ADVISER INVESTMENTS

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

June 10, 2011

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Text This to Your Teens: A Roth IRA Could Make Them a Multi-Millionaire

Teenagers being teenagers, it is rarely easy to get them thinking further into the future than Friday night. But with the summer job season for high school and college students upon us, now is a good time to teach your children, grandchildren, nieces and nephews a valuable lesson about the benefits of putting money aside in a Roth IRA.

While the notion of retirement may seem like an abstraction to a teenager, the idea of becoming a millionaire--or better yet a multi-millionaire--may compel them to put their cell phone aside and pay attention. There are two primary reasons why a Roth IRA is a great starter investment for teenagers and young adults: Taxes and the power of compound growth.

If your child is only working for the summer, or just starting his professional career, he will likely be in one of the lowest tax brackets. Therefore, he may be better served paying taxes on his income now in return for tax-free growth in a Roth IRA over the course of several decades.

Even a relatively modest annual contribution of $1,000 starting at age 15 could grow to nearly $917,000 by age 70, assuming a compounded annual return of 8%. Bump those annual contributions up to $5,000 and your child’s savings could grow to more than $4.5 million by age 70 (again based on 8% compounded annual returns).

The table below illustrates how a Roth IRA can be a great starter investment. We set up several different scenarios for the purpose of this table. All of them assume an 8% annual compounded return. The only difference between these scenarios is the amount contributed per year, which increases in $1,000 increments from $1,000 to $5,000 (the maximum currently allowed for investors age 49 and younger) from age 15 to age 70. As you might expect, the larger the contribution and the longer the time horizon, the larger the account grows. With larger initial (and subsequent) investments, you get even more distance from your dollar.

We also developed another scenario that attempts to show a conservative, natural progression a young person might follow as he or she ages and gains employment (see the "Increasing Contributions" column). It starts by assuming a first summer job at age 15 where they invest $1,000 a year until they graduate from college and get settled into a career. At that point (age 25), they bump their annual contributions up to $2,000. In their 30s, they will be well established (hopefully) and able to again bump their contribution up to $3,000 at age 30, to $4,000 at age 35, and $5,000 at age 40. The table assumes they continue to contribute $5,000 per year through age 70.

Those who follow this hypothetical progressive contribution strategy could end up with more money at age 70 ($2,052,667) than those who contribute $2,000 per year from age 15 on but never increase their contributions ($1,833,674).

Roth IRA Results May Improve with Age

	Annual Contribution Amount					
Age	**$1,000**	**$2,000**	**$3,000**	**$4,000**	**$5,000**	**Increasing Contributions**
15	$1,000	$2,000	$3,000	$4,000	$5,000	$1,000
30	$29,324	$58,649	$87,973	$117,297	$146,621	$42,972
60	$417,426	$834,852	$1,252,278	$1,669,704	$2,087,130	$921,794
70	$916,837	$1,833,674	$2,750,511	$3,667,348	$4,584,185	$2,052,667

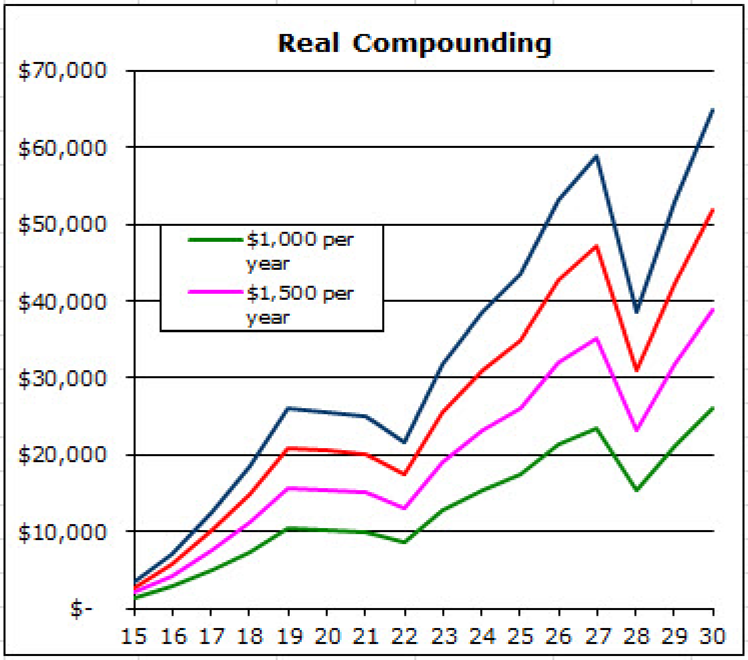
Note: Table assumes a steady 8% annual return. Source: Adviser Investments

