

# WEB WARRIORS TOOLS

The Get Rich Slowly  
Guide to Roth IRAs

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# The Get Rich Slowly Guide to Roth IRAs

1st edition

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**DISCLAIMER IN PLAIN ENGLISH:** *I am not a financial adviser. I'm just a regular guy trying to gather information to help you. Not all the information here is necessarily complete or accurate for your situation. If you need more specific answers, please consult a CPA or an investment professional.*

*I welcome comments and clarifications.  
Corrections will be applied to future editions.*

# Introduction

## The Magic of Compound Interest

If you're young, you may not think you need to open a retirement account. You probably think it's easier to worry about it five years from now. Or ten. You're wrong. No matter how young you are, *now* is the time to begin saving for retirement. In *The Automatic Millionaire*, David Bach writes, "The single biggest investment mistake you can make [is] not using your [retirement] plan and not maxing it out."

After reading *The Automatic Millionaire* a couple years ago, I opened a Roth IRA at Sharebuilder. It was easier than opening a checking account. Don't understand retirement accounts? No problem. This book is for you.

## Saving is the key to wealth

If you do not spend less than you earn, and if you do not save the difference, you cannot build the wealth you desire. The rich are not rich because they *earn* a lot of money; the rich are rich because they *save* a lot of money.

You may be skeptical. I was once skeptical, too. But over the past three years I've read a lot on the subject of wealth-building. Books like Stanley and Danko's *The Millionaire Next Door* make it abundantly clear that it's not a high income that leads to wealth — though obviously that does not hurt — but the ability to save. Those who become wealthy do so by spending less than they earn.

If saving is the key to wealth, then *time* is the hand that turns the key to unlock the door. There is no reliable method to quick riches. There are, however, proven methods to get rich slowly. If you are patient, and if you are disciplined, you can produce a golden nest egg that will hatch later in life.

And a Roth IRA is an excellent place to build that nest.

## The power of compounding

The best way to ensure your future financial success is to start saving today.

“The amount of capital you start with is not nearly as important as getting started early,” writes Burton Malkiel in *The Random Walk Guide to Investing*. “Procrastination is the natural assassin of opportunity. Every year you put off investing makes your ultimate retirement goals more difficult to achieve.”

The secret to getting rich slowly, he says, is the miracle of compound interest. Even modest returns can generate real wealth given enough time and dedication.

On its surface, compounding is innocuous, even boring. “So what if my money earns 3.85% in a [high-yield savings account](#)?” you may ask. “What does it matter if it averages 8% annual growth in a mutual fund? Why is it important to start investing now?”

In the short-term, it doesn’t make a huge difference, but on the slow, sure path to wealth, we take the long view. Short-term results are not as important as what will happen over the course of twenty or thirty years.

For example, if 20-year-old Britney makes a one-time \$5,000 contribution to her Roth IRA and earns an average 8% annual return — a reasonable expectation based on historical data — and if she never touches the money, that \$5,000 will grow to \$160,000 by the time she retires at age 65. But if she waits until she's my age (39) to make her single investment, that \$5,000 would only grow to \$40,000. Time is the primary ingredient to the magic that is compounding.

Compounding can be made more powerful through regular investments. It’s great that a single \$5,000 IRA contribution can grow to \$160,000 in 45 years, but it’s even

more exciting to see what happens when Britney makes saving a habit. If she contributes \$5,000 annually to her Roth IRA for 45 years, and if she leaves the money to earn an average 8% return, her retirement savings will total over \$1.93 million. A golden nest egg indeed! She will have more than eight times the \$225,000 she contributed.

## The cost of waiting one year

It's human nature to procrastinate. "I can start saving next year," you tell yourself. "I don't have time to open a Roth IRA — I'll do it later." But the costs of delaying are enormous. Even one year makes a difference. Here's a chart to illustrate the cost of procrastination. Again, we're using 20-year-old Britney as a basis.

