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Avoid Classic Retirement Savings Goofs

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During the agonizing descent to the lows of the 2007-09 bear market, snappy lines about moving remaining funds to the "Bank of Posturepedic" surfaced. Buy-and-hold was dead.

But going into Friday, the S&P 500 was up 22% so far this year and up 66% from its March low. Now the market is beating the stuffing out of the mattress stuffers.

"Markets outperform mattresses in the long run," said Pamela Villarreal, senior policy analyst for the National Center for Policy Analysis, a nonprofit think tank. "You can bank on it."

Monetary missteps can maim retirement savings. So max out your nest egg by avoiding some of the worst errors, Villarreal says.

Going to cash.

Too many fund investors flee bad markets too late. They think that if stock funds are plunging in value, they should guard their principal by getting out.

The problem: Investors who don't have a proven strategy for getting out and back in often move too late. They end up selling low and buying high — a recipe for lagging returns, if not financial ruin.

And for the most part, unlike with individual stocks, timing funds presents a bigger risk to long-term investors than buy-and-hold. That's because a well-diversified fund will always recover with the next bull market, even if some of its holdings don't.

Underestimating longevity

"More people live longer than earlier generations," Villarreal said. "You need a strategy that keeps pace with inflation. That means keeping a healthy portion of your portfolio invested in stocks."

Shifting all or the bulk of your assets to bonds was fine when the average life-span was around 65 years. But bonds can't keep pace with the cost of living for, say, three decades if you live into your 90s.

The government's heavy borrowing is likely to fuel a period of inflation. If inflation rises

to its historic norm around 3% a year, you'll want nominal return on your nest egg of at least 7% a year, Villarreal says.

That will give you a safety cushion for the occasional bad year in the market. And it will help you cope with unexpected urgent expenses.

Stock funds are certain to be a big part of returns of 7% and above.

Waiting too long

"Young workers think they have all the time in the world to save later," Villarreal said. "But you make saving much easier by starting early."

Look what happens if you sock away $2,000 a year for a decade, starting at age 25. Suppose it gains 10% a year in a 401(k) account. By retirement at age 65, your nest egg is worth about $612,000.

But what if you don't start until age 35? Even if you keep contributing $2,000 a year until age 65, your balance would grow to only $362,000. And you'd have to kick in $60,000 vs. a mere $20,000 if you begin 10 years sooner.

Leaving money on the table

When the economy goes south, many workers boost take-home pay by trimming 401(k) contribution

That's a mistake, unless it can't be avoided. You lose tax-deferred growth on investments bought with that money. You lose time for compounding earnings.

You might also lose a matching contribution from your employer. That's like giving up a pay raise.

"It's like saying no to a bonus," Villarreal said.

Overreliance on home equity

Too many workers think that purchasing a home substitutes for investing in stocks and mutual funds, Villarreal says.

But that strategy often does not work. U.S. home prices gained 5.68% a year on average from 1978 through 2008, according to Ibbotson Associates. The S&P 500 rose 10.84% a year on average.

Cashing out a 401(k) account

That might tempt someone who loses his job. But if you take a lump sum out, you get socked by taxes unless it is a Roth 401(k) account.

"More than one-third of your balance can get eaten up by taxes," Villarreal said.

An early withdrawal penalty can swallow another 10% if you are not yet age 59 1/2.

You have better choices than cashing out. If you are switching jobs, you can do a direct or trustee-to-trustee rollover of your balance to a 401(k) at your new company. You can do the same to an IRA.

Also, many plans will let you leave your balance in your old account. It can keep growing tax-deferred.