A Sleep Well(esley) at Night Fund

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You can be sure that 90% of what you read about retirement investing is either (A) not very helpful or (B) confusing. Yet there are some simple solutions and tools to use that are helpful and easy to understand. One of them is a fund to which I recently made a sizable contribution. But first let's look at the dismal reality of the 401(k), which most baby boomers will depend on in retirement.

Your 401(k) isn't worth as much as you think it is. That's because at age 70½ you need to begin making annual withdrawals based on an IRS life expectancy table and pay taxes at your ordinary income rate, not at the lower capital gains rate.

What’s more, there’s a good chance you’ll live longer than the IRS life expectancy, ensuring that your entire balance will have been subjected to income taxes well before you die. Isn’t that uplifting?

How about giving your money to the government today? That’s what you’ll do by converting to a Roth IRA. If you’re in your prime earning years, you’ll pay taxes at your highest tax bracket. What’s scarier is that after conversion, some investors may think it’s time to get even more aggressive since they’ll never owe taxes on the gains. This is retirement money we’re talking about. You’re no longer a teenager. If you lose it, you don’t have forever to make it back.

You should begin investing for retirement the day you’re born. Most investors start way too late. It’s up to parents and grandparents to get involved with educating children about money. Help them start today. Don’t let them grow up believing the way to riches is playing poker on ESPN.

You need to save until it hurts. How about refinancing to a 15-year mortgage? Or if that isn’t an option due to high closing costs or being too far underwater on your existing 30-year, how about making larger payments? The real-estate market as a supplement to your retirement left the station in 2008.

In 1968, it wasn’t out of the realm of possibilities to be able to buy your home for an amount equivalent to your annual income. Nowadays, in Newport, Rhode Island, for example, even after the crash, it’s difficult to find a home for sale for less than $300,000. If you earn $50,000 per year, that’s six times your income. Why not consider renting and see if you can handle the monthly payments before locking yourself into something you may not be able to afford?

Here’s my number one recommendation for do-it-yourself investors. Keep your investments simple: buy two or three mutual

funds and call it a day. Don’t listen to your stockbroker. They’re salesmen, and very good ones at that, but they’re not investors. They may be nice people, but they don’t know how to build your wealth.

I recently bought the Vanguard Wellesley fund for my family because it embodies what investing is all about. It is a balanced fund with roughly 60% in bonds and 40% in equities. It was down only 9.8% in 2008, compared to a loss of 38% in the S&P 500. Investing math is simple: if you lose 9.8%, you only need a gain of 10.9% to get back to square one, whereas if you lose 38%, you need a gain of 61.3%.

At the core of Wellesley is compound interest. Anyone who knows anything about investing understands the importance of compound interest. Warren Buffet’s right-hand man, Charlie Munger, sings its praises, and Albert Einstein referred to it as the Eighth Wonder of the World. If you compound $10,000 at 6% for a year, you’ll have $10,600; compound that at 6% and at the end of year two you’ll have $11,236, and after 60 years it will be $300,000. Do this for a loved one and he or she will *never* forget you.

So where are we today in terms of valuations for bonds and stocks? Add the yield on the three-month T-bill and the Dow Jones Industrial Average yield to find out. Historically, retirees could purchase T-bills with a yield somewhere between 5% and 6% and forget about stocks. They could be comfortable in retirement with the risk-free rate of return and the full-faith-and-credit pledge of the U.S. government. And historically, the Dow yielded between 3% and 4%.

A solid number for the sum of the yields on T-bills and the Dow has been around 9%. Today, with T-bills yielding a pathetic 0.13% and the Dow yielding a measly (post-crash, mind you) 2.41%, you have a sum of 2.54%. Not good at all. Write this number on a stamp and put it on your fridge.

All you need is your postage stamp, the definition of compound interest on a three-by-five card, and the Vanguard Wellesley prospectus. Use the tools I outlined above, open an account for yourself, your kids or your grandkids, and your family will be on the right path to retirement riches.