Our Perspectives: How to Improve Your Saving This Year

Homestead Funds

If you're like most Americans, you would say you prefer saving to spending.[1] Nearly 60% of people say they prefer saving, more than before the financial crisis. If your financial life is a journey to the future, consider this your savings guidebook.

How Much Should I Save?

Many of us have heard the "10% rule" when it comes to savings: put away 10% of your income, and you'll be in good shape. But is that enough? After all, we rely on savings for a lot of crucial support: emergency savings, retirement funds, long-term healthcare expenses, paying for education, weddings, home maintenance. In practice, it's hard to see 10% covering all of those needs.

Upgrading to a Healthy 20%

Many financial planners urge a higher savings rate of 20%. Indeed, the **50/20/30** rule is popular guidance, where a household uses 50% of income for necessities like housing, insurance, transportation and groceries; 20% to savings; and the remaining 30% for discretionary purchases like dining out, entertainment, vacations, gifts and other non-essentials.

The 50/20/30 Rule is a simple way to allocate your money and use it wisely.

By our math, 20% is about right. We recently crunched the numbers for a reasonable retirement nest egg, and found that saving around 11% of income was a good ballpark for someone who had a long-term, 30-year kind of saving horizon. Another 9% of annual savings would go a long way toward covering those many other demands on your funds.

Before or After Tax?

When you're looking at your budget, you may wonder if this 20% recommendation is before or after income taxes are paid. We think of 20% as the after-tax number. What that means in practice is that if you qualify for "before-tax" savings vehicles, including 401(k)s, traditional IRAs and HSA accounts, you get a little bonus in the dollar amount of your savings, because you'll have a lower base of taxable income and will therefore pay lower current-year taxes. We think of putting the dollar difference into your savings, since pre-tax contributions are (mostly) taxable in some form later.

How Americans Are Stacking Up

The country at-large is doing okay in the savings department, but could be better. Personal savings rates are generally up since the shock of the financial crisis. The latest figures from the St. Louis Federal Reserve show that in aggregate, Americans saved close to 7% of their income this year on an after-tax basis.

From the point of view of 401(k) providers, the numbers are a bit rosier. Recent industry reports show that contribution rates are on the rise, with employees contributing an average of about 6 – 9% of pay to their 401(k), totaling a 10% – 13% contribution when you include employer matches.[2] But those averages only include the employees who choose to participate in their 401(k) plan, and in turn those numbers only include people who have access to a 401(k) plan.

First the Goal, Then the Strategy

For most, saving 20% is aspirational, not a current reality. But progress often starts with a clear goal. The old adage to save 10% may not be quite sufficient, but another adage still holds: pay yourself first. The idea is that saving is such an important part of your life that you should treat it the same way you treat your mortgage or utility bills — pay that first, before you move on to optional expenses. You may have to get resourceful about your other spending habits, but in this new year, you can rise to the challenge.

[1] news.gallup.com/poll/233426/updateamericans-views-spending-saving.aspx
[2] www.fidelity.com/about-fidelity/employer-services/fidelity-announces-q1-2018-retirement-data
institutional.vanguard.com/iam/pdf/HAS18.pdf

Four Ways to Capture Tax Benefits by Saving

Each of these accounts offers tangible advantages compared to saving in a regular taxable investment or savings account. The devil is in the details; there's more to the rules and guidelines for each option than we cover here. Want to learn more? Give us a call or see the links in the Helpful Tips section of our website at homesteadfunds.com.

Compare Tax Saving Options

RETIREMENT ACCOUNTS		
Get untaxed compounding (and no future income taxes) from a **ROTH IRA**	A Roth IRA is retirement-savings account where your investment gains from dividends, interest income and capital gains are not taxable on a yearly basis. You use after-tax dollars to contribute to a Roth. Withdrawals in retirement are tax-free, if you are at least age 59½ and the account has been open for at least five years.	**INTENDED FOR:** Anyone saving for retirement whose annual income is under the limit **INCOME LIMIT:** Contributions phased out for incomes between $193,000 to $203,000 for married-filing-jointly in 2019 **MAX CONTRIBUTION:** $6,000 across all IRAs; those over 50 can contribute an extra $1,000
Lower income taxes & defer investment-gain taxes with a **TRADITIONAL IRA**	A traditional IRA is another retirement-savings account where your investment gains are not taxable on a yearly basis. If you qualify, you can also deduct the amount of your contribution from your current-year taxable income (i.e. you can use pre-tax dollars).	**INTENDED FOR:** Max benefits for those who don't have a 401(k) or similar plan through their employer, plus lesser benefits for anyone else under the income limit **INCOME LIMIT:** Tax-deductible contribution phase-out starts at $103,000, no deductions for those with income over $123,000 (married-filing-jointly) **MAX CONTRIBUTION:** Same as Roth IRA
EDUCATION ACCOUNTS		
Grow education dollars untaxed in **EDUCATION SAVINGS ACCOUNTS** (ESAs, also known as Coverdell)	ESAs have low yearly limits, but every little bit helps. Like a Roth IRA, they use after-tax dollars, while investment gains and withdrawals are tax-free if they're within the guidelines for usage. Notably, expenses for K-12 education can also qualify, and the account owner can change the named beneficiary as long as they stay within the same family.	**INTENDED FOR:** Anyone who wants to contribute to a child's education savings; often popular with grandparents and/or within estate plans **INCOME LIMIT:** Phase-out starts at $190,000, no contributions allowed for incomes over $220,000 (married-filing-jointly) **MAX CONTRIBUTION:** $2,000 per year per beneficiary (not per account)
Unlimited contributions in tax-advantaged **UGMA/ UTMA ACCOUNTS**	Named for the Uniform Gifts/Transfers to Minors Act, these accounts are a unique setup meant to allow large gifts to minors with tax benefits if the gift is used for education expenses. They're unusual in that the account balance is considered the property of the child, and investment earnings are taxed to the child, though a significant amount is considered tax-exempt.	**INTENDED FOR:** Large transfers, gifts or inheritance meant for a minor and intended to be used for education expenses. Also popular with grandparents and estate plans **INCOME LIMIT:** None **MAX CONTRIBUTION:** Unlimited, but beneficiary must be under 18

Homestead Funds does not offer legal or tax advice. Please consult the appropriate professional regarding your individual circumstance.

Homestead Funds client services team would be happy to talk with you about your goals and current investment program. Give us a call at 800.258.3030.

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