Start	End	Annual Contribution	Investment Return	Final Value
18	65	\$4,267.01	8.00%	\$1,932,528.09
19	65	\$4,618.57	8.00%	\$1,932,528.09
20	65	\$5,000.00	8.00%	\$1,932,528.09
21	65	\$5,414.01	8.00%	\$1,932,528.09
22	65	\$5,863.56	8.00%	\$1,932,528.09
23	65	\$6,351.91	8.00%	\$1,932,528.09
24	65	\$6,882.69	8.00%	\$1,932,528.09
25	65	\$7,459.87	8.00%	\$1,932,528.09
26	65	\$8,087.88	8.00%	\$1,932,528.09
27	65	\$8,771.62	8.00%	\$1,932,528.09
28	65	\$9,516.55	8.00%	\$1,932,528.09
29	65	\$10,328.73	8.00%	\$1,932,528.09
30	65	\$11,214.97	8.00%	\$1,932,528.09
31	65	\$12,182.87	8.00%	\$1,932,528.09
32	65	\$13,240.97	8.00%	\$1,932,528.09
33	65	\$14,398.91	8.00%	\$1,932,528.09
34	65	\$15,667.55	8.00%	\$1,932,528.09
35	65	\$17,059.26	8.00%	\$1,932,528.09
36	65	\$18,588.09	8.00%	\$1,932,528.09
37	65	\$20,270.10	8.00%	\$1,932,528.09
38	65	\$22,123.77	8.00%	\$1,932,528.09
39	65	\$24,170.37	8.00%	\$1,932,528.09
40	65	\$26,434.62	8.00%	\$1,932,528.09

If Britney makes \$5,000 annual contributions that earn 8%, she'll have \$1,932,528.09 saved at retirement. But if she waits even five years, her annual contributions would have to increase to nearly \$7,500 to save that same amount by age 65. And if she were to wait until she was as old as I am, she'd have to contribute over \$20,000 a year.

To make compounding work for you:

- **START EARLY.** The younger you start, the more time compounding has to work in your favor, and the wealthier you can become. The next best thing to starting early is starting *now*.
- **MAKE REGULAR INVESTMENTS.** Don't be haphazard. Remain disciplined, and make saving for retirement a priority. Do whatever it takes to maximize your contributions.
- **BE PATIENT.** Do not touch the money. Compounding only works if you allow your investment to grow. The results will seem slow at first, but persevere. Most of the magic of compounding returns comes at the very end.

Compounding creates a snowball of money. At first your returns may seem small, but if you're patient, they can become enormous. The wonderful thing about a Roth IRA is that it allows your money to grow tax-free.

Start saving for retirement *now*! This book will show you how.

# Chapter One

## What is a Roth IRA? (and Why Should You Care?)

IRAs are easy — there's no reason to be afraid of them. Don't let anything that follows intimidate you.

An IRA is an [Individual Retirement Arrangement](#), though it's more commonly called an Individual Retirement Account. An IRA is simply a holding account. It's a label. When you open an IRA, it contains nothing. It's like a bucket, a place for you to put things.

The things you place in your bucket are investments. You might, for example, buy a stock to put in your retirement account. Or maybe government bonds. Some people even use their IRAs to buy investment properties. And some simply let their cash sit there, earning interest, just as it would if it were deposited in the bank down the street.

Smart people mix things up over time. Their buckets might contain a combination of stocks, mutual funds, bonds, and real estate. To begin, however, your own bucket will probably contain just a single stock or mutual fund. And that's fine. It's important to stick with investments you understand.

The important thing to realize is that an IRA is not an investment — it's a place to put investments.

### Types of IRAs

When you use a normal, non-retirement account, you're investing post-tax money. You earned the money through your job, were taxed on it, and then used it to buy stocks or bonds. Depending on how you invest, you may also be taxed on dividends and capital gains along the way. You'll also be taxed on the earnings when you sell your investment.

An IRA avoids one set of taxes, allowing your money to compound more quickly. The two types of IRAs that you should know about are “traditional” IRAs and Roth IRAs.

With a traditional IRA, the money you invest is [probably tax deductible](#), but the money you pull out at retirement will be taxed at the then-current rate.

You don’t get a tax deduction on the money you contribute to a Roth IRA, but at retirement earnings can be withdrawn tax-free.

Put another way: money in a Roth IRA is taxed at the front-end, and money in a traditional IRA is taxed at the back-end. Unless you [earn a lot of money](#), a Roth IRA is probably your best choice. The rest of this book deals specifically with Roth IRAs.

## **Roth IRA rules and requirements**

Not everyone qualifies to contribute to a Roth IRA. These accounts are intended to encourage ordinary working people to save for retirement by providing them with a significant tax break. They’re not meant for the wealthy.

If your tax filing status is single and you earn more than \$99,000, your contributions are restricted. If you are married filing jointly, your contributions are limited if your household income is more than \$156,000. (*Important note:* these income limits are based on your [Modified Adjusted Gross Income](#). If you don’t know what that is, don’t worry about it unless you think you’re close to the limit.) Other important facts:

- If you are not yet 50 years old, you may only contribute \$5,000 to your IRA in 2008 — if you’re older, you may contribute \$6,000. (The IRS imposes penalties for excess contributions. For more information, see chapter four.)
- To invest in a Roth IRA in any given year, you (or your spouse) must have earned income. (In other words, you can’t contribute to a Roth if all of your money came

from an inheritance during a particular year.)

