Retirement Point

NEWS FOR PLAN SPONSORS AND PARTICIPANTS

October 2018

The Snowball Effect

Save and invest, year after year, to put the full power of compounding on your side

THE MONTH IN BRIEF

Wall Street maintained its optimism in September. While trade worries were top of mind for economists and investors overseas, bulls largely shrugged at the prospect of tariffs and the probability of another interest rate hike. The S&P 500 rose 0.43% for the month. On the whole, U.S. economic indicators were quite good, and some offered pleasant surprises.[1]

% CHANGE	Y-T-D	1-YR CHG	5-YR AVG	10-YR AVG
DJIA	7.04	18.22	14.68	15.53
NASDAQ	16.56	24.68	22.56	30.56
S&P 500	8.99	16.09	14.45	16.34
REAL YIELD	**9/28 RATE**	**1 YR AGO**	**5 YRS AGO**	**10 YRS AGO**
10 YR TIPS	0.91	0.44	0.46	2.03

Sources: wsj.com, bigcharts.com, treasury.gov - 9/28/18[1,18,19,20]

Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly. These returns do not include dividends. 10-year TIPS real yield = projected return at maturity given expected inflation.

MONTHLY QUOTE

"The end result of kindness is that it draws people to you."

- Anita Roddick

MONTHLY TIP

Life insurance proceeds normally pass to beneficiaries without being taxed. There is one notable exception: if a policy is transferred between business owners to fund a buy-sell agreement, its tax-exempt status may be lost.

MONTHLY RIDDLE

A thief steals $100 from a cash register at a store. An hour later, he returns with the same $100 and buys $70 worth of goods, receiving $30 back in change. How much does the store ultimately lose to the thief?

Last month's riddle:

Two parents have four girls, and each girl has one brother. Given this, how many people are in this family?

Last month's answer:

Seven people: two parents, four sisters, and one brother.

The Snowball Effect

Save and invest, year after year, to put the full power of compounding on your side

Have you been saving for retirement for a decade or more? In the foreseeable future, something terrific is likely to happen with your IRA or your workplace retirement plan account. At some point, its yearly earnings should begin to exceed your yearly contributions.

Just when could this happen? The timing depends on several factors, and the biggest factor may simply be consistency – your ability to keep steadily investing and saving. The potential for this phenomenon is apparent for savers who start early and savers who start late. Here are two mock scenarios.

Christina starts saving for retirement at age 23. After college, she takes a job paying $45,000 a year. Each month, she directs 10% of her salary ($375) into a workplace retirement plan account. The investments in that account earn 6% per year. Thirteen years later, Christina is still happily working at the same firm and still regularly putting 10% of her pay into the retirement plan each month. She now earns $58,200 a year, so her monthly 10% contribution has risen over the years from $375 to $485. [1]

The ratio of account contributions to account earnings has tilted during this time. After eight years of saving and investing, the ratio is about 2:1 – for every two dollars going into the account, a dollar is being earned by its investments. During year 13, the ratio hits 1:1 – the account starts to return more than $500 per month, with a big assist from compound interest. In years thereafter, the 6% return the investments realize each year tops her year's worth of contributions to the principal. (Her monthly contributions have grown by more than 20% during these 13 years, and that also has had an influence.)[1]

Fast forward to 35 years later. Christina is now 58 and nearing retirement age, and she earns $86,400 annually, meaning her 10% monthly salary deferral has nearly doubled over the years from the initial $375 to $720. This has helped her build savings, but not as much as the compounding on her side. At 58, her account earns about $2,900 per month at a 6% rate of return – more than four times her monthly account contribution.[1]

Lori needs to start saving for retirement at age 49. Pragmatic, she begins putting $1,000 a month into a workplace retirement plan. Her account returns 7% a year. (For this example, we will assume Lori maintains her sizable monthly contribution rate for the duration of the account.) By age 54, thanks to compound interest, she has $73,839 in her account. After a decade of contributing $12,000 per year, she has $177,403. She manages to work until age 69, and after 20 years, the account holds $526,382. [2]

These examples omit some possible negatives – and some possible positives. They do not factor in a prolonged absence from the workforce or bad years for the market. Then again, the 6% and 7% consistent returns used above also disregard the chance of the market having great years.

Repeatedly, investors are cautioned that past performance is no guarantee or indicator of future success. This is true. It is also true that the yearly total return of the S&P 500 (that is, dividends included) averaged 10.2% from 1917-2017. Just stop and consider that 10.2% average total return in view of all the market cycles Wall Street went through in those 100 years. [2]

Keep in mind, when the yearly earnings of your IRA or employer-sponsored retirement plan account do start to exceed your yearly contributions, that is not a time to scale back your contributions. Your retirement account will not do all your retirement saving work for you at that point; you still need to keep the momentum of your saving effort going – and maintaining it will assist the compounding.

For more information on investment choices for your retirement plan, please call our plan's advisor at 703-595-4444 or email at info@pointoak.com

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