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Smart IRA Investing That Can Help You Retire Early

Dan Eggertsen: Hi, I'd like to welcome everyone to the call. This is Dan Eggertsen. I'm here with my father, Karl Eggertsen and we are going to tackle some questions on IRA investing. Now I've taken some time to sift through all the questions we've been getting and I've boiled it all down to the top three questions that we keep getting asked. So how you doing today Dad?

Karl Eggertsen: I'm doing real good Dan.

Dan Eggertsen: Hey good. So you ready to dig into these questions today?

Karl Eggertsen: Yeah I think I'm ready to go.

Dan Eggertsen: Okay. Well let's get started then. The first question we're seeing, the most popular question is number one, "I want to invest for my retirement because I don't trust Social Security. What options are available to me?"

Karl Eggertsen: There are a wide number of options. I think that the first thing that each individual needs to do is to consider saving if they aren't already, consider saving 10% and as much as 15% of your salary per year. That may seem real difficult until you sit down and take a look at your budget and figure out what are the expenses that you really don't need or maybe you could cut down on some expenses for example, going out to dinner a number of times a week. Some people go out to dinner all the time and that could add up to 6, 7, \$8,000 a year when you add it up across a year.

Dan Eggertsen: Easily.

Karl Eggertsen: Yeah and that's just one item. 10% to 15% most everybody should be able to do that. But the key is to save as much as possible on a regular basis and automatically. Just pull it out of your paycheck and invest it but before you get your hands on it. Like we all like to spend money and see things we want to buy.

So once you've got the savings going, the first place to start on retirement investing, assuming that your employer has a retirement plan and especially if they have a matched contribution. For example, if you contribute 10% to their retirement plan if they match 10% then you would, in other words these plans can match anywhere up to 25% of what you contribute up to 100%. But

if they contribute anything like that, you're getting at least 25% and up to 100% on your money, up to the percent that they'll match.

Dan Eggertsen: Right.

Karl Eggertsen: That's the first place to start. Plus the retirement plans are tax deferred so you're not going to be paying taxes on them. So that is the number one place to invest and invest at least up to the maximum percent that they will match. Then the next step would be IRAs, individual retirement annuity accounts. These are tax deferred accounts. You can invest in a wide variety of things; mutual funds, stocks, bonds, exchange-traded funds, index mutual funds, even real estate.

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You can establish these accounts through banks, brokerage houses like Charles Schwab, mutual fund companies like Vanguard and Fidelity, a wide variety of institutions that will set up a retirement account for you; an IRA. The next step would be, if you're still looking for places to invest, taxable accounts are great because you're wide open to the investments that you can put in taxable accounts and there's no penalty to withdraw any money as there would be in these other retirement plans that are tax deferred.

And there're no limits on contributions, you can invest as much as you want to. So I think that if, as somebody's investing and their salary's increasing to spread your savings and investment dollars across these three areas. A fourth one that I think can work for some people, I don't think it's always the best for everybody and that's an annuity.

They have different types of annuities but these are tax deferred accounts that you can be set up and there's fixed annuities, there're variable rate annuities, and there's immediate annuities. They have some advantages because there's absolutely no limit to what you can contribute to it. What I would recommend is people take a really close look at what the cost of the annuity is. Some are very high cost, as much as 1% or 2% or more of the amount of money you have in there every year. Whereas the Vanguard Group which is the lowest I've ever seen is only 0.18%, about as low as an index fund.

Dan Eggertsen: Right.

Karl Eggertsen: So if one is looking at annuities, I recommend number one is to consider what type you want and find one that's very low cost. The fixed annuities are just a fixed rate over your lifetime or a guaranteed rate of percent off your money that you contribute that's distributed to you over your lifetime or over some fixed period for a contractual agreement.

The variable annuity is invested in growth assets like stocks and bonds so you could have growth but you also have volatility. So you never know where your fund's going to be, where your value's going to be at any particular time. But it's another type and it distributes your money to you over a fixed period of time. But of course it can't guarantee you a fixed rate because it's a variable.

The other one that's very interesting is an immediate annuity and that's a fixed or variable annuity. How it works is you contribute, let's say you have a pot of money, maybe you sell a piece of real estate that's worth half a million, you put \$500,000 into an immediate annuity, if one would do that you would immediately start getting income that's guaranteed for a contract for the rest of your life. And you can get an inflation clause on that so it would even accommodate inflation.