- You can use a Roth IRA even if you have a 401k or other retirement plan.
- You must make your contributions by the tax deadline each year. That is, you have until 15 April 2009 to make your Roth IRA contribution for 2008.
- Reinvestment of dividends and distributions are *not* counted against your contribution limit.
- You can invest in almost anything you want. (Some things — such as life insurance or collectibles — are off-limits.)
- You may withdraw your *contributions* at any time without penalty. If you attempt to withdraw your *earnings* before the age of 59-1/2, they will be subject to taxes *and* a 10% early withdrawal penalty (except in special circumstances).
- Also — and this is important for many people — you may withdraw up to \$10,000 in earnings without penalty to [buy your first home](#).

IRAs are easy. They're just tax-advantaged holding accounts for your investments. There are other arcane guidelines and provisions, but these are the basics. For further information, consult the current edition of [IRS Publication 590](#). (Don't worry – it's not as scary as it sounds.)

I also recommend "[The world's easiest guide to understanding retirement accounts](#)" at I Will Teach You to Be Rich.

# Chapter Two

## How to Start a Roth IRA (and Where to Do It)

You've heard how awesome Roth IRAs are and understand that opening one now can mean big bucks later in life. You even have a vague idea of how a Roth IRA works. Now what? How do you actually start one yourself? It's surprisingly easy to set up a retirement account and to begin investing in your future.

### Before you invest

Saving for retirement is important, but there are other aspects of personal finance, and you should take care of two of them before opening a Roth IRA.

1. Tuck away at least \$1,000 for emergencies. More, if you can. Before you save for retirement, save for the present. Without a rainy day fund, even small disasters can sidetrack your savings for months (or years). I recommend an [online high-yield savings account](#).
2. Pay off your credit card debt. At the very least, make significant headway on your debt and have a plan for its elimination.

Here's an excellent way to begin your retirement savings: When you finish paying off your debt, take the amount you were applying toward payments each month and, instead of spending it, stick it into a retirement account. You've already developed the habit of using the money to improve your financial life; this is just another way to do it!

## Where to open a Roth IRA

Deciding where to open your Roth IRA is the most difficult part of the process. Many financial institutions offer IRAs. Each has its own strengths and weaknesses. It's important to search for a company that suits *your* needs. Don't fret about finding the perfect match — find a good match and then get the IRA in motion. Questions to ask during your research include:

- Is there a minimum initial investment?
- What sorts of fees are assessed to the account?
- Does the company offer automatic contributions? What are the limits?
- What investment options are available? Can you invest in stocks? Mutual funds? Real estate?
- Is it possible to download statements automatically into Quicken or other financial software?
- How reputable is the provider?

If you already have an investment advisor, ask her for recommendations, but look for other options, too. Some banks and credit unions offer Individual Retirement Accounts. My credit union, for example, has Roth accounts, but they're limited to certificates of deposit currently yielding 1.11%. [ING Direct offers Roth IRAs](#) with a \$10 annual fee and [no other commissions or fees](#). Their investment minimums are low, but their universe of funds is [very limited](#).

If you're willing to make some decisions on your own, you can open a self-directed IRA through a mutual fund company or through an online discount brokerage.

**IMPORTANT NOTE:** *The perfect is the enemy of the good. It is far better to open a Roth IRA now through any provider than it is to delay because you're worried about finding the number-one best place. Do some research. When you find a place that*

meets your requirements, open an IRA. Don't fuss and fret, worrying whether it's the best choice. Find a good choice and act.

## The Big Three

For many people, it makes sense to go with one of the Big Three: Fidelity, Vanguard, or T. Rowe Price. These mutual fund families are the Big Three not only because they're enormous, but also because they offer a variety of funds that cover nearly every investment style and market segment you could wish for.

If you're just starting out, you should probably pick just one family of funds and stay with it as you begin to invest. You'll be able to track all your investments more easily in one place. I explored each company's web site to discover what sorts of Roth IRA options they offered for beginning investors. Here's what I found.

**FIDELITY INVESTMENTS** offers a [no-fee IRA](#). There's a \$2,500 minimum initial deposit, but this is waived if you commit to \$200/month automatic contributions. They offer [4,500 mutual funds](#), about a quarter of which have no transaction fee. In short, you can open a no-cost IRA at Fidelity with a \$200 starting investment *if* you invest in mutual funds and you agree to contribute \$200/month.

[Apply for a Roth IRA with Fidelity.](#)

It's also possible to open a no-cost Roth IRA at **THE VANGUARD GROUP**. To do this, you must [elect to receive electronic statements](#) and start with \$1000 in the company's [STAR](#) fund. (The STAR fund is a [mutual fund of mutual funds](#), a safe choice for beginners.) Additional contributions require a minimum of \$100 *unless* you use their Automatic Investment Plan, in which case the minimum is \$50. There are no fees to purchase the STAR fund.

