer an interest rate linked to an index market. In years when the market does well, the annuity earns an interest rate close to that of the index market; in years when the market does poorly, the annuity earns the guaranteed interest rate.

Income Assets: Certificates of Deposit

A certificate of deposit, or a CD, takes a sum of money and locks it into an account with a fixed interest rate for a specific amount of time. Typically, the longer you let your money sit in a CD, the higher the guaranteed interest rate will be. When you redeem your CD after the term expires, you receive both your principal investment and accumulated interest. CDs offer higher interest rates than savings accounts because you are promising not to claim the money for the term of the CD. They come with penalties for early withdrawal.

CDs are typically offered by banks and credit unions.

Income Assets: Savings Accounts

A savings account is an account offered by a bank or credit union that provides a safe location to store cash and earn interest. That said, savings account interest rates are notoriously low, and are unlikely to keep up with inflation. Given their liquidity, savings accounts are a good place to store your **emergency fund**.

Income Assets: Money Market Accounts

A money market account functions like a combination of a checking account and a savings account. It may come with checks or a debit card, like a checking account, but the balance of the account also earns interest, like a savings account. Typically, money market accounts earn a higher rate of interest than savings accounts. Further, a money market account is more liquid than a CD – you can make a limited number of transactions if you need to – but your cash is not normally quite as accessible as it would be in a savings account.

Growth Assets: Real Estate

Investing in real estate simply involves purchasing a property and hoping that its value increases over time. To earn money on real estate investments, you need to charge more for rent than you are paying for the mortgage and upkeep. If you do, real estate can provide a steady income stream and capital appreciation. However, real estate requires a significant capital investment, and if you change your mind and want to pull money out of real estate, it can take time. Remember, too, that real estate investment comes with significant costs, as the owner is responsible for the maintenance of the property and any increases in taxes while they own the property.

> **Note:** Real estate values are heavily influenced by location. The area's employment rate, local economy, crime rates, transportation facilities, schools, and property taxes all play a role in determining both price and demand for particular properties.

Growth Assets: Mutual Funds

A mutual fund pools money sourced from many individual investors that is invested by a single entity into a portfolio of stocks, bonds, and other assets to produce income for each investor. Mutual fund portfolios consist of anywhere from 20 to 200 different assets, allowing for diversification of your investment.

With a mutual fund, you're giving the portfolio manager – i.e., the person making investment decisions – a sum of money to invest how they see fit. Other investors do the same thing, and so the amount of money that the portfolio manager is working with is much more than what you alone contributed. Mutual funds depend on the skills of the portfolio manager, and some provide more income growth than others.

Growth Assets: Stocks

When you buy stock in a publicly traded company, you are buying part of the business itself. Stock is typically bought from other stockholders through regional or national stock exchanges; the main U.S. stock exchanges are the New York Stock Exchange and NASDAQ.

Stock prices are determined by supply and demand. Demand is determined by company revenue and earnings, the potential for growth, and current or expected stock market and economic conditions. When demand for a stock is high, there are more purchase orders than sale orders, and the price goes up. If more people are selling than buying, the price goes down. If you sell when the price is high, you can make money. However, if the price goes down, you have the potential to lose money. There is no guaranteed return on investment with stocks, and their value can fluctuate significantly over short periods.

It's important to be thoughtful when selecting sources for passive income. Unlike pension payments and retirement account withdrawals, which are often streamlined, you have to actively decide how and where to invest the rest of your funds. Growth assets often require working with a brokerage firm or other financial management service. Income assets can be self-managed through your bank. Remember, your time horizon, the amount of money you have to invest, and your risk tolerance should all play a role in your investment decisions.

> Navy Mutual offers annuities to current and former servicemembers and their families. These low-risk vehicles can help secure income throughout your retirement. If you're interested in learning more, **schedule an appointment** today.