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Start Investing Early, or Start Now

What a confusing mess.

Whether you are 25 or 45, you are probably getting this message from political feuds over Social Security, from chatter at work, or from conversations with friends or relatives: You need to figure out how to save more and invest right for retirement so you don't end up living a dreary life in a broken-down hovel when you are 70.

Yet, responding is daunting.

You probably have a job that takes too much of your time, family and friends vying for your attention, a need to have a little fun and more sleep, loans to pay, and a paycheck that is already stretched to the limit.

In short, you are like most Americans: stressed out about time and money.

So maybe you look for a quick fix: Perhaps you turn to a friend, a coworker, a neighbor, or a spouse thinking that person must understand the mystery behind the befuddling process of investing better than you. Maybe you defer to that person—sticking your money where he or she says to put it, or second-guessing yourself.

But you could end up like Lorraine, the 72-year-old woman who called me for a way out of her job at a Minneapolis dry cleaner a few years ago. Despite failing health, she couldn't quit because she had turned to a coworker for advice on her $120,000 in savings. She did exactly what he suggested, and put the full $120,000 into a mutual fund that had made him a lot of money. Unfortunately, he—like most Americans—knew little about investing. The mutual fund he recommended turned out to be a disaster. Lorraine lost all but $55,000 in a few months, and if she responded to her achy back and knees and retired at that point, she wouldn't have enough to cover rent, food, and medicine each month. She could count on less than $1,000 a month in Social Security and not even $400 a month from her savings.

At 72, Lorraine's mistake was a devastating one—one that would keep her toiling at the dry-cleaning business for years longer. But people of all ages commit similar errors when they follow their friends and coworkers, or—even worse—procrastinate.

If you have been procrastinating, you are the norm, not the exception. Over the years, I have heard from thousands of people like you.

You may be afraid of making a mistake with your money, and you probably promise yourself that when you have more time or more money you will figure out the 401(k) retirement plan at work, or all the TV blather and hype about IRAs, mutual funds, and the stock market.

But if you follow the usual pattern, the extra money never materializes. If you are like today's average college graduate, you start life sickened when you think about the $20,000 in college loans hanging over your future. You are figuring out a job, or hoping to find the right one. You tell yourself there is plenty of time for retirement saving later—time to make sense of the confusing 401(k) plan at work will come another day.

Then come car payments. And time passes. There's still no money left just before payday, and you are so busy you can hardly think. Next your first home and mortgage payments arrive, and maybe kids. You are buying Adidas and PlayStations, helping with homework, rushing from work to parent-teacher conferences at school. And the kids' college years get closer and closer with nothing stashed away to pay for any of it.

That's why you need to start saving small amounts for retirement now and, if you've already begun, to invest smarter now so that each penny counts. What you do matters. And saving early matters greatly. It saves you from the heavy lifting you will need to do if you wait. Here's the illustration often tossed about in training seminars for financial planners:

Imagine two twins—both 18. One twin decides at 18 to start stashing money away. So she opens a Roth IRA—a magical moneymaking tool I explain in Chapters 3 ("Savings on Steroids: Use a 401(k) and an IRA") and 4 ("An IRA—Every American's Treasure Trove").

She puts $2,000 into that Roth IRA retirement savings account at 18, invests it in the stock market, and adds another $2,000 again each year when she's 19, 20, and 21. But, then, after age 21, she never puts any new money into that account. As the years go by, her money grows 11 percent a year, on average, through the good graces of the stock market. And when she is 65 and retires, she has $1,031,700.

Now consider her sister, who decides at age 18 that there is plenty of time left to save. She waits until she is age 30. Then she invests $2,000 in the same mutual fund her sister has been using for years. And then every single year until the day she retires, she diligently invests another $2,000.

Despite that determination, she never catches up to her sister. The twin, who simply waited until she was 30, ends up with only $843,900—about $187,800 less than the sister who became an investor at 18. And to amass that smaller amount, the 30-year-old put aside a total of $72,000 of her own money, or $2,000 year after year. Contrast that to the sister who started at 18. She only took $8,000 out of her pocket during four years and ended up with over $1 million.

Let's look at this another way: Assume you would like $1 million when you retire at age 65. If you start investing at age 18, you will only have to put about $20 a week into a mutual fund to get there if you earn 10 percent a year on average on your money. In other words, you would invest roughly $1,000 a year, and earn approximately what the stock market has provided investors historically.

But if you wait until you are age 25 to start, you'll need to invest about $39 a week—or roughly $2,000 a year—to get to $1 million. If you are 35 when you start, you will have to devote about $105 a week, or approximately $5,500 a year. And if you are 45 and haven't saved a dime, you will have to stash away close to $300 a week—or over $15,600 a year—to get to the same point at retirement that the 18-year-old does by investing only $20 a week. You can try this yourself on Internet calculators like "What Will It Take to Become a Millionaire" at www.choosetosave.org. (Keep in mind as you use various calculators that each rounds numbers and makes assumptions about timing. So outcomes will vary somewhat. Seek a ballpark idea, rather than expecting a precise number.)

The moral of this story: Start investing early, because your early savings magically transform nickels and dimes into thousands of dollars. Although you might think you are making a sacrifice to save when you are young, you are actually making life easier on yourself later.

On the other hand, if those early days have already passed you by, don't think it's futile. Starting now still puts you way ahead of where you would be if you waited 10 years, or even a few more months. If you are 40, and start investing $50 a week sensibly now, you still could have about $300,000 when you retire.

Is that a lot or a little? I'll help you put that into perspective in the next chapter.

The key is to start now, because today's money will get you much further than next month's.

