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Why Maxing Out Your Retirement Fund May Hurt Your Finances

by Marie DeFreitas

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We've always been told to save as much as we can for our retirement, right?

There's a good reason why we're told that. Approximately 45% of baby boomers have no savings at all, according to a report from the Insured Retirement Institute. Plus, those who do have savings, about a quarter of them have less than $100,000 put away. But that money won't go very far if you're considering the several decades you may spend it retirement.

It probably seems like the obvious action to take: to start loading up your 401(k) or IRA as much as you can. Sometimes, that is indeed the right moves. But in some cases, maxing out your retirement fund may actually hurt your finances.

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Savings is all about priorities. Your retirement fund is important, but so other things like knocking out your debt and setting aside an emergency fund. If you aren't paying attention to either of these two financial aspects, it might not be the best idea to just throw all your money into your retirement fund.

High-interest debt is dangerous territory. The average credit card interest rate hovers just above 17% per year, according to *The Motley Fool*. Meanwhile, your retirement investments may only be earning a 7% to 10% annual rate of return.

Depending on how much debt you have and how much you have saved in your retirement fund, there's a chance you're paying more in interest on your debt than you're earning on your investments. In that case, it;s the wrong move to focus more on retirement saving than paying off your debt.

Why Maxing Out Your Retirement Fund May Hurt Your Finances

If you don't have any emergency savings, that's another problem. Only 61% of U.S. adults have enough savings to cover a $400 unexpected expense, according to research from the Federal Reserve Bank. This means a lot of Americans are at risk of going into debt or tapping their retirement funds to cover unexpected costs.

If you withdraw money from your 401(k) or traditional IRA before age 59.5, you'll typically face a 10% penalty plus income taxes on the amount you take out. Nobody wants that. So if you don't have an emergency fund and you're hit with an unexpected expense, you may actually end up undoing some of your hard work if you have to withdraw your savings early.

So how do you prioritize these things?

The Motley Fool suggests to firstly see if your employer offers matching 401(k) contributions. If so, save enough to earn the full match. Matching contributions are essentially free money, so do your best to take full advantage of them.

Next, take a look at your debt. High-interest debt should be next to tackle on the list. Low-interest debt, like a mortgage or student loans, are important to eventually pay off too. However, with these you don't need to put your other financial goals on hold in order to do so.

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Your next step is going to be creating the emergency fund. According to *The Motley Fool*, most experts recommend saving enough to cover three to six months' worth of living expenses. But really, if you can only get in a few dollars each week, anything helps here.

Finally, take a look to your retirement savings. Based on the type of debt you have, and how much money you have in that emergency fund, decide what works best for you. Once you have the bulk of your high-interest debt paid off and a few thousand dollars stashed in your rainy day fund, you can dive right into saving for retirement.

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