Dan Eggertsen: Wow.

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Karl Eggertsen: What is recommended, what I recommend is don't put any more than about a third of your total retirement funds into an immediate annuity if that's one that you'd be using so that you'd have the other two-thirds or so of your money that you'd have access to. Once it's in an annuity, it's locked into the contract so no more than a third of your money. But these are the types of options that people have and I talk to them in the sequence that somebody should tap these assets. Okay?

Dan Eggertsen: Well that's great. Great answer and great stuff and again, the key to making all this work is to do consistent, automatic withdrawals from your paycheck that automatically go into these different things. That's the key to making this thing work. Because you know if it goes into a checking account there's always that desire that possibly you could spend it or whatever before you get a chance to invest it. There're all kinds of ways to set up an automatic contribution thing to go into these accounts. All right, question number two and this is for you Dad. "How did you invest for your retirement specifically?"

Karl Eggertsen: It turns out ultimately and I was learning as everybody learns when they're starting out. I graduated from college, got married, took my first job. The first place I started investing is kind of in the sequence that I just went through on question one. I invested in my place of work which was the Federal Government.

I worked for the Department of Defense as an engineer and then a program manager and I, all the years that I worked for the Federal Government I contributed to the Civil Service Retirement system. It served us very well. I did that over a 30 year period. So I have a pension from that. The second thing we have done is we're utilizing Social Security; both my wife and myself now are drawing social security.

We also have contributed over our working years to IRAs. At the time we were contributing, there was no ROTH IRA. We'll be getting into the different types of IRAs but we contributed to what's called the Traditional IRA where we put in pre-tax dollars into this tax deferred account. It served us very well. It's grown. We invested in a variety of investments, mutual funds primarily but global as well as some real estate investment trust and mutual funds.

So we used the IRA and then we invested in various investments in taxable portfolios and a wide variety and that's where we have most of our money, is in our taxable portfolios. Finally started investing probably about 10 years after I graduated from college into our first real estate investment; it was a small single-family rental home.

I subsequently, years later bought another one. Then just after I retired, I took an early retirement and started investing in small apartment buildings for income. So we draw income from all of these things. But this kind of follows – I also have an annuity by the way. I invested in an annuity. It's a variable annuity and I did a little bit of that. But as I went down the chain of things, I felt that the annuities, as I indicated in the first question are really like the fifth step that you would want to go to.

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Because I think the others are better but the annuity can be a powerful addition if somebody has some extra money and/or eventually when they're in retirement they sell an asset that has considerable value, an immediate annuity and I kind of point to that specific type of annuity has some real potential if it's low cost and if it's an immediate annuity with a reputable firm and it's something you can tap for life. And if you have an inflation clause on it you don't have to worry about inflation getting ahead of you.

Dan Eggertsen: Okay.

Karl Eggertsen: So anyway, that I think answers the second question.

Dan Eggertsen: Excellent. Let's move on to the last question. We've got about five minutes left so we'll hit this one. The third question is, "What is an IRA and are there different types? If so, what are the pros and cons of each and who should invest in the various types?"

Karl Eggertsen: Well there're two basic types. One is the traditional IRA which we talked about which is something that my wife and I have taken advantage of. There's only one type that we were able to use when we were contributing. You can contribute up to \$5,000 a year and if you're over 50 you can contribute an addition \$1,000 for a total of \$6,000.

So that's basically what an IRA is. It provides tax deferred savings, you have limit - there's really no limits in pretty much. Even commodities, I mean real estate you can invest in really anything. I don't know of many limits on it. It's a very powerful tool. Again, the two different types are the traditional which you're providing pre-tax dollars.

Then everything grows tax free until you start drawing from it. You have to start withdrawing by the time you're 70 ½ years old. At that point you have to, you're required by law to start withdrawing or you suffer some penalties.

Dan Eggertsen: Right.

Karl Eggertsen: So I consider that a disadvantage. If somebody's going to live to until they're you know is very healthy at 70 ½ and they got plenty of other money, why should they have to start withdrawing and pay taxes when you'd like your dollars maybe to keep growing. Okay, the IRA solves that problem is you can have it you never have to take it out if you don't want to...

Dan Eggertsen: The ROTH you mean.

