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Roth IRAs, annuities and your retirement

By Chris Kissell • Bankrate.com



Victor Ricciardi

GOUCHER

—college—

Retirement planning can be a confusing, overwhelming experience.

Today's workers have many options for where to invest their retirement savings -- from 401(k) plans to individual retirement accounts and annuities. Because options abound, it's easy to become trapped in "analysis paralysis" and find yourself procrastinating instead of making the tough choices.

However, a little forethought -- and some insight from a good financial adviser -- can help you craft the right retirement plan for your goals and circumstances, says Victor Ricciardi, an assistant professor of finance at Goucher College in Baltimore.

In part one of a two-part interview, Ricciardi discusses who should consider investing in a Roth IRA and whether the time is right to purchase an annuity. (Part two discusses how to fix Social Security, and retirement advice for young workers.)

For what type of investor is the Roth IRA and Roth 401(k) best suited?

I find it difficult to make a full assessment of the Roth 401(k) plan because this type of company retirement plan is a fairly new product. The Roth 401(k) plan has been around for only a few years, and most companies still do not offer it because of the additional paperwork, payroll processing issues and costs of implementing a new retirement plan feature.

It is my belief that it will be a number of years before the Roth 401(k) plan becomes widely available.

A better idea is to make a comparison between the traditional 401(k) and the different types of IRAs. My preference is for the traditional 401(k) plan, because of the benefits of the company matching contribution and the income tax savings on your retirement contributions.

In addition, if the company has a wide range of mutual fund choices across different asset classes, my personal choice is the traditional 401(k) over an IRA.

If you can also afford to invest in IRAs, you should apply a portfolio approach and allocate money to both a Roth IRA and a traditional IRA, because there is a degree of uncertainty involving what the tax rates will actually be in the future when you are ready to retire.

A retirement saver should receive the advice of a financial planner in order to utilize a much deeper analysis of his or her personal financial situation.

If a person utilizes effective tax-planning techniques and withdraws only the minimum distribution requirement from a traditional 401(k) at age 70 ½, along with collecting Social Security income, an individual can avoid having a tax liability.

For example, a married couple -- with effective tax planning that only withdraws the minimum distribution -- may never pay any tax on retirement income during the lifetime of the 401(k) traditional plan if the couple's taxable income is minimized each year in retirement.

Should retirees embrace immediate annuities for their main source of income? Or are annuities too expensive right now?

I would not necessarily lock into a fixed annuity currently because interest rates are so low. But I think the right annuity as part of an overall portfolio is a good idea. Annuities can be an important component of providing retirees a fixed-income stream during their retirement years.

A financial planner can assist individuals in the assessment of yearly expenses, surrender fees, the interest rate of the annuity and the credit quality of the issuer of the annuity in order to select the right product.

I think it is a matter of informing retirement investors to consider what they are using the annuity for during their retirement years. It is not just an objective income stream; it is framing it around the idea that you would be able to use that income each month for a vacation or playing golf.

So if an individual makes a connection of the annuity income to a future spending activity, people are more likely to contribute money to this type of product and view annuities as an important product for retirement planning.

Interestingly, Social Security benefits are a form of an annuity; however, the general public does not always make that association to this government program.