BY ROB CORBO

Keep It Simple: Making Retirement Savings Work

Last month, in part one of this series on retirement, we concluded that saving for retirement can be difficult for small construction and remodeling companies, but it's necessary for everyone's future well-being. We established that traditional and Roth IRAs are viable and powerful options for retirement saving, and we focused on the importance of starting an account now, contributing regularly, taking advantage of tax-free growth, and letting the wonder of compounding (time) work for you. When it comes to saving for retirement, you can't start early enough, and it's never too late to start.

In this article, we will dive deeper into two forms of IRAs, examine the significance of fees, and weigh in on finding IRA investment opportunities that maximize gains.

Two forms. Both traditional and Roth IRAs come in two forms, regular and self-directed. A regular IRA is simple to open and allows you to invest in stocks, bonds, certificates of deposit (CDs), exchange traded funds (ETFs), and mutual funds. A self-directed IRA is complicated and more difficult to open, and it has significantly more IRS rules, but it allows you to pursue alternative investments including rental property, precious metals, commodities, limited partnerships, and more.

Being that we in the industry are regular folks, a regular IRA is the perfect investment vehicle. It has more than enough investment options, and, most importantly, a number of financial institutions charge no IRA account management fees (be sure to ask), leaving your retirement account with the maximum amount of money to compound. Come retirement, any reduction in your savings base, no matter how small, will be magnified in the final dollar total. When it comes to saving and compounding, fees are your enemy.

Where to open an account. You can open an IRA account at any number of brokerage firms and banks. The application process shouldn't take more than 20 minutes. When selecting a financial institution, look for one that does not charge you a fee for opening your account, managing your account, sending regular contributions, and buying or selling funds in your account (transaction fees). Also look for a firm that offers commission-free ETF purchases and no-transaction-fee (NTF) mutual funds.

If your bank only offers CDs and savings accounts, as many do, open your IRA at a brokerage firm so you have access to stocks. Stocks have returned 10% a year on average over the last 100 years. In comparison, Treasury bonds have averaged 5% since 1926 but are at 2.2% today, and a 5-year CD is paying 0.8%. The "rule of 72" helps clarify what these percentages mean in real terms: Divide 72 by the interest rate (expressed as a whole number) on a particular investment to find the number of years it takes to double your money. At a 10% rate, it will take 7.2 years to double; at 0.8%, 90 years.

Investing. Once you open your regular IRA, you must decide how to invest your contributions. Because contributions represent a lot of sweat equity, your goal is to balance reward and risk. To maximize reward, it's best to invest in the stock market. To minimize risk, it's best to diversify, so no single company's failure dooms your future. The best way to diversify is to invest in a variety of companies, and one way to do that is to invest in an ETF or a mutual fund index fund; each share of an ETF or a mutual fund represents a basket, or variety, of companies.

When you're investing, your goal is to balance reward and risk. To maximize reward, invest in the stock market. To minimize risk, diversify.

ETFs duplicate an index, say the S&P 500; stocks in the index are in the fund. There is no turnover—no buying and selling—the fund is passive (not actively managed), and the expense ratios (fees) are low.

Mutual funds. Some mutual funds are passive index funds with low expense ratios. Others, which have higher expense ratios, are actively managed by a fund manager who continuously changes the mix of companies in an effort to achieve higher returns. Over the long term, due to higher expense ratios, many actively managed mutual funds realize lower returns than passive index funds.

Remember the Einstein quote last month? "Compounding interest is the 8th wonder of the universe. He who understands it, earns it; he who doesn't, pays it." Paying a higher expense ratio than necessary is an example of "he who doesn't, pays it." A $10,000 investment with a 10% annual return over 20 years with an expense ratio of 0.50% accrues to $61,159; with an expense ratio of 2.0%, it accrues to $49,157. Expense ratios for mutual funds range from 0.50% to 2.0%, while those for ETFs range from 0.05% to 1.00%. The Vanguard S&P 500 ETF has one of the lowest expense ratios, at 0.04% or 40 cents per $1,000 invested.

Dollar cost averaging. Warren Buffett, one of the most successful investors in the world, has said that an index fund, because of its low expense and simplicity, is the most sensible investment for most folks. "By periodically investing in an index fund, the know-nothing investor can actually outperform most investment professionals," Buffet says. He recommends investing what you can afford, in a timely manner, over a long time horizon—a method know as "dollar cost averaging."

With dollar cost averaging, there will be periods when your index fund is buying stocks at their highs, and other times at their lows. You must be disciplined enough to make your IRA contribution on a regular basis, through thick and thin. The stock market is a roller coaster ride. Rather than becoming anxious when the market drops 20% to 30%, delight in the fact that you are able to buy stocks at a discount. Who doesn't enjoy buying a new tool at a 20% discount? Buffett has said that investors should be fearful when others are greedy, and greedy when others are fearful. So, when the market is down big, in correcting mode, and investors are fearful, you might want to consider increasing your contribution, buying more for less.

Don't wait. Open your IRA now. Is the stock market high as I write this? Yes, it's high on low interest rates, government stimulus, vaccinations, and hopes for a back-to-normal economy. Will it correct sometime in the future, maybe this year? Absolutely. Is that a reason to delay? No. Make your contribution on a regular basis, as if it is a household expense. Write a check for retirement when you pay the utility bill. Better yet, have your checking account debited automatically. You are dollar cost averaging, flattening the roller coaster, making any correction a bit less painful and a bit more rewarding. Time is on your side.

Our goal as regular folks navigating the financial landscape is to keep it simple. Open a regular IRA, traditional or Roth. Open it at a reputable financial institution with numerous offices, an online presence, and no IRA account management fees. Purchase an exchange traded S&P 500 index fund, and sit back and enjoy the ride. (Cue up Pink Floyd: "Money. It's a gas. Grab that cash with both hands and make a stash. ...")

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