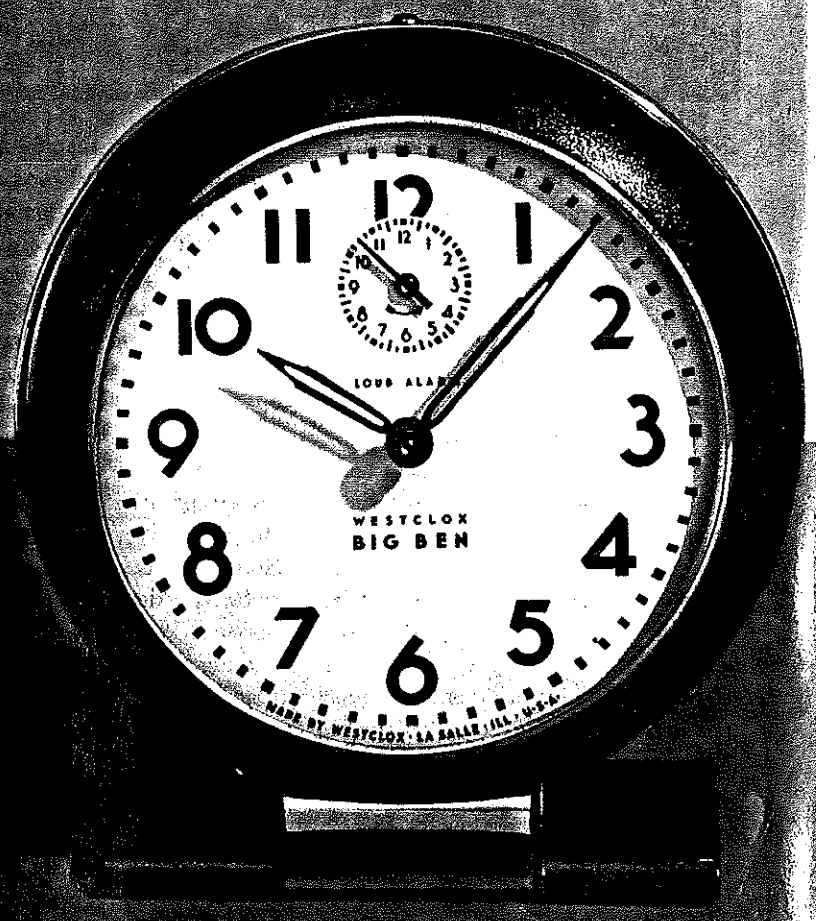
TIME IS STILL ON YOUR SIDE

REALITY CHECK | How much must you save today to pay for a **COMFORTABLE RETIREMENT** tomorrow?

AMERICANS are a confident bunch. In the shadow of the second-worst bear market since the Great Depression, two-thirds of those questioned in a recent survey say their investments remain on track to pay for the retirement they want. Unfortunately, a lot of those confident souls have never taken the time to figure out just how much



living that retirement life will cost. In fact, half the people who take the time to do the calculations realize they had better start shoveling more money into their 401(k)s and other retirement accounts as soon as possible.

If your retirement nest egg took a beating over the past two years, it doesn't take a financial genius to understand that it's up to you to make up for the damage. That probably calls for a combination of saving more and investing smarter. This special package aims to help in both regards, by pointing out new laws that let you save more in your 401(k), IRA and other tax-favored accounts, and outlining an investment strategy to make your investments flourish in the years ahead. As badly as the markets performed in 2000 and 2001, there is no reason to believe that, over the long haul, stocks will fail to deliver their historic long-term annual average return of better than 10%. At that rate, your money will double in less than seven years. Time is *still* on your side.

The general rule for saving for retirement remains unchanged: Save as much and as early as possible. Investments compounding inside a tax-sheltered 401(k) are a marvel to behold. But how much do you need to save? Many unknowns make precision impossible: How much will your investments earn? What will inflation be? How much will social security pay? When will you retire? Will your health hold up? How long will you live?

Still, it's essential that you get an idea of what you need to be saving today to pay for tomorrow. Before you tackle the worksheet, be warned that the bottom line may be scary—suggesting a nest-egg gap that requires you to increase your savings by an amount that seems impossibly high. Say, for example, that the verdict is you need to boost your savings by $1,000 a month, starting with your next paycheck. If you're 35, carrying a huge mortgage and facing the prospect of sending three children to college, that might sound like a cruel joke. Perhaps this dose of reality will even convince you that your plans for early retirement were a pipe dream. You may just need to work a few years longer than you had hoped.

