

Saving is Easy!

Payroll Deduction

You save money in your 401(k) by payroll deduction. This means that once you designate the amount you wish to contribute to the plan, your employer will deduct the money from your paycheck every paycheck period and deposit it in the plan for you. Consider your 401(k) contributions to be mortgage payments on your retirement. After 30 years of paying a little each month, you will own a financially secure retirement.

The saying "you never miss what you never had" is true for 401(k) saving. Why? You are less likely to spend, plan to spend, or wish you could spend those funds on anything other than your 401(k). Payroll deduction makes everything automatic, reducing paperwork and eliminating your chances of forgetting to contribute. Using payroll deduction means one less financial worry.

No Minimum Contribution Requirements

Because there is no federally required minimum contribution to a 401(k) plan, you can save as little or as much as you want. For example, it is perfectly okay if you can only save 1 percent of your income, which could be \$20 a month from a salary of \$24,000 a year. Also, there is no minimum on the amount you can invest on each of the funds in your plan. For example, it is permissible for you to divide your \$20 a month evenly among four different funds, resulting in a monthly investment of \$5 in each fund. No other investment program works this easily.

Automatic Investment

Once you have determined how your 401(k) account will be invested, your savings will be automatically invested as you have directed every time your contributions are deposited into the plan. After your very first contribution you will begin to earn returns on your investments. Because you don't have to call a broker, initiate a financial transfer, or continually make decisions, your 401(k) makes investing easy.

Dollar Cost Averaging

Using your 401(k) payroll deduction to save, you are investing a fixed amount in your portfolio at regular intervals throughout the year. This results in an investment practice called dollar cost averaging. Dollar cost averaging means you are investing the same amount of money on a regular schedule rather than making one big investment. If the price of your chosen investment changes-which is always happening with the share price of stocks or stock mutual funds- you automatically buy more shares when the price is lower and fewer shares when it increases. By investing via dollar cost averaging you ensure that the cost of your shares is at the long-term average price, which reduces the uncertainty of short-term market volatility.

While the stock market ebbs and flows, you remain constant and steady. This means you never have to worry about incorrectly timing the market by purchasing all your stock at too high a price. For example, suppose you would like to buy shares of a stock that is particularly hot at the moment. Because everyone would like to own some of this stock, the cost per share rises to \$10, costing you \$6,000 for 600 shares. If you would have used dollar cost averaging and invested in the same stock every month with an amount of money that remained constant over the entire year, you could have purchased 895 shares for an average of \$6.70 per share rather than 600 shares at \$10 each. This dollar cost averaging approach is detailed in Figure 2.5.

Figure 2.5 Dollar Cost Averaging

Money to spend: \$6,000, or \$500 per month

<i>Month</i>	<i>Price Per Share</i>	<i>Shares</i>
January	\$10	50.0
February	\$12.50	40.0
March	\$10	50.0
April	\$8	62.5
May	\$8	62.5
June	\$8	62.5
July	\$5	100.0
August	\$4	125.0
September	\$6.25	80.0
October	\$5	100.0
November	\$5	100.0
December	\$8	62.5
Average Cost	\$6.70	Total Shares 895

Screened Investment Choices

When you invest in your 401(k), you are not forced to choose your investments from the thousands of choices listed in the Wall Street Journal. The advantage of 401(k) is that your employer has researched and carefully considered all the options in order to provide you with a limited number of high-quality investment choices. Investing comes complete with its own language, rules, and thousands of alternatives. This is intimidating and may lead to poor choices. Having only a few employer-screened investments from which to choose simplifies your investment decision and greatly improves the likelihood of your financial success. Your employer may invest your money for you, which makes 401(k) investing even easier.

You Know What You Have

401(k) makes it easy to know what you have. Because 401(k) savings are in your own account, you can track your contributions, your employer's matching contributions, and the effects of your investment's return on your 401(k) assets. Typically, your employer will provide you with quarterly statements reporting activity in your 401(k) account. Increasingly, such information is also available via your company's telephone response system, intranet system, or on the Internet, from which you can access your account via a PIN of your choosing.