

# A Balancing Act — Saving for Retirement and an Education


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To successfully save for retirement, we feel it is critical to start early and keep saving. But how can you stay on track for retirement while balancing other financial priorities, such as saving for your children's education?

## What is an employer matching contribution?

Your employer puts in money to "match" the money that you put into your retirement account. For example, for every \$1.00 you save, your employer may contribute \$0.50, up to a certain percentage of your salary. There are different kinds of match structures, so look at what your employer offers and consider contributing enough to your retirement account to maximize your employer's match.

<sup>1</sup> You will be subject to federal income tax, and a 10% federal tax penalty may apply on earnings if amounts are withdrawn for something other than qualified education expenses. The Secure 2.0 Act of 2022 allows for 529 assets that have been maintained for at least 15 years to be rolled over on a tax-free basis to a Roth IRA for the benefit of the beneficiary, subject to a lifetime limit of \$35,000. This is effective for distributions after December 31, 2023. There are other restrictions not listed here that may apply. Consult your tax advisor.

Fortunately, there are tax-effective ways to save for retirement and higher education that can help accomplish these goals. 401(k) plans and IRAs allow for tax-deductible retirement contributions and tax deferral on investment gains while 529 savings plans defer taxes on investment earnings and offer withdrawals free from federal taxes if used for qualified education expenses.<sup>1</sup>

## This might sound familiar

Erin started a new job right out of college and increased her retirement plan savings over the years. Now age 35, she saves 10% of her pay, which includes maximizing her employer's matching contributions (4.5%). She's made a great start building toward a comfortable retirement portfolio with over \$100,000 currently in her retirement account. However, life sometimes gets in the way of savings goals: Erin and her spouse just welcomed a new baby — Luis — into the family.

Erin knows funding an education can be expensive and is likely to be even more so in the future. So she has a dilemma — should she continue to save towards her retirement plan, or start setting aside money for Luis' education?

Let's look at how Erin's retirement account might be impacted if instead of directing 10% of her pay to her retirement plan, she directs 6% to retirement (continuing to maximize her employer's match) and 4% to a 529 plan.<sup>2</sup>



**It's a balancing act — now Erin has a smaller retirement savings account balance, but she also has some savings in Luis' 529 account**



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### <sup>2</sup>Key assumptions

Starting age = 22

Starting salary = \$40,000

Annual pay increase = 2%

Employee contribution = 3% escalating by 1% per year up to 10%

Employer contribution = 3% match on first 3% deferral, plus 50% of next 3% deferral (maximum match of 4.5%)

529 plan savings starts at age 35 and continues for 18 years until age 53

Between ages 35 and 53, 6% of pay directed to retirement account and 4% of pay directed to 529 plan savings

From age 54 to age 65, retirement account contribution goes back to 10%.

Assumed fixed rate of return of 6% per year

Age at retirement = 65

Excess returns are above and beyond the passive; for example, excess return of 0.5% uses a 6.5% annual return.

These hypothetical examples are for illustrative purposes only and are not intended to predict the returns of any investment choices. Rates of return will vary over time, particularly for long-term investments. There is no guarantee the selected rate of return can be achieved. Any investments may have fees and expenses that are not taken into account which would lower the performance. Regular investing does not ensure a profit or protect against loss in declining markets.

The good news is that Luis' hypothetical 529 account is assumed to grow to \$76,000, which would certainly help with future education expenses. However, this comes at a cost to Erin's retirement account; she is projected to have \$159,000 less than she thought she would.

### Adding in active management

How might the results look if Erin, by investing in actively managed funds, were able to earn just a half-percent more a year on her investments from age 35 on?<sup>2</sup>

**Half a percentage point in additional returns could potentially put Erin back on track with her retirement account while also potentially adding to Luis' 529 account.**



**RETIREMENT SAVINGS (6% OF PAY ANNUALLY)**



**529 SAVINGS (4% OF PAY ANNUALLY)**



**ACTIVE MANAGEMENT (0.5% ADDITIONAL RETURN)**



**\$1,322,000** in Erin's retirement account at age 65 and **\$80,000** in Luis' 529 account at age 18

Here we see that the additional return of 0.5% per year, 6.5% altogether, could result in a retirement account balance of over \$1.3 million, more than her original retirement projection, and a projected 529 account balance of \$80,000, further helping defray future education expenses.

When considering active and passive funds (*i.e.*, index investing and ETF's) there are some differences between the two investing styles. Investors may want to consider aligning with their goals and what is important to them. Index funds and ETF's generally track the indices or exchanges on which they are modeled. Active managers seek to outperform market indices and can make strategic decisions as well as attempt to manage risks in market fluctuations that are unavailable to index/ETF managers because of specific guidelines. Looking at long-term performance might provide greater insight to how a fund performs in up and down markets than short-term returns.

### Key takeaways

- Early saving can form a foundation to help cushion unexpected changes in your retirement journey.
- Although active management can lose money, the possibility of added returns above an index from active management, often referred to as excess returns, can potentially help balance retirement and educational savings goals.

Keep in mind that all investments, including mutual funds, carry a certain amount of risk including the possible loss of the principal amount invested.

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