But don't throw in the towel. Remember: Two decades from now, when the house is paid for, the college bills are behind you and your salary is far higher than it is today, your ability to save should be greatly enhanced. That's good news, but don't let it deter you from trying to save more starting right now. Saving an extra $2,500 this year will knock $27,000 off what you'll need to save 25 years from now, assuming the money grows unmolested by the IRS at an annual rate of 10%. Here's how to complete the worksheet; you can skip the math by using the interactive version on our Web site, at www.kiplinger.com.

STEP 1 | How much income will you need? Start with your current income (and your husband's or wife's if you're married), and apply a growth factor from Table 1 on page 85. Assume, for example, that inflation will average 3% a year between now and the time you retire, and that your salary will keep up. If you plan to retire in 20 years, find the place where 20 and 3% intersect on the table: 1.81. Enter this factor on line B and multiply to find your estimated preretirement income.

A common rule of thumb suggests you'll need 70% to 80% of that income to maintain the same lifestyle in retirement. Some expenses will fall, such as taxes and the amount (probably substantial) that you're socking away *for* retirement. Some will rise, such as what you pay for health care. While 80% might not be precise, it's as good an estimate as any for the purposes of the worksheet. When you get within five years of retirement, work up a detailed budget to get a better estimate.

STEP 2 | How much will social security and a pension pay? Workers age 25 and older should receive a notice from the Social Security Administration each year estimating the size of their monthly benefit when they retire. If your personal estimate isn't handy, you can use an estimate based on these examples: If you are 40 and earn $84,900 or more, you can expect a monthly benefit of about $1,990 (in current dollars) at your full retirement age of 67. A 40-year-old who earns $50,000 can expect about $1,560 a month at age 67.

If your company has a traditional pension plan, ask someone in the benefits office for an estimate of your monthly benefit at retirement. Note that the worksheet asks for annual social security and pension figures, so multiply the monthly estimates by 12. Add the pension and social security benefit together and adjust the total, assuming the amount will keep up with inflation between now and when you retire. Use a conservative growth factor of 3% from Table 1. Write the total adjusted figure on line J.

STEP 3 | How much do you need? The difference between those sources of income and the amount you need has to come from 401(k) money and other personal savings. Table 2 shows how much you need to save to produce $1,000 of monthly income over various periods assuming different returns.

A big question is, how long will your retirement last, or, more bluntly, how long will you live? According to the National Center for Health Statistics, a 65-year-old man is expected to live for about 16 years, while a woman of the same age has a life expectancy of about 18 years. Those numbers are averages, which means lots of us will live longer. To be conservative (as well as

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Don't want to do the math? You can skip the inflation and growth factors, not to mention basic addition and subtraction, with our online version.

PHOTOGRAPH BY PETE MCARTHUR

Worksheet How much you need to save to pay for the retirement you want

	YOURSELF	YOUR SPOUSE	COMBINED
STEP 1 | How much income will you need in retirement?			
A. Current annual income	$_____	$_____	
B. Growth factor from Table 1	x_____	x_____	
C. Projected annual income at retirement	=$_____	+$_____	=$_____
D. Percentage of income you want to replace (suggestion: 80%)			x_____%
E. Target annual retirement income, in future dollars			=$_____
STEP 2 | How much will you get from social security and a pension?			
F. Projected annual social security benefit, in today's dollars	$_____	$_____	
G. Projected annual defined-benefit pension, in today's dollars	$_____	$_____	
H. Total (add lines F and G)	=$_____	$_____	
I. Growth factor from Table 1 (assume 3%)	x_____	x_____	
J. Adjusted benefits	=$_____	+$_____	=$_____
STEP 3 | How big a nest egg do you need?			
K. Target annual retirement income, in future dollars (line E)			$_____
L. Combined social security and pension benefits, in future dollars (J)			- $_____
M. Annual income needed from nest egg, in future dollars			=$_____
			divided by 12
N. Monthly income needed from nest egg, in future dollars			=$_____
			divided by 1,000
			=$_____
O. Amount needed to generate $1,000 a month (from Table 2)			x $_____
P. Preliminary nest-egg goal			=$_____
Q. Inflation-protection factor			x_____
R. Inflation-adjusted nest-egg goal			=$_____
STEP 4 | How much have you already accumulated?			
S. Current value of 401(K)s, IRAs, Keoghs and other retirement savings			$_____
T. Growth factor from Table 1			x_____
U. Projected future value of current savings			=$_____
STEP 5 | How much will you draw from home equity?			
V. Current home value			$_____
W. Growth factor from Table 1			x_____
X. Estimated home value at retirement			=$_____
Y. Mortgage remaining at retirement + down payment on new home			- $_____
Z. Home's contribution to nest egg			=$_____
STEP 6 | How much more do you need to save?			
AA. Inflation-adjusted nest-egg goal (line R)			$_____
BB. Future value of current savings (line U) + home's contribution to nest egg (Z) + any other assets			- $_____
CC. Nest-egg shortfall			=$_____
DD. Savings-target factor from Table 3			x_____
EE. How much you need to save per month			=$_____