[Start a Roth IRA at Vanguard.](#)

**T. ROWE PRICE** charges \$10/year for [Roth IRA accounts](#) until you have a balance above \$5,000, after which there is no fee. You need \$1,000 to open your IRA, but this minimum goes away if you sign up to contribute at least \$50/month with the [Automatic Asset Builder](#). There are no sales fees or commissions to invest this money in **T. Rowe Price mutual funds**.

[Open an IRA at T. Rowe Price.](#)

The information above will get you started with the minimum investment and the lowest costs. If you have more money at your disposal, you have more options. It's possible to make much more sophisticated trades with each of these companies — purchasing stocks, for example — but not for free. I encourage you to look more closely at each company's web site, and to read the literature for each investment you consider.

## Discount brokers

Discount brokers appeal to many people because they have a low barrier to entry. They offer lower fees than traditional brokers because they don't have research departments and they don't offer investment advice. They only act as go-betweens for trading in the market.

I opened my Roth IRA at [Sharebuilder](#) after reading David Bach's *[The Automatic Millionaire](#)*. It felt great to finally open a retirement account. Now, though, I fret about the costs. Sharebuilder charges a \$25 annual custodial fee for a Roth IRA, plus \$4 every time I make an automatic investment. (If I make a real-time trade – buying or selling – it costs \$9.95.) Because I'm careful, I'm not hit with a lot of fees. Though I love how easy it is to automate investing through Sharebuilder, my research for this book revealed two other discount brokers that look appealing.

People have all sorts of good things to say about [Firstrade](#). This company offers a no-fee Roth IRA, but requires a \$500 minimum initial investment and \$100 subsequent

investments. Firsttrade charges \$6.95 per transaction, though they do offer a wide range of mutual funds that one can purchase for no charge. Firsttrade looks good for somebody who wants to invest in mutual funds, but doesn't want to (or can't afford to) sign on with a larger mutual fund company. Firsttrade does not offer online registration, but you can [begin the Roth IRA application process here](#).

[Zecco](#), the new kid on the block, charges \$30 a year to carry a Roth IRA. If your account balance is \$2,500 or more, you receive ten free trades per month. If you make more than ten trades in a month, or the balance in your account is less than \$2,500, then trades cost \$4.50 each. The Zecco investment universe includes most stocks and exchange-traded funds, including some tasty Vanguard index funds. [Open a Roth IRA at Zecco](#).

Discount brokers are a good option if you're primarily interested in buying individual stocks instead of mutual funds. They're also a fine choice if you want to get started *now*, but can't afford a program with one of the mutual fund companies. Another option if you're short on cash is to open a CD-based IRA at a bank until you've saved enough for the minimum initial deposit at one of the Big Three.

## How to open a Roth IRA

Here's a secret: opening a Roth IRA is easy. Have you ever filled out a job application? Have you ever applied for a credit card? Have you ever opened a bank account? That's exactly what the process is like to start an individual retirement account.

Some firms require that you download the forms and then to mail or fax back. Most companies, however, provide online applications. Before you begin the application, you will need the following:

- Your social security number.
- Your bank account information.
- Your employment information.
- Money in a bank account. (Depending on where you choose to open your IRA, or you may need \$25 or you may need \$3000.)
- About an hour of uninterrupted time. (You probably only need fifteen minutes, but allocate more time just to be safe.)

Gather this information in one location when you're ready to begin. (If you're opening an IRA through a brick-and-mortar bank or broker, take this info with you.) From this point, it's simply a matter of answering simple questions. (Here's a [walk-thru of opening an IRA at Vanguard](#).)

Once you've completed the application process, you will be asked to transfer money to your account. This money will probably earn interest in a money market fund until you choose an investment. (In the next chapter, we'll discuss good investment options for Roth IRAs.)

I'm a big fan of automatic investment plans. Most of the companies I've mentioned offer some sort of program that will pull money from your bank account every month to invest in stocks or mutual funds that you designate. By setting aside \$50 or \$100 or



\$500 in this way, saving becomes a habit. You don't notice that the money is missing. It's a regular expense that becomes incorporated into your budget.

Making automatic regular investments in a Roth IRA is a fantastic way to build wealth. Do this, and you'll put yourself far ahead of your peers.

### **Now what?**

That's all there is to it. Really. The most difficult part of this process is deciding where to open an account. Set aside an hour or two some Saturday morning to explore your options over a cup of coffee. With some research, you should be able to find a company and program that fits your place in life.

