401(k) TODAY

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Save your way into the
MILLIONAIRE CLUB

By Stephen J. Butler

Saving a million dollars will support a pretty eccentric personal life-style.

If you wanted to live on just the income for a while, you could expect to make about 6 percent, or $60,000, a year on your million dollars without dipping into the principal.

Life could be sweet -- and it could all happen well before "normal retirement age."

I have bumped some numbers around to illustrate how people in varying circumstances can generate that illusive $1 million sooner and easier than they think.

We'll take three examples: a young couple in their early 30s who, between them, have $30,000 in 401(k) plans. They can reach $1 million in 15 years.

A couple with $100,000 can reach $1 million in 12 years.

A couple with $200,000 today can reach $1 million in 10 years.

Sound fantastic? Check this out: A young couple with two jobs and a combined total of $30,000 in retirement plans today could reach $1 million in 15 years at a cost per month in take-home pay of $1,500. That's less than they are probably making in car payments, registration and insurance on the BMW, the truck and the ski boat right now.

We'll assume that money in mutual funds earns an annual average of 10 percent. Their $30,000 will double every 7.2 years and total $120,000 after doubling twice.

A 401(k) contribution from each of two jobs totaling $27,000 a year will accumulate to $880,000 and cost $18,000 in annual take-home pay.

At least $9,000 of the $27,000 will be paid with money that would otherwise have been owed in state and federal income taxes. Saving and investing $18,000 in annual take-home pay works out to $1,500 a month.

For a couple with $100,000 in retirement plans today, the million comes up a little faster:

In just more than 12 years, both contributing a total of $30,000 per year accumulates to $660,000, and the original $100,000 compounds to about $340,000 for a total of a million.

The tax-deductible $30,000 costs the average two-income couple about $1,625 a month in take-home pay -- perhaps even less if they've otherwise been hit with the alternate minimum tax (AMT).

For a couple with $200,000 already, the million arrives in just 10 years at the $30,000 per year contribution level.

Today's $200,000 more than doubles to $520,000, and the annual $30,000 accumulates to $480,000.

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Inside...

Time to revisit our tolerance for RISK

By Stephen J. Butler

With the market off 5% over the past few weeks, this could be a good time to revisit our tolerance for risk. Those of us who periodically check total values of our retirement accounts have been experiencing a smug sense of satisfaction over the past three years. Our values- assuming if we have stayed the course in stocks and didn't panic – have returned to the levels reached at the height of the 1990's boom. The system has worked and we have been rewarded for our patience and staying power.

Now, however, we're ten years older than we were in 1996 when the boom was just getting under way, and the thought of once again losing 35% --- a repeat of 2000 – 2002 results --- may be more than we want to contemplate. Instead of the abstract concept of percentage losses, think about dollars. How many actual dollars would you lose today if your assets shrank by 35%? Do you hear me now?

Moving toward retirement, we go from "leading lives of quiet desperation" to finally arriving at a place where we are standing, at least figuratively, in a shaft of sunlight without a care in the world. Going one step further would be the New Yorker cartoon depicting the two male angels sitting at a bar in heaven. One is saying, "You know, it's always happy hour up here."

The purpose of planning and saving for retirement is not to accumulate a pile of money. It's to create what that pile of money can offer. For my late father-in-law, it was a world he appreciated with a life he described as "smooth." There were no tough decisions, and he totally enjoyed himself from day to day through a well-deserved retirement period that stretched for almost thirty years.

If we're reasonably on schedule to meet the financial needs of retirement, based on current asset values plus future contributions, this may be the time to consider some strategic moves. We may want to lock in current values with a portfolio allocation that would offer some reasonably predictable gains as we move forward. This would be a departure from the roller coaster ride that brought us to where we are today.

The record-breaking 10% annual gains in corporate profits over the past several years have translated directly into rising stock values, but there are clouds on the horizon. While corporations have more cash today than at any time in history, the question is whether or not consumers will have much to spend if interest costs on mortgages and debt continue to rise and the average person spends a minimum of $4,000 more per year on all fuel-related purchases --- everything from gasoline and heating oil to products made out of plastics. Then there's the deficit, Iraq, Iran and a lack of any political will for fiscal leadership.

I can't second-guess what might be the right thing for other readers in their fifties and sixties, but for those who might be curious, I will point out how my own asset allocation shapes up as it reflects my concerns. Today, I have roughly 65% of total assets in large value-oriented stocks and mutual funds. I have roughly 10% in a foreign stock mutual fund that is also a large-cap value fund. I still have 6% in an REIT fund which I have been systematically selling off over the years as it continued to outpace the rest of the market. The same is true with some small cap funds and some individual stocks. Finally, I have the rest of the funds in a combination of cash and Vanguard's high yield bond fund.

In theory, this mix should earn an average of about 9% per year going forward and the downside should be limited to about 2% in a single year two-thirds of the time. In a doomsday situation, where the market loses as much as 24%, I should lose something more like 14% with this mix of investments. I can live with this.

Conversely, during a euphoric period when the market might be up as much as 44%, (expected about one out of twenty years) I can still expect to earn 34% with this mix. I still get to play in the sand box and gain some protection against inflation.