hopeful), assume you'll live to age 90. Pick the factor from Table 2 that comes closest to the number of years your money has to last after you retire. For example, if you expect to earn an 8% annual return in retirement and want your nest egg to last for 25 years, find the point where 8% and 25 years intersects. That tells you that you need $130,400 for every $1,000 of monthly income you desire. Enter that figure on line O and, if you need $8,000 a month from your nest egg (remember, these are inflated dollars), multiply it by eight. The result, $1,043,200, is your preliminary nest-egg goal.

Just as tax-free compounding can make your 401(k) explode, inflation can inflict a devastating blow to your purchasing power over the years of retirement. If you need $8,000 a month from your nest egg when you retire, you'll need almost $12,500 15 years later to maintain the same purchasing power, if inflation averages 3% a year. If you assume your investments will grow at an annualized rate of 8% in retirement, multiply the initial nest-egg goal by 1.3 to build in 25 years of inflation protection; if you assume a 6% rate of return, multiply the initial goal by 1.6 to buy that 25 years of protection. Enter your inflation-protection factor on line Q and do the math.

STEP 4 | How much have you already got? Don't freak out. You may have more than you think. Add up everything in your and your spouse's 401(k)s, traditional and Roth IRAs, Keogh plans and any other tax-favored accounts, as well as other money earmarked for retirement. Enter the total on line S and then adjust it for anticipated growth between now and your retirement date using a growth factor from Table 1. If you have $250,000 now and expect it to grow for 20 years at 10%, for example, then multiply by 6.73. That's $1,682,500.

STEP 5 | Will your home contribute? If you sell your house at retirement and buy or rent something less expensive, the leftover cash becomes part of your nest egg. Because the first $250,000 of profit from the sale of a home is tax-free ($500,000 if you are married and file a joint return), it's unlikely that taxes will cut into your profit. For a quick-and-dirty estimate of how much home equity you can count on, take the value of your home today and multiply it by a growth factor from Table 1, assuming 3% growth over the years you have until retirement. Subtract any mortgage you expect at that time and the down payment for a new home, and enter the result on line Z.

STEP 6 | How much more do you need to save? Subtract the future value of your current savings, your home's contribution and any other assets you plan to use for retirement (such as the proceeds from the sale of a business or an expected inheritance) from your goal to find the shortfall (line CC). Multiply that amount by the savings-target factor in Table 3 to see how much you need to save each month between now and retirement. If you need, say, an extra $400,000 over the next 20 years and expect your investments to earn an average 10% return, then multiply your shortfall by 0.0013 (the factor where 10% and 20 years intersect). The result—$520—is how much you need to save each month to build your nest egg. This amount includes your employer's match for 401(k) contributions. Even if you can't squeeze out the full amount now, boost your savings as much as you can as soon as you can. K

—*Reporter:* **JOSEPHINE ROSSI**

Table 1 Money-growth and inflation factors

YEARS TO RETIREMENT	ANNUAL GROWTH AND INFLATION RATE					
	3%	4%	6%	8%	10%	12%
5	1.16	1.22	1.34	1.47	1.61	1.76
10	1.34	1.48	1.79	2.16	2.59	3.11
15	1.56	1.80	2.40	3.17	4.18	5.47
20	1.81	2.19	3.21	4.66	6.73	9.65
25	2.09	2.67	4.29	6.85	10.83	17.00
30	2.43	3.24	5.74	10.06	17.45	29.96
35	2.81	3.95	7.69	14.79	28.10	52.80

Table 2 Nest eggs for $1,000 a month

YEARS IN RETIREMENT	ANNUAL RATES OF RETURN			
	6%	8%	10%	12%
20	$140,300	$120,400	$104,500	$91,700
25	156,000	130,400	111,000	95,900
30	167,600	137,200	114,900	98,200

Table 3 Savings target factors

YEARS IN RETIREMENT	ANNUAL RATES OF RETURN			
	6%	8%	10%	12%
5	0.0143	0.0135	0.0128	0.0121
10	0.0061	0.0054	0.0048	0.0043
15	0.0034	0.0029	0.0024	0.0020
20	0.0022	0.0017	0.0013	0.0010
25	0.0014	0.0010	0.0007	0.0005
30	0.00099	0.00067	0.00044	0.00028
35	0.00070	0.00043	0.00026	0.00013