Feeling Incompetent

Let me assure you, if you feel unsure of your capability to invest wisely, you are not alone. In a Harris poll of people who were investing in stocks, bonds, and mutual funds in 2002, only 2 percent said they felt like they knew everything they needed to know to make their investment decisions. And 82 percent wished their financial advisers would do more to educate them so that they could make better investments.

If you were investing in a 401(k) or IRA at the beginning of 2000, you are probably still wondering where half of your hard-earned money went, what you did wrong, and how to fix it so that it never happens again. Or maybe you aren't wondering—but just hoping. The bruising blows of the stock market crash probably eroded what little confidence you had.

This book will remove the confusion and help you put your good intentions into action that works. Saving merely $20 to $50 a week now could rather easily set you up for a $1 million retirement if you start when you're young, understand the simple lessons I will provide on the stock market and mutual funds, and use retirement accounts that give your money the best boost possible.

I'm not going to thrust theory and tips at you and send you away to struggle with this later. I'm going to tell you where to go to get the best investment deals and how to buy what you need to buy. I'm going to provide models you can easily copy. There's no "just trust me" to this book. You will know why you are doing what I'm telling you to do. That will give you the confidence to proceed through life—even during times when the stock market seems scary.

Everyone who has graduated from high school has the innate ability to grasp and do what I will suggest.

Shared Ignorance

If Lorraine's story didn't make you cautious about trusting another person with your money, maybe this one will show you that you are part of a large club of people—all in the dark about handling their money.

A couple years ago, I got a call from a 25-year-old who had just graduated from business school. He wanted to know the names of good index mutual funds and where to find them. In Chapter 13, "Index Funds: Get What You Pay For," I'll tell you more about these funds because they are an excellent, and easy, investment choice. But for now, I just want you to focus on this 25-year-old business school graduate.

He'd learned in business school that an index fund was a smart way to invest. But that was it. He still had no idea how to put the concept to work. So he called me for advice.

"Where do I find the best index fund, and how much money do I need to get started?" he asked me.

I ran his question in my column, along with tips for him, and it caused quite a stir among my readers. Because his question was so elementary, some of my readers were sure that either the question was a phony or the young man had attended a rotten university.

Neither was true. And I tell you the story now, as I told it then, for one reason: A person can be educated in business, run a business, be brilliant in math, and read the business pages in newspapers and still lack practical tools for investing—for example, where to find a good mutual fund.

So before turning your investing decisions over to a friend or spouse, think twice about your own capabilities. As a columnist, I hear continually from perfectly capable people with valid questions. Still, they believe they are unusually ignorant. They almost always start their calls to me with a confession: "I don't know what I'm doing." Many assume they are lacking some innate ability. But it just isn't true. It's primarily the language of the financial world that makes people feel incompetent—that, and the fact that the stock market appears to work in mysterious ways.

Yet you should know that few people have an edge over you. You would be stunned by the number of multimillionaires who successfully run businesses and ask me to review their investments because they aren't sure whether their broker has led them astray.

Keep this in mind: The person you think is so advanced compared to you might simply appear more confident or more educated. He or she might simply be more willing to jump into the task of investing money. But you can do it, too—and maybe better than a financial adviser—if you merely follow the steps I will lay out for you.

If you learned addition, subtraction, multiplication, and division in grade school, you have more math than you will probably need. And the Internet calculators I suggest will do the work for you. Eventually, you will be able to eye your 401(k) account or an IRA and quickly pick mutual funds with the ease you would in following a recipe. And if you do it, you will feel comfortable that you won't live like a pauper now or when you retire.

Get Real

People are great at deluding themselves—at telling themselves everything will work out when it won't.

In 2004, Towers Perrin surveyed people within 10 years of retiring. Among those who had saved nothing, 58 percent not only were confident that they would have everything they needed in retirement but expected to be able to take trips and buy luxuries, too.

This delusional thinking gives new meaning to the term "American Dream." We are a nation of optimists, but this takes it a bit too far.

So don't fool yourself. If you don't save, Social Security—alone—won't do it for you, even if the system lasts instead of crumbling the way some analysts are predicting. You won't be buying luxuries. You will be wondering how you will pay for electricity and heat your home or apartment. According to a 2006 survey of seniors done by AARP, half of retirees worry they won't be able to pay their utility bills during the next year.

And it's no wonder. About half of seniors now depend on Social Security to cover at least 50 percent of their living expenses. And the average senior gets $1,011 in Social Security a month.

So let's get real. Think of your lifestyle now, and how you'd handle it if you were living on just $1,011 a month.

But let's take this a step further. Imagine that you have saved what the majority of Americans who are 10 years away from retirement have saved: It's no more than $88,000, according to the latest research by the Congressional Research Service. What would $88,000 give you? If you bought an annuity when you retired—an insurance policy that promises you a certain monthly income for life—you would be able to buy one that would give you about $653 a month.

So that's perhaps $653 from your lifetime savings, and $1,011 in Social Security—or about $1,664 a month to live on.

How does that sound?

Oh, and one more thing. People often think Medicare will cover all their health needs in retirement. But that's not true. The average retired couple has to pay about $330 a month for extra health insurance, because Medicare pays only part of what people need, according to the Medicare Payment Advisory Commission. And then there are prescription drugs. Remember, older people aren't usually as fit as younger people.

Perhaps you've heard that there's a new Medicare program that provides free drug coverage. But that's not true either. It helps pay for drugs. Even with the new coverage, the ordinary retiree will have to spend about $790 a year for prescriptions, according to a Congressional Budget Office estimate.

So now look at a monthly income of about $1,268 after paying for medical insurance and medicine.

Could you handle it?