Karl Eggertsen: I mean the ROTH yeah. The ROTH IRA solves those problems of having to withdraw by a certain age, you don't have to. You can withdraw whenever you want to and you contribute after tax dollars so all taxes are paid at the time you contribute so those dollars are tax free forever. Another advantage of the ROTH is it's the best of the two types of IRAs to pass on to your heirs because there're never any taxes that have to be paid.

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You can pass on a ROTH IRA to your kids, you know after you're gone and they have to pay no taxes. So there are advantages to the ROTH.

Dan Eggertsen: Right. Yeah well it sounds like there're huge advantages in that. The downside of the ROTH is you can tell it's a real good vehicle because they limit the amount of money you can put it. So that's that little indicator there that it's really good and you want to definitely max that out if you can.

Karl Eggertsen: Yeah for somebody starting out, assuming that they make less than \$100,000 a year because that's the one key limit on a ROTH is if you make less than \$100,000 dollars a year you can't contribute. I mean you're living on what you can contribute.

Dan Eggertsen: If you make more yeah.

Karl Eggertsen: Right.

Dan Eggertsen: Are there penalties if you make over \$100,000 a year and you're still contributing? Because I don't think anyone actually stops you but would that be a problem down the road?

Karl Eggertsen: Yeah it would be because the IRS would catch that. As long as you're making under \$100,000 you don't suffer any limitations. I think the limitations are on how much you can contribute. Because I know I dealt with that on the regular IRA. If you get above a certain amount then you end up having to reduce the amount you can contribute and after a while if you make too much you can't contribute anything. I'm pretty sure that's the way it still works.

Dan Eggertsen: Now typically a traditional IRA is run through your employer correct? Or can you do it on your own?

Karl Eggertsen: No, traditional IRAs are not run through your employer. What you have is you have ROTH 401Ks.

Dan Eggertsen: Oh right, 401Ks.

Karl Eggertsen: And that's a little confusing. It's not an IRA per se but it has a very same structure...

Dan Eggertsen: And then what happens is if you leave that employer typically you'll roll that into an IRA.

Karl Eggertsen: Right. You'd roll it right into an IRA and I actually did that. I rolled an equivalent type account from the government into my IRA when I retired.

Dan Eggertsen: Yeah I've done that too.
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Karl Eggertsen: And you don't pay any taxes. The key is you never touch the money. It's all done through paperwork and it goes right into your account so you can't touch it. If you took a check and took it to your bank, you'd pay huge taxes. It needs to be done without going through your hands. Okay? Let's see was that everything? I think you were asking about see the pros and cons, we've been kind of talking about those...

Dan Eggertsen: We've been talking about those and who should invest in each one.

Karl Eggertsen: ...in the various types. Okay. Yeah that's the other part of the question.

Dan Eggertsen: You hit that too but go on, summarize.

Karl Eggertsen: I think that anybody starting out with IRAs should go with a ROTH IRA because of the advantages that I've talked about. You pay the taxes up front, you never pay taxes again when you start taking out the money or you pass it on to your heirs, there's no more taxes to be paid. It just keeps growing and growing and growing and you never have to take it out by a certain time limit or anything.

Dan Eggertsen: Right.

Karl Eggertsen: And for people who were already in a traditional IRA like my wife and myself, we basically have already split our IRA into a traditional IRA and took half of it out and paid some taxes and moved it into a ROTH.

Dan Eggertsen: Okay.

Karl Eggertsen: So that is, if somebody wants to ask what is the best to use in the long run I personally think the ROTH is but if somebody sees advantages for them in both and they can't answer the questions which are pretty hard to ask is, what is your tax bracket going to be when you retire? Who knows for sure?

Dan Eggertsen: Yeah who knows?

Karl Eggertsen: And who knows what the Federal tax rates are going to be in the future? Nobody can really predict so the best answer I ever heard is split between the two. Have a traditional IRA 50% and 50% in a ROTH. Okay? Especially if people are already invested in a traditional if you just move a little bit every year into a ROTH from your traditional and end up with kind of a 50/50 split. That's probably the best you can do to make sure that you don't, if the Federal Government makes some decisions that really hurt you then one or the other is going to be better for you of these two.

Dan Eggertsen: Okay. All right.

Karl Eggertsen: So I think that ends it.

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Dan Eggertsen: Well thanks a lot Dad. You've done a great job again. I thank everyone for being on the call. Thank you for your time Dad and we'll talk to you again soon.

Karl Eggertsen: Okay Dan. Take care.

Dan Eggertsen: Thanks. Bye-bye. All right.

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