Orchestrating Your Retirement Accounts

An orchestra is merely a collection of instruments, each creating a unique sound. It is only when a conductor leads them that they produce the beautiful music imagined by the composer.

The same can be said about your retirement strategy.

The typical retirement strategy is built on the pillars of your 401(k) plan, your IRA, and taxable savings. Getting the instruments of your retirement to work in concert has the potential to help you realize the retirement you imagine.[1]

Hierarchy of Savings

Maximizing the effectiveness of your retirement strategy begins with understanding the hierarchy of savings.

If you're like most Americans, the amount you can save for retirement is not unlimited. Consequently, you may want to make sure that your savings are directed to the highest-priority retirement funding options first. For many, that hierarchy begins with the 401(k). Next comes an IRA, and after that, a taxable investment account.

You will then want to consider how to invest each of these savings pools. One strategy is to simply mirror your desired asset allocation in all retirement accounts.[2]

Another approach is to put the income-generating portion of the allocation, such as bonds, into tax-deferred accounts, while using taxable accounts to invest in assets whose gains come from capital appreciation, like stocks.[3][4]

Withdrawal Strategy

When it comes to living off your savings, you'll want to coordinate your withdrawals. One school of thought recommends that you tap your taxable accounts first, so that your tax-deferred savings will be afforded more time for potential growth.

Another school of thought suggests taking distributions first from your poorer-performing retirement accounts, since this money is not working as hard for you.

Finally, because many individuals have both traditional and Roth accounts, your expectations about future tax rates may affect what account you withdraw from first. (If you think tax rates are going higher, then you might want to withdraw from the traditional before the Roth.) If you're uncertain, you may want to consider withdrawing from the traditional up to the lowest tax bracket, then withdrawing from the Roth after that.[5]

In any case, each person's circumstances are unique and any strategy ought to reflect your particular risk tolerance, time horizon, and goals.

Kind Regards,

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[1] Distributions from 401(k) plans and traditional IRAs are taxed as ordinary income, and if taken before age 59½, may be subject to a 10% federal income tax penalty. Generally, once you reach age 70½, you must begin taking required minimum distributions. 401(k) plans and IRAs have exceptions to avoid the 10% withdrawal penalty, including death and disability. Contributions to a traditional IRA may be fully or partially deductible, depending on your individual circumstances.

[2] Asset allocation is an approach to help manage investment risk. Asset allocation does not guarantee against investment loss.

[3] The market value of a bond will fluctuate with changes in interest rates. As rates rise, the value of existing bonds typically falls. If an investor sells a bond before maturity, it may be worth more or less than the initial purchase price. By holding a bond to maturity an investor will receive the interest payments due, plus their original principal, barring default by the issuer. Investments seeking to achieve higher yields also involve a higher degree of risk.

[4] The return and principal value of stock prices will fluctuate as market conditions change. And shares, when sold, may be worth more or less than their original cost.

[5] Roth IRA contributions cannot be made by taxpayers with high incomes. To qualify for the tax-free and penalty-free withdrawal of earnings, Roth IRA distributions must meet a five-year holding requirement and occur after age 59½. Tax-free and penalty-free withdrawal can also be taken under certain other circumstances, such as a result of the owner's death. The original Roth IRA owner is not required to take minimum annual withdrawals.