Refine Your Savings Strategy During Peak Earning Years

When you're in your 20s and 30s, retirement feels like a far off concept; there's plenty of time left to stash money away for the future! But then you reach your 40s and 50s and suddenly retirement becomes a not so far off reality.

For many, this is the prime time to maximize your retirement savings, since you're likely in your peak earning years. Hopefully you've contributed to various retirement accounts over your working life, as well as opened several types of accounts with different investment strategies.

But now major expenditures, such as college savings for your kids, home improvements and repairs and maybe even supporting an elderly family member are becoming a bigger reality. You're also probably starting to think about Social Security benefits and retirement income, since retirement is right around the corner.

In this article, we'll explore the different challenges and opportunities that many people face as they surpass the halfway mark of their careers and typically earn their highest salaries.

Let's look at Tony. Tony is 48 years old, married with two kids (aged 15 and 17), earns $100,000 a year and enjoys traveling and restoring classic cars.

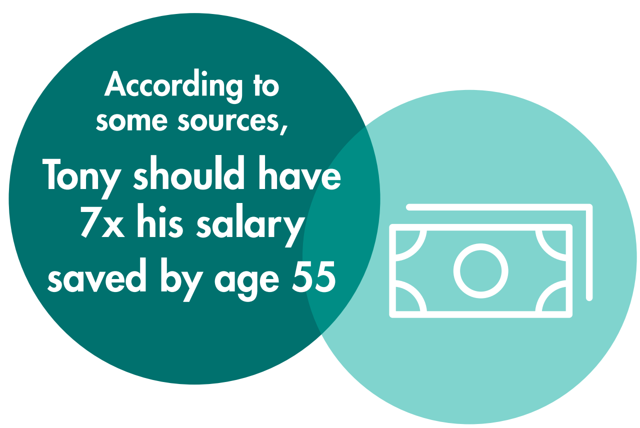
TONY

48 years old

Tony started contributing to his retirement savings in his 30s and now saves through his employer-sponsored 401(k), as well as a traditional IRA and a Roth IRA. In addition to these accounts, Tony and his family maintain a modest savings account, which they use as an emergency fund.

Tony is saving in a variety of ways, but is there more he can be doing? Will he and his family have adequate savings to pay for upcoming major expenditures and live comfortably in retirement?

According to Payscale, Tony is at the age where his income is likely at its peak. And, since some retirement savings models say Tony should have saved seven times his salary by age 55, ensuring that his money works hardest for him is more important now than ever. With his current savings strategies, he has a few different options to help him stay on track.



Assessing Savings Contributions

Tony is currently contributing 5% of his salary into his 401(k) and $5,000 per year combined into his traditional and Roth IRAs. While all of these savings add up, there are a few different ways Tony could further enhance his strategy.

For example, the main difference between a traditional IRA and a Roth IRA is the tax implications.

Contributions to traditional IRAs are often tax deductible in the year they're made, but you will pay taxes when you withdraw the money. Roth IRA contributions, however, are not tax deductible, but earnings and withdrawals are generally not taxed – as long as you take the money out after you are 59 ½ or meet other criteria.

Given that Tony is likely in a higher income tax bracket now than he will be when he retires, it might make more sense for him to contribute more to his traditional IRA than his Roth IRA. With this strategy, he can enjoy the higher tax bracket deduction now for the contributions and the lower tax bracket later, when he withdraws the funds.

Additionally, employers that offer a 401(k) typically offer a program where they will match a percentage of your savings. If your employer does this, take advantage of their matching contributions as much as possible.

In a few years, Tony can also take advantage of "catch-up" contributions. This means, if you are 50 or older, you can contribute additional money to your retirement accounts.

For 401(k) and other employer-sponsored plans, you can contribute an additional $6,500 in 2020. For IRAs, you can contribute an additional $1,000.

What about the short-term?

Traditional retirement accounts, like the ones discussed above, are all very important, but it's important to remember they're not very liquid, meaning Tony cannot easily access the money in them without penalty.

To ensure Tony can handle unexpected expenses, such as job loss, health issues or emergency repairs, he could also contribute more to his savings account. Not sure how much you would need for emergencies? A typical rule of thumb is three months of basic living expenses.

Navigating your prime earning years is incredibly important, as they are often the best time to make your money work hardest for you. You should consult with an advisor to help make sure your strategy is appropriate for your personal situation.

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