# Chapter Three

## Which Investments are Best for a Roth IRA?

I used to believe the stock market would make me rich. All I needed to do was pick the right stock and I'd be a millionaire. In March of 2000, I decided that stock was [PALM](#), which I bought the morning it went public. Within days my \$1,000 investment was worth \$600, and my fantasies of instant wealth were swept out the door. My mistake was a desire to get rich quickly — greed clouded my vision. I was uneducated. I didn't understand how investing worked. In time, I learned a better way.

Now that we've discussed what an IRA is, and learned how to open one, it's time to explore investment options. You can use your Roth IRA to make just about any investment you want. Because my focus is the slow, sure path to wealth, I'm going to focus on a few choices that make sense within this philosophy. I can't tell you exactly which stocks or mutual funds you should buy, but I can give you some ideas.

**REMEMBER:** *I am not a financial adviser. I'm just a regular guy trying to gather information to help you. If you need more specific answers, please consult a CPA or an investment professional.*

### Reviewing the basics

It's a mistake to jump into investing and make your decisions blindly. Before you begin any investment program, it's important to have an understanding of basic concepts. If you feel lost, set aside some time to review Michael Fischer's video series on [Saving and Investing](#). Some of the episodes most relevant to this discussion include:

- What is a bond?
- What is a stock?

- What is a mutual fund?
- Types of mutual funds
- The importance of diversification
- What is a stock market index?

You may also want to do some reading about [risk tolerance](#) and [asset allocation](#). To learn more about investing, head to your library and borrow one of the following books:

- *The Bogleheads' Guide to Investing*
- *The Random Walk Guide to Investing* by Burton Malkiel
- *The Only Investment Guide You'll Ever Need* by Andrew Tobias
- *Saving and Investing* by Michael Fischer

These books will help you become acquainted with ideas like asset allocation, diversification, risk tolerance, stock valuation, and more. The better educated you become, the better investment decisions you will make.

## Common-sense investing

There are several thousand mutual funds available in the United States alone. There are mutual funds for those interested in [socially-responsible investments](#). There are mutual funds for those who like tech stocks. There are mutual funds based around Biblical principles. There are mutual funds that attempt to beat the markets in an aggressive fashion. There are junk bond mutual funds. There are real estate mutual funds. There are foreign funds. There are mutual funds that target specific retirement dates. You name it, and there's probably a mutual fund for it.

Picking mutual funds is like picking stocks: your choice depends on your objectives, how long you wish to invest, and on your risk tolerance.

However, many investment experts recommend the same slow, sure path to wealth: invest your money in index funds. Index funds are low-maintenance, low-cost mutual funds designed to follow the price movement of a broader index, such as the [Dow Jones Industrials](#) or the [S&P 500](#). These are boring investments, but they work. (If you're investing for the excitement, you're doing it for the wrong reason.)

## Investing on auto-pilot

If you're a do-it-yourself type and like to select your own funds, then Vanguard's [Total Market Stock Index Fund](#) is a good place to start. It's consistent with the "get rich slowly" philosophy. (Similar funds are available from [T. Rowe Price](#) and [Fidelity](#).) Begin by buying the market as a whole, and then branch out as you learn more about investing. You're not committed to any one fund. You can buy and sell investments inside your Roth IRA just as you could if they weren't in a Roth.

However, if you're a set-it-and-forget-it type, then you might want to pick a "life-cycle" [retirement fund](#). Advantages of a life-cycle fund include:

- You get instant international exposure. A life-cycle fund is a "fund of funds," including some international funds.
- You get automatic asset allocation, since life-cycle funds cross asset classes.
- You get automatic rebalancing. Life-cycle funds change their asset allocation to become more conservative as you approach retirement.
- You can pick a fund according to your risk tolerance. You don't have to pick a fund that coincides with your retirement date. If you are interested in more growth (and don't mind the higher risk), you simply pick a fund with a retirement date later than your actual planned retirement date.

The drawback is that you have no control. For example, if you want your international allocation of equities to be 50% (or more!), you're out of luck. Some people are okay

with that, but the lack of control makes others crazy. You should do what works for you.

Each of the Big Three has varying degrees of aggressiveness and conservatism for any given retirement date. Choose the retirement fund that fits your risk tolerance. If you choose to go with a life-cycle fund, commit to that fund. If you spread your money around (especially to other life-cycle funds), [you defeat the purpose](#).

## Exchange-traded funds

If you open a Roth IRA with a mutual fund company, it makes sense to select from the products they offer. If your Roth IRA exists with some other financial institution, you may still be able to invest in the mutual funds from these companies. But some brokers — such as Sharebuilder — only allow trading in exchange-traded funds (ETFs), which are mutual funds that trade like stocks. They are bought and sold through the market instead of through the mutual fund companies.

