Why Save for Retirement?

Those saving for retirement today have unique challenges compared with past generations.

For much of the last century, many companies offered pension plans that rewarded a lifetime of work with guaranteed income for their retirement years. And if retirees weren't lucky enough to receive a pension, at least there was Social Security – a guaranteed lifetime benefit paid by the federal government. Many retirees received *both* a pension and Social Security.

The world is a different place today – at least for those who have not yet retired.

Pensions for most private sector (non-governmental) employees have been all but phased out over the past few decades, and persons for public sector workers are much less generous than before. And Social Security, a system never paid for by retirees' own contributions, but always by the contributions of current workers, is facing funding challenges over the long-term unless benefits are cut or taxes are raised. For those with years to go before retirement, the future is filled with uncertainty.

An important question to ask yourself is *how* do you want to live during retirement. The average American now lives almost twenty years longer than when Social Security was first developed. It's not unusual for people to live well into their 80s, and those over 100 are the fastest growing age group today. Do you want the freedom to travel the world to visit friends and family, or would you rather depend on a part-time job to make ends meet? Would you like to age gracefully in a cheery retirement community or rely on the charity of others for things like food and heat?

The best way to protect your future is to start a disciplined retirement savings plan as soon as possible. When combined with the security of home ownership, a retirement savings plan means that you don't have to strike it rich to be comfortable in retirement. If you are relatively young, you don't necessarily need a lot of money now to secure your retirement, you have something just as valuable as money – time.

Power of Compounding

When you plan to grow wealth over a lifetime, one of the most important concepts to understand is compound interest. Compound interest happens when interest is added to the principal, so that from that moment on, the interest that has been added also earns interest. So if you saved $100 that earned 8% interest per year, at the end of the first year you would have $108. During the second year, interest is earned not only on the first $100, but the additional $8 – for a total of $116.64. That extra 64 cents may not sound like much, but over a lifetime, the effect can be almost magical.

Here's an example – say you start saving $200 per month at age 22, and save until you are 65. If you earn the historical average stock market return of 8.5%, after 43 years you would not only have the $103,200 you saved, but you would have an additional $946,377.17. That's a total of over $1,050,000, all for $200 per month.

But what happens if you don't start saving until you are 40 years old, cutting your years of contribution and compounding from 43 to 23? Rather than over one million dollars, you would be left with a somewhat less impressive $167,000, meaning the annual contributions will need to be higher to reach one million dollars.

These examples are not retirement plans, and they assume a rate of return that's based on historical averages that may never return. They also assume tax-free growth in an IRA, 401(k) or similar account, and don't account for fees. But these examples do illustrate an important point – **by starting early, you can dramatically increase your wealth and the quality of your life at retirement**.