5 Myths of IRA Investing: How to separate fact from fiction

Research shows that more than half of Americans are missing out on one of the best retirement savings opportunities -- an IRA. * And it's mainly because of misperceptions about them. Here are some common ones.

1 Retirement is 20 years away, so I have plenty of time to save in an IRA.

Starting to save as early as possible is one of the best ways to prepare for the future, and the earlier you start, the harder your money will work for you. A hypothetical investor age 25 who puts $250 a month in an IRA that earns a hypothetical 7% annual rate of return until age 70 1/2 could end up with as much as $1 million for retirement.[1]

Ask your broker or advisor: What are the advantages of contributing to a Traditional IRA versus a Roth IRA?

2 Skipping a year of IRA contributions won't make much of a dent in my future savings.

Many people share this false belief. Even a small amount of money contributed this year could yield major benefits over time. The IRA contribution limit for tax year 2007 is $4,000, but it increases to $5,000 beginning in tax year 2008. An investor who skips a 2008 IRA contribution could be missing out on a lot more than $5,000 one day. Making a one-time $5,000 contribution today at age 35 could potentially result in over $53,000 by retirement. In fact, whatever amount that is put away could still add up for tomorrow. Contributing to an IRA every year has the potential to really add up over time.[2]

Ask your broker or advisor: What investment choices should I consider for my 2007 and 2008 IRA contributions?

3 I can't contribute to both my 401(k) and an IRA in the same year.

More than half (52%) of Americans who do not have an IRA believe that they cannot contribute to both an IRA and a workplace savings plan in the same year.[3] The fact is an individual, even if he/she participated in a 401(k) in 2007, can contribute up to $4,000 to an IRA. And he/she has until April 15, 2008 to make a contribution. For 2008, an individual can contribute up to the annual contribution limits for both a 401(k) ($15,500, subject to plan rules) and an IRA ($5,000). Those age 50 or older can also add an extra $1,000 to an IRA and $5,000 to a 401(k) for both 2007 and 2008.

Ask your broker or advisor: How should I consider allocating my investments across multiple retirement accounts to be properly diversified?

Consolidate your Retirement Assets

The majority of Americans juggle their retirement savings across multiple accounts.[7] You may find it more manageable to consolidate your various IRAs and former employer plan assets into fewer IRAs. It may be easier to analyze your overall portfolio and discuss your investment allocation with your broker or advisor.

Talk to your broker or advisor about the steps you need to take to simplify your IRAs.

4 My 401(k) savings should be enough.

Fidelity estimates that most retirees will need at least 85% of their pre-retirement income to live comfortably,[4] so a workplace savings plan may not be enough. Using an IRA now to supplement workplace programs can help investors ensure their savings continue to grow and potentially last throughout retirement.

Ask your broker or advisor: Can we set up a meeting to discuss my retirement income plans?

5 If I make too much money to qualify for a tax deduction, an IRA isn't right for me.

While it's true that a 2007 Traditional IRA contribution of $4,000 is only fully tax deductible for households earning less than $83,000 annually,[5] contributing to a Roth IRA, or a nondeductible Traditional IRA, can also benefit your retirement savings. The Roth IRA is one of the only retirement savings vehicles available today that allows for federal tax-free withdrawals.[6] Even a nondeductible Traditional IRA still offers tax-deferred growth. Remember that 2007 contributions can be made until April 15, 2008. (Contributions for 2008 can made any time in 2008 and up until April 15, 2009.)

Ask your broker or advisor: How can I determine the amount of my IRA contribution that might be deductible or if I can make at least a partial contribution to a Roth IRA?

** Investment Company Institute, Research Fundamentals, January 2006*

1. This hypothetical example assumes the following: (1) monthly $250 IRA contributions made on the first of each month beginning at age 25 and continuing through age 70, (2) annual rate of return of 7%, compounded monthly, and (3) no taxes on any earnings within the IRA. The ending values do not reflect taxes, fees, or inflation. If they did, amounts would be lower. Earnings and pre-tax (deductible) contributions from Traditional IRAs are subject to taxes when withdrawn. Earnings distributed from Roth IRAs are income tax free provided certain requirements are met. IRA distributions before age 59 1/2 may also be subject to a 10% penalty. Systematic investing does not ensure a profit and does not protect against loss in a declining market. This example is for illustrative purposes only and does not represent the performance of any security.

2. This hypothetical example assumes the following: (1) one annual $5,000 IRA contribution made on January 1 of the first year (2) annual rate of return of 7%, and (3) no taxes on any earnings within the IRA. The ending values do not reflect taxes, fees, or inflation. If they did, amounts would be lower. Earnings and pre-tax (deductible) contributions from a Traditional IRA are subject to taxes when withdrawn. Earnings distributed from Roth IRAs are income tax free provided certain requirements are met. IRA distributions before age 59 1/2 may also be subject to a 10% penalty. Systematic investing does not ensure a profit and does not protect against loss in a declining market.

3. "A Study on IRAs," Northstar Research Partners for Fidelity Investments, November 2007.

4. "Improving America's Retirement Readiness," Greer and Harlow, Fidelity Management and Research Company, 2005.

5. Subject to retirement plan participation status and modified adjusted gross income (AGI) limits. For 2007, full deductions are allowed for single filers who earn $52,000 or less and a partial deduction may be permitted up to $62,000. For 2007, full deductions are allowed for married filing joint filers who earn $83,000 or less and a partial deduction may be permitted up to $103,000. For 2008, full deductions are allowed for single filers who earn $53,000 or less and a partial deduction may be permitted up to $63,000; married joint filers who earn $85,000 or less may be permitted a partial deduction up to $105,000.

6. Contributions can be withdrawn at any time without paying taxes or penalties. Earnings can be withdrawn federally tax free and penalty free if the five-year aging requirement and one of the following other conditions are satisfied: age 59 1/2, death, disability, qualified first time home purchase.

7. Commingling different sources of assets into a single IRA could limit future decisions you make about the assets. Please discuss your particular situation with your tax advisor.

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