There are many exchange-traded index funds available. For example, my Roth IRA, which is with Sharebuilder, currently contains:

- [QQQQ](#), an index fund that tracks the [NASDAQ](#) stock market index
- [IWD](#), an index fund that tracks a subset of the [Russell 1000](#)
- [EFA](#), an index fund that attempts to mirror the [MSCI EAFE](#) index of international stocks

I'm not recommending these funds for *you*, but they seemed right for me. A life-cycle fund doesn't appeal to me. I like to be able to have some control over my investments.

Don't worry about exchange-traded funds unless they're your only option. Because of their lower costs, beginning investors are better served by focusing on normal mutual funds.



In this discussion, I've focused on mutual funds — particularly index funds — because I think they're the best choice for most investors. They typify the “get rich slowly” ideology. Some of you will want to purchase individual stocks in your Roth IRA. Some will want to purchase real estate, or invest in precious metals. If you make educated decisions, these can be excellent moves. However, for most investors, index funds are a smart way to own a piece of the market while mitigating risk.

After reading this book, you may still be uncomfortable making your own investment decisions. There's no shame in this. If this is true, I recommend speaking with a [financial advisor](#). My wife does this, and it makes her much happier than if she were to pick investments on her own.

# Chapter Four

## Questions and Answers About Roth IRAs

In this final chapter, I'll answer some common questions, all of which were submitted by Get Rich Slowly readers.

*Can I have more than one Roth IRA? For example, can I have one at ING and another at Vanguard?*

You can only have one Roth IRA; however, you can have multiple *Roth IRA accounts*. For example, I currently have a Roth IRA account with Sharebuilder, but I plan to open a new account with Vanguard by the end of the year. Both of these are a part of my total Individual Retirement Arrangement. The Roth IRA is the bucket into which I place my retirement investments. The Roth IRA accounts are like partitions in that bucket.

In other words, your contribution limit (\$5,000 in 2008) applies to *all* of your IRA accounts collectively; they don't each get a \$5,000 limit. In other words, you can contribute \$100 each to 50 different Roth IRA accounts, but not \$1000 to each of them.

*Which is better: investing in a Roth IRA (with after-tax dollars) or investing in a 401k (with pre-tax dollars)? Does it make a difference if there's an employer match? And if I already have a 401k through work, then why would I want to add to a Roth IRA?*

The standard answer to this question is to invest in the following order:

1. If your job offers a 401k, contribute to that each year until you've reached the limit of the employer match.
2. If you still have money to invest, contribute to your Roth IRA.
3. If you *still* have money to invest, then max out your 401k.

4. Once you've contributed all you can to these investments, then invest however you see fit in regular, taxable accounts.

The answer for your situation may be different. Some people like to have all their accounts in one place. If you're this sort of person, you may benefit from simply putting all your money into a 401k and not worrying about a Roth IRA.

My CPA says, "When debating a 401k versus a Roth IRA, why not check with your employer to see if they offer a Roth 401k, which combines the best of both worlds?" Also note that you can invest in *both* a 401k and a Roth IRA as long as you meet the requirements for both programs.

*What happens if I contribute too much to a Roth IRA?*

If you contribute more than allowed, you are subject to a 6% excess contribution penalty. However, you have until the annual contribution deadline (generally April 15th) to withdraw any overage — including earnings — before the penalty is assessed. Some people believe they can game the system by over-contributing to a Roth IRA, but that's not the case.

*How does the IRS know that you contributed to a Roth IRA? How does it know if you contributed more than you were allowed?*

At the end of the year, the investment company submits [Form 5498](#) to the IRS. It reports the amount that you invested. For example, it might say, "In 2007, J.D. invested \$4,000 in a Roth IRA." The IRS computers then match this form electronically to your tax return to check for discrepancies. If you're over the income limit, your return will be flagged.

*Can legal U.S. residents who are not citizens open an IRA? Is it a good idea? What if I don't plan to be in the U.S. at retirement age?*

Anyone with earned income in the U.S. can contribute to a Roth IRA — citizenship is not required. However, for greater flexibility, you may want to consider a traditional IRA or other investment accounts, depending on your goals.

*I have a bank account in the U.S. Can I start a Roth IRA if I live and work in another country? I'm afraid to save in my country's currency because inflation will ruin my investments.*

No — you must have earned income in the United States to open a Roth IRA. However, you can open a regular taxable investment account using U.S. dollars. You won't get the tax breaks, but if you're primarily looking to escape inflation in your own country, this might be a good choice.

