

Investing for Yourself and Your Future

Members of the military have special financial-planning needs. And, as a servicemember, you have access to many valuable investing programs that aren't available to the general public. You may qualify for a pension in your late thirties or forties, far earlier than any civilian, and could receive health benefits for life. But there's no "partial vesting." You won't get anything unless you stay in the military for 20 years, and, frankly, most people don't stick around that long.

Even if you do qualify for a pension, it's doubtful that the payments will cover all your bills. You're usually entitled to 50% of your base salary if you retire at 20 years (and an extra 2.5% for every year you stay beyond 20 years). Plus, and this is a real sweetener, the amount is increased each year after you retire to keep up with inflation. But special pay and allowances (such as your housing allowance) don't count toward your pension calculation, so you could end up with much less than half of the income you're earning at the time you retire.

It's essential to do some of your own saving. The younger you are when you start setting aside even just a little each month, the easier it will be to build a healthy nest egg. Fortunately, members of the military have some excellent retirement-savings plans available, and the options have recently improved. Uncle Sam helps, too, giving you tax breaks to help supercharge your savings. It's up to you to make the most of your retirement-saving options.

Thrift Savings Plan: An Easy Way to Invest for Retirement

Military personnel have access to the same retirement-savings plan—the Thrift Savings Plan—as do civilian federal employees. Similar to a 401(k), the TSP offers a low-cost, tax-advantaged way to save for the future.



PHOTOGRAPH BY JASON WALLIS

Air Force fighter pilot Josh Andrews automatically contributes a few hundred dollars every month from his paycheck to his Roth IRA. It's a relatively painless way to build a tax-free retirement fund.

You can invest up to \$16,500 in the TSP in 2009, and even more if you receive tax-exempt pay while serving in a combat zone. You can contribute combat-zone pay up to a total of \$49,000 in 2009. (Get this: \$30,000 contributed this year would grow to more than \$300,000 over 30 years if your investments grow at an average rate of 8% a year.)

Because contributions from your regular pay escape taxes, they don't lower your paycheck nearly as much as you might expect; contributing \$10,000 cuts your take-home pay by just \$7,500 if you're in the 25% tax bracket (and even less if your contributions also escape a state income tax).

The TSP makes it easy to save. Contributions are deducted automatically

from each paycheck, and steady investing can pay off big time. Say you contribute \$300 every paycheck, which lowers your take-home pay by just \$225 in the 25% tax bracket. Do that twice a month and you'll save \$7,200 for the year. If you start at age 25 and contribute for the next 30 years, you could end up with more than \$900,000 by the time you're 55, if your investments return 8% per year. And even if you leave the military at age 40—after 15 years of contributions—and never add another dime to your TSP account, you could still end up with about \$670,000 by age 55 (again, assuming an average return of 8%).

Reality check: Although 8% might seem outrageously high considering recent stock-market returns, the long-

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term return of the stock market is even higher. Despite the devastating 37% loss of Standard & Poor's 500-stock index of large-company stocks in 2008, the average return over the past 82 years—a period that includes several lousy markets, including the Great Depression—stands at 9.6%.

The TSP offers five index funds that invest in large companies, small companies, international firms, bonds or government securities. Or you can opt for a lifecycle fund, which builds a

Tax-free combat pay can go into a Roth IRA and that money—and all the earnings on it—come out tax-free in retirement. Now that's a sweet deal.

diversified portfolio of the other funds to match your time horizon (see Q&A on page 3 for more information). Expenses for all of the funds are extremely low: about 15 cents a year for every \$1,000 invested. So for a \$100,000 portfolio, you'd pay just \$15 a year in investment-management fees.

The TSP is a tax shelter, so you don't owe tax on earnings until you withdraw the money, and you won't ever be taxed on contributions from tax-exempt combat-zone pay. (A portion of every withdrawal will be tax-free to ensure that you never pay tax on that combat pay.)

You can keep the money in the Thrift Savings Plan after you leave the military, or you can roll it into an IRA or another employer's 401(k), where it can continue to grow tax-deferred. If you take the money and spend it, you'll face an immediate tax bill and, if you're younger than 55 in the year you leave the military

and tap the account, you'll generally pay a 10% penalty to boot. For more information about the rules, visit www.tsp.gov, which also includes a calculator to help you project your future account balance.

Tax-Free Earnings From a Roth IRA

Unlike contributions to a traditional IRA, which can earn you a tax deduction and therefore lower today's tax bill, contributions to a Roth IRA offer no instant gratification. But the delayed gratification of doing without a tax deduction now is sweet indeed: All withdrawals from a Roth in retirement will be tax-free, whereas withdrawals from a regular IRA are taxed in your top tax bracket. Another advantage of the Roth is that you can withdraw Roth contributions at any time tax- and penalty-free if you get in a pinch.

You can contribute up to \$5,000 to a Roth IRA in 2009 (or \$6,000 if you're 50 or older) as long as your adjusted gross income is \$105,000 or less; or \$166,000 or less if married filing jointly (you can make a partial contribution if you earn \$120,000 or less; or \$176,000 or less if married filing jointly).

You need to have earned income in order to qualify for a Roth IRA, and tax-free combat-zone pay counts. In fact, the Roth can be a particularly good deal if you have tax-exempt deployment pay. Your money goes in tax-free and your contributions as well as your earnings come out tax-free, a double tax benefit that's tough to beat.

If you earn income but your spouse doesn't, you can contribute \$5,000 to an IRA in his or her name, too.

