WHY YOU SHOULD KEEP CONTRIBUTING TO YOUR 401(K)

Save for retirement consistently, regardless of how the market behaves.

Presented by Glazer Financial Network

There is seldom a dull moment on Wall Street. Stocks may rise or fall dramatically over the course of a year or a decade. Sometimes, breaking news may tempt you to pull money out of your 401(k) or greatly reduce your contributions. If you're considering such a move, think twice.

Don't stop saving for retirement. Even if you think you're wealthy enough to forego putting money in your 401(k) for a while, you could end up seriously shortchanging your retirement savings potential by reducing your retirement plan balance or elective salary deferrals.

A 401(k) plan is a terrific retirement savings vehicle – and the fact is that most Americans have not saved enough for their retirement years. Additionally, if you withdraw money from a 401(k) plan before age 59½, you'll face a 10% tax penalty (with few exceptions) and you may end up spending money today that could have enjoyed tax-deferred compounding in the future.[1]

Don't lose out on the power of tax deferral & compounding. Together, these factors have the potential to exponentially grow your retirement savings. As an example, let's say you enroll in a 401(k) plan at age 25 and contribute $2,000 a year for 40 years with an annual return of 10%. At age 65, your $80,000 of contributions will be worth $973,684 thanks to compounding and a consistent inflow of new money.[2]

Contributions to a traditional 401(k) also reduce the amount of taxable income listed on your W-2 form. They may lower your initial tax hit on your state return as well; most states exempt traditional 401(k) contributions from tax. Self-employed individuals can actually deduct 401(k) plan contributions.[2,3]

The 2012 401(k) contribution limit is $17,000, with $5,500 in additional "catch-up" contributions permitted for workers 50 and older. These limits may rise slightly in 2013.[4]

Don't lose out on a match. Will your employer match your contributions – say, a dollar-for-dollar match on the first 3% of salary? If you make $60,000 per year, 3% is $1,800. Would you throw away $1,800 worth of free money each year? You shouldn't, especially given that this money will grow tax-deferred.

Do keep contributing steadily. It's a good idea to keep up the dollar cost averaging and continue to make steady month-to-month or paycheck-to-paycheck salary deferrals. In all probability, this is central to your financial plan - and how will you amass the retirement savings you need if you stop contributing? Sure, there are other ways to build retirement savings, but dollar-cost-averaged contributions to a 401(k) represent a consistent, recurring way to get that job done.

If you contribute to your 401(k) plan through a dollar cost averaging approach, your investment dollar buys shares at a lower price in a bear market – and it also buys more shares for your money. So when a bull market cycle resumes, you may end up in a really good position.

It's a good idea to keep contributing even if you are falling behind financially. Should you pay down debts with your 401(k) assets? Only as a last resort. In fact, if you are looking at a bankruptcy you should know that 401(k) assets are protected in Chapter 7 bankruptcies under federal law.[5]

Do review your goals with your financial advisor. Look at your time horizon. Look at your overall financial plan. Whether you are nearing retirement or far away from it, you will see that your 401(k) is a vital tool for pursuing your financial objectives. Whatever this or that website may proclaim, don't be discouraged by short-term headlines; abide by the long-term plan created personally for you.

Citations.

1 – www.irs.gov/taxtopics/tc424.html [8/11/12]
2 - www.womensfinance.com/wf/401k/taxes.asp [10/9/12]
3 - finance.zacks.com/tax-deductions-contributions-401k-plans-1852.html [10/9/12]
4 - www.irs.gov/uac/IRS-Announces-Pension-Plan-Limitations-for-2012 [10/20/11]
5 - www.boston.com/business/personalfinance/managingyourmoney/archives/2010/05/bankruptcy_prot.html [5/17/10]