*Can I really withdraw money from my Roth IRA without penalty?*

Yes, up to a point. You may always withdraw your *contributions* without penalty or taxes. For example, if you opened a Roth IRA with \$5,000 last year and the account balance is now \$6,000, you can take out \$5,000 (leaving just the \$1,000 in earnings) without consequence. There are taxes and penalties, however, for early withdrawal of *earnings* for non-approved uses.

It's important to note that once you withdraw the contributions you have just 60 days to replace them. After 60 days, the money cannot be returned to the IRA. Also, you can only borrow from each IRA account *once* every twelve months.

*I'm self-employed and I make more than the maximum allowable for a Roth IRA. Does a SEP-IRA make sense?*

This is another question I bounced off my CPA. He says that a SEP-IRA may make sense, but that it will depend on your individual circumstances. Basically, self-employed people can contribute roughly 20% of their first \$200,000 of pre-tax earnings to a SEP-IRA. However, they must contribute the same percentage for all employees. If you are the only employee, or if you don't mind giving all employees the same retirement benefits, then this may be a good choice. This is another case in which you should consult a financial adviser.

*What options are there if I earn too much to contribute to a Roth IRA?*

If you make too much to contribute to a Roth IRA, be sure you're maxing out your 401k, if you have one. You can also contribute to a traditional IRA. Both of these are excellent options. (But note that if you have a 401k at work, your contributions to a traditional IRA may not be tax deductible.) For more on this topic, check out [this thread](#) from the GRS discussion forum.

*I heard that in 2010 the income limits on Roth IRAs will expire, and that it'll be easier to roll a traditional IRA into a Roth at this time. Do you have any info on that?*

As the law is currently written, in 2010 the income cap will be lifted on conversions from traditional IRAs to Roth IRAs. But 2010 is a long time from now. There will be a new political environment in 2009. Congress can change current laws, and there's a good chance they will. Still, if you're willing to play the odds, putting your money into a traditional IRA now for a potential rollover in 2010 might be a profitable venture.

*My wife is a stay-at-home mom and doesn't have any earned income. Does this mean she cannot have a Roth IRA?*

To every rule, there is an exception. If you're married and filing a joint return, then both spouses can max out IRAs from a single income (so long as the other Roth IRA requirements are met). Read more about this subject [in the GRS discussion forum](#).

*Is it possible to roll a 401k into a Roth IRA?*

It is possible, but you have to be careful. It's not a one-step process. Also, it's difficult to do with an active 401k account. A mistake along the way could cost you a lot of money, so it's a good idea to consult a financial adviser for help. There's a [lengthy conversation](#) about this subject in the GRS discussion forum.

*I opened a Roth IRA at a local bank, but I noticed that I'm only getting a 1.98% return. This seems unusually low. Should I withdraw my money and move it to Vanguard, Fidelity, or T. Rowe Price?*

Your money is probably in a savings account or certificate of deposit. Your bank may offer additional financial services — check with them to see where else you can put the money. Barring that, yes absolutely move the money to a different location. You may have to pay a transfer fee, but it's worth it.

Traditional banks are generally not a good place to invest because they usually offer conservative investments and charge higher service fees than most other brokerages.

*I want to open a Roth IRA but am confused by the mutual funds offered by different companies. For example, ING Direct offers six funds, and another bank offers only five. What's the difference? Which should I choose?*

Only you can answer that question. Here's how I would approach this problem: I would first locate the investment I want to purchase. Is it an individual stock? Is it real estate? Or is it, as I prefer, an index fund?

Once I decided on an investment, I would then find a company that would let me buy the investment from within a Roth IRA. This shouldn't take too much effort. [Zecco](#), for example, would allow me to purchase any publicly traded security at basically no charge. If, like me, you decide you like Vanguard's mutual funds, then open an account directly with Vanguard.

*Can I really use my Roth IRA to buy a house?*

You can't purchase your own home with money that's *inside* a Roth IRA, but, with certain restrictions, you can take money *out* of the IRA to do so. As mentioned earlier, you may always withdraw the full amount of your contributions. You may also withdraw up to \$10,000 of *earnings* to purchase a first home. (You can use money *inside* an IRA to buy a house for investment purposes, but it can't be a residence for you or your immediate family. For more information, consult a professional.)

*Is there such a thing as a Roth IRA "savings" account that gets rates comparable to a good "regular" savings accounts (5% APR or higher)?*

Many investments one can make outside an IRA can also be made *inside* an IRA. The trick is finding an institution that can help you make the investments you want. A savings account isn't really appropriate for an IRA, however. Though it's possible to withdraw money from your account under special circumstances, IRAs are designed for *retirement*, not for easy fund access.

Still, there are options available that mimic the risk and return of a savings account. Two spring immediately to mind.