You can open a Roth IRA with a brokerage firm, mutual fund company, credit union or bank. When selecting an IRA administrator, look for low fees and a range of investment choices. If you have 20 or 30 years until retirement, it's usually best to invest the money in a diversified portfolio of mutual funds.

You can invest the maximum in both a Roth IRA and the Thrift Savings Plan in the same year. If you can't afford to

A Realistic Way to Plan for Your Military Pension

When it comes to pensions, a critical issue is how quickly your benefits are “vested”—that is, how quickly you really earn the right to a benefit. In the civilian world, for example, an employee might become 20% vested after two years on the job and 100% after seven years. But there is no partial vesting for military pensions. If you don't stay for 20 years, you generally get nothing. For that reason, it's usually best to avoid including the pension in your retirement-planning calculations until you're just a few years away from qualifying. “So many things can happen between start and finish that you just don't know what to bank on,” says Patrick Beagle, a former Marine helicopter pilot who is now a certified financial planner in Fairfax Station, Va., specializing in military families.

For help figuring out how much you might receive if you do end up staying in the military, go to www.defenselink.mil/militarypay and click on “retirement.”

invest in both plans, consider a Roth IRA first if you expect your income—and tax bracket—to increase by the time you plan to withdraw the money, especially if you had tax-free income in a combat zone. Because of other tax-free benefits, most military personnel are in a lower tax bracket now than they will be after they leave the service, so it makes sense to pay tax on Roth contributions now and enjoy tax-free income later.

You can invest either a lump sum or sign up to have money automatically shifted from your bank account or paycheck. Investing \$416.67 per month will get you to the \$5,000 annual limit. You have until April 15, 2010, to make

your 2009 Roth IRA contributions, but the sooner the money is tucked into the account, the sooner tax-free earnings begin to grow.

Josh Andrews, a fighter pilot stationed at Creech Air Force Base in Las Vegas, automatically contributes a few hundred dollars to his Roth IRA and to a spousal IRA for wife Kelli every month. Investing the same amount at regular intervals, a strategy called dollar-cost averaging, buys you more shares when prices are low and fewer when prices are high. As a result, the average purchase price of your stock or funds will be lower than the average price in the market over the same length of time. “I see a market downturn as an opportunity to buy cheap,” says Josh.

Dollar-cost averaging can also help eliminate the urge to try to time the market—which is virtually impossible to do successfully. Too often investors jump into the market to chase rising prices, then bail out when prices begin to fall, putting them in the unenviable position of buying high and selling low. Nobody



U.S. NAVY PHOTO BY DAVID RUSH

knows which investment will do best next, so it's much more sensible (and less scary) to make regular investments in a well-diversified portfolio. If you're investing for a goal that is more than ten years in the future, like the Andrews are with their retirement fund, then it's best to start with most of your money in stock funds that include large companies, small companies and international firms. At age 32, Josh has plenty of time to weather the market's ups and downs before retirement.

No Scam: Get 10% Guaranteed

Too-good-to-be-true offers should usually send you running in the other direction. But this deal is for real: Servicemembers deployed in designated combat zones qualify for a savings program that guarantees 10% a year.

The Savings Deposit Program allows you to invest \$10,000 from the time you are deployed until 90 days after you leave the eligible region. During that time, your savings earn a rate of 10% a year.

At the very least, plan to stash in the Savings Deposit Program the amount you'll save in a combat zone by avoiding federal taxes on your pay. If you're in the 25% bracket (with taxable income over \$33,950 on an individual return), waiving the tax-free wand over \$1,000 in combat-zone pay saves you \$250; stick it in the 10% account. You can withdraw the money and all that sweet interest 90 days after you return.

For more information, go to www.dfas.mil/militarypay.html and type “Savings Deposit Program” in the search engine. ←

Q+A

An Early Start . . . and a Simple Plan

My son is in the Army in Iraq. He has no investments to speak of and is single. He wants to put much of his income into some form of investment, most likely a mutual fund. Do you have any advice for him for selecting a fund?

The easiest way for him to get started is to invest in the Thrift Savings Plan, and he can open an account even while he is deployed. All he has to do is sign up to have a percentage of each paycheck go directly into the TSP. Troops can generally contribute up to

\$16,500 to the Thrift Savings Plan in 2009. But your son can also contribute all of his tax-exempt combat-zone pay, as long as his total contributions for the year don't exceed \$49,000. He can start very small—the minimum contribution is just 1% of basic pay each period—but you should encourage him to set aside as much as he can.

The simplest investment choice is a lifecycle fund (the L Fund in the TSP). Lifecycle funds—sometimes called target-date funds—invest in a portfolio of other funds based on

an investing time frame. They start out with more money invested in stock funds—when you have many years before you plan to touch the money—then gradually become more conservative as your goals get closer. The lifecycle fund automatically adjusts the investments every quarter, so you don't need to make any changes yourself.

You should pick the lifecycle fund with a target date closest to when you plan to withdraw the money. If your son is in his twenties and doesn't plan on tapping the account

until he's in his fifties, then he'd pick the L 2040 fund. This fund starts with most of its money invested in an S&P 500 index fund (large U.S. companies), followed by an allocation to the international fund and small-company index fund, and just 15% of the money in the fixed-income fund. The allocation gradually changes through time, with most money invested in the government securities fund by 2040. Visit the L Funds page at www.tsp.gov to see how the allocation becomes more conservative as time passes.