How Much Should I Save For Retirement?

Published October 04, 2011 | SecondAct

We all know we need to save for retirement, but how much?

There is no magic number, and that's why it can be hard to know if you're on target, especially amid the stock market tumult of the past few years.

"All too often, people start on a retirement savings plan without knowing where they are going," says Greg Hammond, a certified financial planner in Wethersfield, Conn. "This is like heading out on a vacation without deciding on a destination. Without a destination, how will you know when you will get there?"

Read the story on SecondAct here

Despite the economic uncertainties, you can adopt a relatively simple plan of action to determine if you're on the right track, or to get on the right track if you're not there already. Here's the plan in a nutshell: Save. Budget. Remain flexible to consider new options as you approach your target date.

Save As Much As Possible

How much of your current income you need to set aside depends on many factors, including your income level, your current spending habits, the lifestyle you'd like to have when you cut back your work schedule and how much of a nest egg you've saved already.

The old rule of thumb was that you need about 75% of your pre-retirement income to fund a retirement, but that's often not the case anymore.

"Rules of thumb don't work. The only thing we can count on is change," says Thomas Scanlon, a certified financial planner in Manchester, Conn.

Active retirees may face new expenses, such as travel and leisure costs, inflation risks, and the increasingly expensive long-term health-care costs that accompany a longer life expectancy.

"All of these retirement desires and goals have additional costs that you may not have currently. So although you may lose the professional business attire and commuting expenses, you will need to make sure any additional expenses are taken into consideration when planning for retirement," Hammond says.

While the old rules may not be reliable, one thing is certain: The older you are, the more you will need to set aside.

"When [investors] are young, 10 to 15% [of current income] works nicely; later, as much as 25% may be required if they have not been saving throughout their career," says Thomas Howard, a certified financial planner in Streamwood, Ill. "Of course, you can only save what you do not spend, and even frugal families can have a hard time saving these days."

That makes your employer's retirement plan a slam dunk strategy. If you are eligible for a 401(k) or other savings plan, be sure to enroll and contribute as much as possible. Payroll deductions will put your savings on auto-pilot.

"One never sees the money as it is taken before they are paid," says Kevin Meehan, a certified financial planner in Itasca, Ill. "If the money comes home, it is most often spent."

Automatic savings is just one of the benefits of an employer plan. The money you save is tax-deferred, meaning you won't pay taxes until it's withdrawn in retirement. Contributions will also lower your taxable income for the year in which you make the contribution.

You should try very hard to max out your plan. You can save $16,500 in 2011, and if you're over 50, you can save an additional

$5,000.

One easy way to boost your 401(k) savings level, even if you can't max out the plan, is to contribute enough to get full matching funds from your employer.

"A company match is basically free money," says Francine Duke, a certified financial planner in Vernon Hills and Lincolnshire, Ill. "Also, when you contribute to a company plan on a regular basis, investing becomes more effortless."

If you've maxed out your workplace plan or your employer doesn't offer one, another good savings option is to open an Individual Retirement Account (IRA). You can put away $5,000 in an IRA in 2011, and if you're over age 50, you can save an additional $1,000.

Saving outside of retirement plans is also a smart move, especially if you plan to stop working full time before age 59 1/2 -- the age at which you may withdraw most retirement funds without penalty.

Wherever you save, consider investing a portion of your portfolio in equities. Of course you don't want to lose money, but historically, stock investing is one of the only ways to keep up with and beat inflation. You're not going to need all of your retirement money at once, so you'll have a longer time horizon for a portion of your savings.

"Don't look back at the last 10 years and conclude investing in the stock market is not a good idea," says Robert Higgins, a certified financial planner in Charlotte, N.C. "Even an index-based diversified portfolio has performed satisfactorily, even in this environment."

Estimate Your Retirement Budget

Even if you're many years from retirement, you may have a general idea of what you'd like to do with your future. Perhaps you plan to travel or take up surfing or go back to school. Maybe you plan to buy a second home.

Those items all cost money.

"It is easier to spend money when you aren't working. Just like an old car, it costs more to keep us running as we age," Higgins says.

The first step is to go through the exercise of determining what you would like your retirement to look like so you can estimate the amount of income you might need. [Read more: Take the Retirement Budget Test]

Once you have a realistic picture of your future life, you can then work backward to determine the amount you should save to reach your retirement goal, Hammond says.

Remember that a retirement budget will vary, just like your pre-retirement budget probably does. You may have higher travel costs in your early years of retirement, with bigger medical expenses in your later years.

Another big-ticket item is one that people don't plan on: their adult children.

"This is not easy to cut for some as the children have developed a lifetime habit of parental dependency," Meehan says.

If regular spending to help your family is expected, add it as a line item on your budget.

Next, consider your income sources. Fewer people have pensions, so most will rely on their own nest eggs and Social Security. Most advisors say they don't believe Social Security is going to vanish, though benefits may be lower or the retirement age will be higher in years ahead.

Whatever your budget or income level, it's important to remember that increased life expectancies mean more years in retirement, and the longer your money will have to last.

Consider your family's history of longevity and your own health in your planning. The national life expectancy has climbed to 77.9 years.

"If you don't expect to live long, you would probably be more interested in an early retirement," Higgins says. "If you don't need to fund as many years, you don't need as much money to retire."

But most people do not want to risk outliving their money if they live to 95 or 100, and many would like to leave an inheritance for their families.

When you're a few years away from your target date, it's a good idea to test-drive your retirement budget. Try living on your anticipated retirement budget for a few months.

"This will provide some insight on whether the income level is realistic," Hammond says.

Financial Flexibility Is Key

If it looks like your retirement income will fall short of covering your anticipated budget, there's still time to make changes to improve your chances of success.

1. Spend less now: If you cut your budget today, you'll have more dollars available to save. Being frugal isn't being cheap -- it's being smart. Check out my column, Eight Easy Ways to Save $5,000 a Year.

2. Spend less later: Consider cutting back your retirement budget. Perhaps you can take one trip a year instead of two, or you could dine out less. Maybe you can pay off your mortgage while you're still working so you'll have fewer expenses in retirement.

3. Save more: Take advantage of all savings opportunities, including the catch-up contributions to 401(k) plans and IRAs for those over age 50.

4. Earn more now: If you've already cut your spending and you still don't have enough cash to set aside for the future, consider taking a part-time job or starting your own moonlighting business on the side. Use the extra income exclusively for retirement savings.

5. Have a part-time job in retirement: More people are working part time, either out of financial necessity or because they want to stay active and competitive in the work force. Here are 10 Reasons to Delay Retirement. Whatever your reasons, working part time can help delay withdrawals from retirement accounts. This gives your money more time to recover from tough economic conditions, Higgins says.

6. Alter your plan: Consider working full-time a few extra years so you can save more and further delay dipping into your savings. "By delaying retirement two or three years, assets might grow sufficiently to reduce the risk of depletion," Higgins says.

When you're getting close to your target date, experiment with your retirement budget and adjust it based on your nest egg and your goals.

"It is important to note that this picture will change over time, so your retirement savings should not be a one-time 'set it and forget it' plan," Hammond says. "Each person's retirement plan should be monitored and adjusted periodically for changes in goals and the financial markets."

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