One option is to put the money into [certificates of deposit](#). You lose some flexibility when you tie your money up in CDs, but they offer decent returns over the short term. I phoned my credit union to ask about their current rates for CDs held inside a Roth IRA. As of May 2008 they offer:

- 12 months @ 3.05%
- 24 months @ 3.05%
- 36 months @ 3.30%

They offer longer CDs, too, but the rates top out at 3.30%. Your bank or brokerage may provide similar options. (Check [Bankrate](#) for more information.)

If your IRA is held through a brokerage, you may also be able to obtain a relatively high rate through the company's money market fund. For example, my Roth IRA is currently with Sharebuilder. Most of that money is invested in stocks and index funds, but the cash that isn't sits in a money-market fund. If I wanted, I could hold all of my retirement investments in this fund. That fund currently earns me 2.76%, though it is *not* [FDIC-insured](#). (Current [online high-yield savings account](#) yields are slightly higher.)

While it's possible to make investments in your IRA that approximate the risk and return of a savings account, they should be viewed as "deposit only." You want to put the money in, but not withdraw it until you're ready to retire.

*Which is better, a Roth IRA or a traditional IRA?*

It depends. There are several [subtle differences between the two](#) that affect those near (or in) retirement. *Your* circumstances determine which makes the most sense for

you. If the choice is not clear, you should probably consult a qualified professional, such as an accountant or a certified financial planner. I asked CFP Dylan Ross of [Swan Financial Planning](#) for his recommendation:

*I think it makes sense to try to have tax-free (Roth) and tax-deferred savings, so I can have options in the future. If I want to save some of my tax-free when I'm retired because tax rates are at a low and I suspect will eventually rise, I'll pull from my traditional IRA. If tax rates are super high, I'll tap the Roth. I'm an advocate of diversifying the tax treatment of my retirement savings, but in the end, when you have a choice, putting it all in the Roth is usually the better move.*

### *Seek professional help*

In many cases, complex Roth IRA questions are best answered by a qualified financial professional. Each person's situation is different. It's difficult to give one-size-fits all advice in the context of this book. Use the [National Association of Personal Financial Advisors](#) to find an independent fee-only adviser, or check with the [Garrett Planning Network](#).

**REMEMBER:** *I am not a financial adviser. I'm just a regular guy trying to gather information to help you. If you need more specific answers, please consult a CPA or an investment professional.*

# Afterword

## The Perfect is the Enemy of the Good

"I'm going for a walk," I announced to my wife at 10:30 one Saturday morning. I needed some exercise — it had been a while since I'd made my three-mile stroll through the neighborhood. But it looked cold and rainy outside. Before I could get out the door, I decided to change into warmer clothes.

I went upstairs and rummaged around to find the perfect pair of pants. I sorted through my sweatshirts, looking for my favorite. When I couldn't find it, I had to settle for second best. I put it on. Then I decided that the wind would be too cold on the back of my neck, so I pulled off the sweatshirt, put on a turtleneck, put on the sweatshirt again.

Now that I was dressed, I had to find my shoes. My lawn-mowing sneakers were by the front door, but I couldn't find my walking shoes. I eventually found them in my office. I put them on. I grabbed my iPod from the kitchen table. My gloves were there, too, and I paused for a moment to debate whether I needed them. I decided against them.

"I'm going," I shouted, as I paused briefly to check my e-mail. The clock on the computer said 10:51. One message needed an immediate reply. I was hungry, so before I wrote back, I went to the fridge to get a snack. I microwaved some leftovers, then sat down to reply to the e-mail.

Finally, at 11:16, I left the house. I started walking downhill and realized I *did* want my gloves after all. I went back to get them. As I was leaving a second time, one of our cats came meowing up to me. I went back to let him inside. It was now 11:20. It dawned on me that I had done everything I possibly could to avoid this walk, so I procrastinated just a little longer. I sat down to write this story.

It took me *over an hour* to actually leave for my walk. This was dumb. I could have — and should have — simply opened the door, put one foot in front of the other, and *walked*.

It's the same with your finances.

You can come up with all sorts of reasons to put off establishing an emergency fund, to put off cutting up your credit cards, to put off starting a retirement account. **STOP IT.** Stop making excuses. Your best choice is to *start now*. Who cares if you don't find the best interest rate? Who cares if you don't find the best mutual fund? You've found some good ones, right? Pick one. Get in the game. Just start. Starting plays a greater role in your success than any other factor.

**THE PERFECT IS THE ENEMY OF THE GOOD.** When you spend so much time looking for the “best” choice that you never actually do anything, you are sabotaging yourself. You're sabotaging your future.

Open the door, put one foot in front of the other, and go. 