We also created another scenario that may be more realistic, particularly when we're talking about real markets and real teenagers. First off, few teenagers are going to be able to earn $4,000 in a summer (though they might be able to hit that number or higher if they work during the school year as well).

It's also clear that markets don't compound in a straight line. They go up and they go down. Therefore, in the chart below we have assumed that our hypothetical teenager is not only stashing away more modest sums in his or her early years, but also that returns from the market mimic those of the past 15 years (using returns from Vanguard's Total Stock Market Index over that period).

As you can see, the power of compounding relatively small sums of cash annually is a highly effective means to save money over a 15-year period, even if your investment suffers significant losses during that time. Take a look at the V-shape formed by the lines between ages 27 and 30 on the chart, which represents the 37% decline suffered by Total Stock Market Index in 2008 and the subsequent rebound in 2009 and 2010. In this example, each investment recovered from its losses and continued to grow through a combination of a couple of years of positive returns and steady annual contributions.

Potential Growth of Varying Annual Contribution Amounts over Past 15 Years*



*Source: Adviser Investments. Based on annual returns of Vanguard Total Stock Market Index from 1996 through 2010.

Roth IRAs Provide More Flexibility than Traditional IRAs
The idea of tying up savings in an IRA may not appeal to a teenager or a young adult who may need to access her savings to pay for a new car, a wedding or a down payment on a first home. With a Roth IRA, however, the rules do provide some flexibility.

Contributions to a Roth can removed penalty free at any time. Of course, that defeats the purpose of saving in a Roth IRA, but the ability to access cash in a pinch may be a selling point to your teenager. In addition, a Roth owner can withdraw up to $10,000 in earnings on contributions after five years for a qualified first-time home purchase. Earnings can also be taken tax-free after five years for disability, death or once the account owner reaches age 59-1/2. Keep in mind, however, that non-qualified withdrawals on earnings taken for any reason prior to five years are subject to a 10% early withdrawal penalty and are taxed as ordinary income.

Getting Started
The scenarios described above clearly demonstrate the benefits of investing in a Roth IRA, starting at an early age. Nevertheless, the question remains: How do you get a teenager to plan ahead and start saving in a Roth IRA?

Our suggestion is to lend a helping hand (or dollar, in this case). Assuming you can afford to match your child or grandchild's summer earnings, do it. Let them keep their hard-earned money, but open a Roth IRA in their name and contribute the money yourself. Remember, the child may earn $1,000, but taxes will reduce his take-home pay. But that shouldn't keep you from contributing a full $1,000 into a Roth IRA (note that contribution amounts cannot exceed the child's earned income for the year). If you prefer not to contribute the full amount, consider making a deal with your teen to match a portion of his earnings as long as he contributes to his Roth IRA as well.

Finally, there is the issue of fund minimums. Fidelity requires a minimum of $2,500 for most funds and Vanguard has $3,000 minimums for a majority of its funds. One option would be to start your child in Vanguard's STAR or Target Retirement funds of funds for just $1,000 (as their investment grows, we'd advise moving out of these starter options). Or, if you have a personal representative at Fidelity, Vanguard or any other fund family, see if they will waive the minimum for your child or grandchild. If these firms are smart, they will see this as a way to grab a potential long-term client at an early age.

Putting your teenage child or grandchild on the road to a comfortable retirement may be one of the best gifts you can give them. Along the way, you will also be teaching them fiscal responsibility and the importance of long-term financial planning from an early age. If your child or grandchild has plans to work this summer or already has started working, we urge you to steer them towards a Roth IRA.