How to Invest Wisely for Retirement

There are hundreds of ways to invest for retirement. Sales pitches from stock brokers abound, as do articles and websites devoted to retirement investments, many written or sponsored by companies that sell investment products. All of this advice can be confusing and contradictory.

Fortunately, you can learn the basics of smart retirement investing by following several simple strategies. These strategies meet the three main goals of retirement investing:

- to keep your savings safe so they will be there when you need them
- to keep them growing so they will more than outpace inflation, and
- to invest them in ways that minimize profit-draining taxes and fees.

Be content to amass your nest egg slowly, but surely. You want your money to grow while at the same time minimizing the risk of a big loss. Here are some basic strategies to do this.

Pay Off Debt First

Pay off high-cost debt and commit to living mostly debt-free (except for your mortgage) before investing in retirement. It makes no sense to buy stocks while you are paying 14% interest on credit card debt.

Don't Be Too Greedy

Time has shown that you can achieve solid, inflation-beating returns over the long term, but can easily lose big if you try to double or triple your money fast. Aim to save for a comfortable retirement, not start a second career as a speculator.

There Is No Substitute for Saving

No investment strategy will make up for inadequate savings. To add a dollar to your retirement stash, don't spend it.

Invest in Products You Understand

If you are unfamiliar with the risks and rewards of futures trading, currency hedges, buying on the margin, or taking a short position on a biotech stock, leave them alone. Stick to investments that you understand.

Make Investment Decisions Yourself

It's almost always a mistake to make an investment decision based solely on the advice of a friend or relative. And take investment advice from financial planners with a grain of salt too. Often, you can do a better job yourself. Here are some tips.

Steer Clear of Commissioned Salespeople. These folks have a built-in bias towards convincing you to buy and sell investments - it puts money in their pockets every time you buy or sell something. Unfortunately, you'll pay taxes and fees or commissions to the adviser - not the best way to save your money. Even worse, commissioned salespeople often get extra compensation if you purchase a particular product that their company is pushing.

Be Aware of Financial Advisers That Charge Management Fees. Many financial planners don't earn commission on each transaction, but instead charge you a management fee based on the size of your portfolio. Although seemingly less biased than the commissioned salesperson, you should still use caution when considering their advice. Conflicts of interest are bound to occur with people so embedded in the industry. More important, it is difficult to know if the adviser is competent.

Be Your Own Investment Adviser. Most people can devise a wise investment plan by following the advice in this guide and investing in a good mix of stock and bond mutual funds (especially low-cost, tax-minimizing index funds). And doing your own investing has several advantages over paying someone to manage your investments. Here are two big benefits to doing it yourself:

- You can invest the money you would otherwise pay the adviser.
- You'll stay away from consumer-unfriendly investments, such as life insurance, annuities, or individual stocks that many advisers push to get commissions.

If You Use a Financial Adviser, Choose Carefully. Some people have a good reason to pay someone to manage their investments, especially very wealthy people who can afford the fees and don't have the time or interest to stay on top of their large portfolio. If you decide to pay for a financial adviser, thoroughly research their references, credentials, and track record. Some good ways to do this include:

- Check if the adviser is a member of a professional trade organization.
- Check credentials. Is the adviser a Certified Financial Planner (CFP) or a Certified Public Accountant-Personal Finance Specialist (CPA-PFS)? Better yet, is she a fee-only financial planner who doesn't take commissions? The National Association of Personal Finance Advisors (www.NAPFA.org) can help you locate a fee-only adviser.
- Ask the planner for Part I and Part II of the Federal Securities Disclosure Form ADV. It contains information about the planner's qualifications and discloses any past legal or financial problems. You can also get the ADV from the U.S. Securities and Exchange Commission

Know Your Comfort Level for Risk
All investments other than a bank account or other cash-equivalent investments will fluctuate in value, some more so than others. When devising an investment plan, honestly evaluate your comfort level with risk. If you will panic at sharp losses, don't buy more volatile investments, such as stocks and bonds. The reason is simple: if you lose your nerve when markets take a big drop and sell your investments, you'll do much worse than if you had invested more conservatively in the first place.

Take Advantage of Tax-Advantaged Investments
401(k) plans, 403(b) plans, Keoghs, IRAs, and SEP-IRAs allow you to defer income tax on money you put aside for retirement. In addition to investing money that would otherwise be subject to income tax, your nest egg grows tax-free until withdrawal (after age 59 without penalty). Some employers will match some or all of your contributions into these plans.

It is a good idea to invest in these tax-deferred savings plans. However, consider adding other non-tax-deferred investments to your mix as there are a few downsides to tax-deferred plans:

- Withdrawals from these plans are taxed as ordinary income - not at the lower capital gains rates of Roth IRAs or unsheltered investments.
- Withdrawals from your 401(k) increase your retirement income, which increases the amount of your Social Security check that is taxed.
- If you are currently paying a mortgage, contributing to a retirement plan reduces your income and therefore reduces the value of your mortgage-interest deduction.

As with all your investments, spread your tax-deferred money across a sensible mix of reasonably conservative investments. It's especially unwise to invest a major portion of your 401(k) in the stock of a company you work for. If the company does poorly, you could both be out of a job and suffer a hit to your retirement nest egg.

Diversify Your Investments
There are many types of investment options, ranging from bank savings accounts to stocks to real estate. How do you choose?

Learn About Each Investment Option. Learn about the ins and outs of each investment choice, while keeping these key concepts in mind:

- Money and risk always march together. The bigger the risk you're willing to take, the bigger your possible gain or loss.
- Most investments are products you purchase at a cost. Costs aren't always closely related to risk or likely investment returns. Some, like low-cost index funds, are much cheaper to own than others, such as high-fee mutual funds, variable annuities, and precious metals. Over many years, low costs often translate into better returns.

Diversify Your Investments. Usually, the best long-term plan is to divide your money among several categories of well-researched and thought-out investments (for example, stock mutual funds, bond funds, and money market funds), each of which charges comparatively low fees and over time and is likely to grow somewhat faster than the rate of inflation. Within each category, further diversify your holdings among several investments.

Stick With Your Plan. And just as important as devising a sound strategy in the first place, you need to stick with it over the long term, which means being willing to ride out any temporary downturns.