Over a ten-year period, I can expect to see my current holding increase by about 2.5 times their current value. There is a 10% chance that they could actually decline in value by 15% (the doomsday outcome) OR, there is a 10% chance that they might also increase to almost ten times their current value. Consistent with behavioral economics, I couldn't care less about a ten times return, but I get concerned about the possibility of actually losing money over the next ten years. Anxiety about the downside trumps any euphoria when contemplating the possible upside. But again, I can live with the possibility of only a 10% chance of actually losing money. If the world goes to hell in a hand basket, I'll be satisfied with 85% of what I have today.

But enough about me. Is your comfort level with risk consistent with the risk profile of your assets? Think about it. ●

401(k) key to south of the border retirement dream

By Stephen J. Butler

To attend a family wedding and do some surfing, we flew to Costa Rica last week and landed at the town of Liberia, where the American CIA had built an international-class air facility back in the early 1980s. At that time, the United States needed a substantial airfield in order to secretly supply the Contras with weapons during the civil war in neighboring Nicaragua.

While on this trip, I was told that there are hundreds of CIA-funded airports throughout Latin America, built with our tax dollars to support various insurgencies.

The insurgencies all lost, so today those airstrips are valuable for another reason. They make it increasingly convenient for Americans to retire in these tropical paradise nations. Fawn Hall and Ollie North didn't sacrifice in vain. Easy travel to and from these former banana republics has opened them up to an explosion of American expatriates who are moving beyond just Mexico to Belize and other stable Latin American countries. Even Nicaragua is back in our good graces.

The reasons are tempting. To begin with, there are Century 21 Real Estate signs everywhere. Condominiums and ocean-front villas sell for a fraction of what they would go for here. A health insurance policy offering a gateway into the Costa Rican national health system is $500 a year. Supplementing that opportunity are private hospitals. Most of the doctors received their training in the United States or Europe. In short, it's time to learn some Spanish -- or at least gain a proficiency in Spanglish -- and head south.

A growing number of my friends and acquaintances have purchased properties in Mexico in just the past few years. Anytime I notice something happening around me involving my early-60s contemporaries, I regard it as the beginning of a trend.

Why? Because "my people," born in 1944 or thereabouts, represent the very first members of the post-war baby boom. We determine what's cool and the rest of the baby boomers follow us like lemmings. They have us to thank for rock and roll, rocket science -- and more recently, the Internet. But getting back to Latin America ...

Those who might consider living this retirement era dream could close their eyes and imagine themselves as a typical Bay Area couple. Their plan is modest in scale. These folks, about my age let's say, have decided to retire to Mexico and live in La Paz at the southern tip of Baja. In their case, it amounts to a three-step process:

First, they sell their house in Northern California and clear about $300,000. They have another $200,000 in combined 401(k) and retirement accounts, and they feel that they really should have another $100,000 or more before cutting the cord to salaried jobs.

This means that they plan to work long enough to make three more maximum contributions into their retirement plans -- each. This means an annual maximum of $20,000 for each of them for a total of $120,000. If they start by the end of 2006, make a full contribution again in 2007, and a final shot in early 2008, they will be able to say, "adios, amigos" by mid-year.

About $48,000 of the $120,000 is money that would otherwise have been paid in state and federal income taxes, because the couple's last $40,000 of annual income would have been taxed at a combined rate of almost 40 percent.

Meanwhile, their house being built in a gated community south of the border will be costing about $175,000 and they will own it free and clear. With total income-earning assets of more than $400,000, they can expect to earn 6 percent or about $24,000. Combined with Social Security of about $24,000 they will be in good shape with more income than they will need to spend.

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Millionaire club... *(from page 1)*

Again, the cost in take-home pay is $1,625 or possibly less.

With all of these couples, we are assuming that both are working and that each member has an opportunity to participate in 401(k) or similar retirement plans with annual contribution levels of up to $15,000 each.

There are variations on the theme as well. For example, each person can borrow up to $50,000 from most retirement plans for any reason without triggering a tax. This provides a $100,000 safety valve if something else came up as an opportunity or need to use the money outside the retirement plan.

If the 10 percent return assumption seems questionable, there are good, balanced funds like Vanguard Wellington that have averaged 12 percent per year for 15 years.

Most balanced funds have a third of their money in bonds, and this fund type typically lost only between 2 percent and 4 percent during the entire down market of the early 2000s.

If we use a 12 percent assumption rather than the more conservative 10 percent, all of these time periods reduce by about one to two years.

These three examples are linear, meaning that cutting all dollar amounts in half will get you to $500,000 in the same time periods. If you can shoot for just the first $500,000 today, the other half will come much faster and easier.

For further inspiration, there's Walter Gutman's classic book, "You Only Have to Get Rich Once."

Go for it.

Think of that $1 million. Think about how fast the last 10 years have gone by. How good would it feel to arrive at $1 million in just 10 more years? Is it worth altering priorities?

And how much of what we spend our money on will we be glad we still own 10 years from now? How will it compare to being within striking distance of $1 million and a life free of financial concerns? ●

401(k) key... *(from page 3)*

The key to having the puzzle fall into place was the realization that they could contribute so much as tax-deductible contributions to a 401(k). There are no longer any percentage-of-income limitations on a contribution. If someone made only $20,000 at a part-time job, they could contribute the entire amount as a pretax contribution. A couple with a sudden inkling to do something wild and crazy (like retire in Latin America) could shorten the preparation time-frame by doing whatever is necessary (like taking an extra job) to make these large contributions that add a cash cushion to their nest egg.

Meanwhile, waiting for them in Latin America is an airstrip with their name on it -- not far from a beach, golf course, good restaurants and fellow Americans. ●

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