Now that you have graduated

People face different financial choices as they move through their lives. While in college, they may decide whether to borrow money or whether to buy a fancy coffee. At this time, most of them don't worry about saving for retirement – and they shouldn't. Instead, they should concentrate on getting through school without taking on too much debt. But once they graduate, they should start saving for retirement.

Joe McGarrity

The recent graduates, now newly hired full-time employees, often feel ill prepared to make good decisions regarding their retirement savings. After all, most of them have no practice making these types of decisions; they never earned enough money to worry about such matters. To these people, I have three pieces of advice.

First, sign up for your company's retirement plan right way. Money that you save now has a chance to grow into a lot of money by the time you retire. For instance, suppose that you invest in a broad-based stock market index fund, perhaps one that tries to match the return of the top 2,000 firms. Even after adjusting your returns for inflation, you can expect your investment to double every ten years. So if you start working at 22 years of age and retire at 72, your money will double five times (even after adjusting for inflation). This means a $5,000 contribution in your first year of working will grow to $160,000 when you are 72. Or more generally, every $1,000 you invest at 22 will grow to $32,000 you are 72. As you can see, you can earn a lot of money from the contributions you make when you are 22.

Second, keep in mind that companies often fully or partially match your contributions to your retirement account. I know of a recent graduate whose company will fully match the first three percent of her salary that she devotes to her retirement account and it will match 50 percent of her remaining contributions. So if she puts 10 percent of her salary into her retirement account, her employer adds another 6.5 percent to it. That is an immediate 65 percent return on her retirement contributions. For instance, in her first year of working, if she contributes $10,000 to her retirement account, the employer will kick in $6,500. Or if she contributes $5,000, the employer will contribute $3,250. As you can see, her employer's matching policy gives her a good immediate return on her contributions.

Third, set up your retirement account in a way that you do not need to adjust it. Some very astute financial advisors and even Richard Thaler, a Nobel laureate in economics, recommend something very different: they think that people should begin to contribute a small amount of their salaries to their retirement accounts and then increase their contributions every time they get a raise. Certainly, this approach has an appealing quality: people who get a raise aren't used to spending the new money yet, so they won't feel like they are giving anything up by devoting a portion of that raise to their retirement accounts.

Even so, I don't think devoting a portion of each pay raise to your retirement account is a good strategy. It requires you to make regular adjustments to your retirement account. If you are like almost everyone else, other priorities will come up and you won't make these adjustments. You would be far better off picking a long-term strategy and sticking to it. For instance, when talking to the recent graduate, the one I mentioned previously, I recommended that she devote 10 percent of her salary to her retirement account (remember, her company is contributing 6.5 percent to it as well). She can keep contributing 10 percent of her salary throughout her career. Then, she does not even need to think about her retirement account again until she gets close to retirement, when she may want to move some of her money out of stocks to other safer, less volatile investments. But she can worry about that issue several decades from now.

Recent college graduates who fail to set up their retirement accounts will regret this decision come retirement time. By setting up their retirement accounts now, recent college graduates can ensure that they can enjoy financially secure retirements.

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