Client Conversations

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The Teenager's Guide to a Comfortable Retirement

Investing in a Roth IRA at an early age could help set you up for a comfortable retirement.

When it comes to planning for a financially secure retirement, starting early can make all the difference. Investing in a Roth IRA might seem like a concern for adulthood, but using earnings from a summer job can help get your retirement savings off to a strong start.

The Power of Compounding

By starting at a young age, you give your investments more time to benefit from the power of compounding. For example, if you contribute $3,500 annually from ages 16 to 21, those contributions can potentially grow significantly thanks to compounding.

FIGURE 1

Contributing Early to a Roth IRA Can Lead to Significant Growth Over Time

Hypothetical $3,500 Contribution From Ages 16 to 21

Age	Annual Contribution	Total Contribution	Estimated Growth (8% Annually)
16	$3,500	$3,500	$3,780
17	$3,500	$7,000	$7,862
18	$3,500	$10,500	$12,271
19	$3,500	$14,000	$17,033
20	$3,500	$17,500	$22,176
21	$3,500	$21,000	$27,730
68	-	$21,000	$1,032,437

The compounding example is a hypothetical example that assumes a $3,500 annual contribution and annual 8% return. Also assumes that an investor stays below the income limitations to contribute to a Roth IRA which are less than $146,000 for full eligibility for single filers and less than $230,000 for full eligibility for married filers as of October 2024. The example doesn't represent any particular investment and is for illustrative purposes only to show the mathematical concept of compounding. It does not account for inflation, and the rate is not guaranteed. Taxes are not included in the calculations. Investments are subject to risk, including the loss of principal.

Key Points

- Time is one of the most important factors in investing; young investors can benefit a great deal by giving their portfolio time to compound.
- Roth IRAs can help young investors start saving for retirement early and offer tax-free savings later in life.
- Parents can help teens begin investing by matching contributions to help grow portfolios and instill good habits.

Maximizing Earnings From Summer Jobs

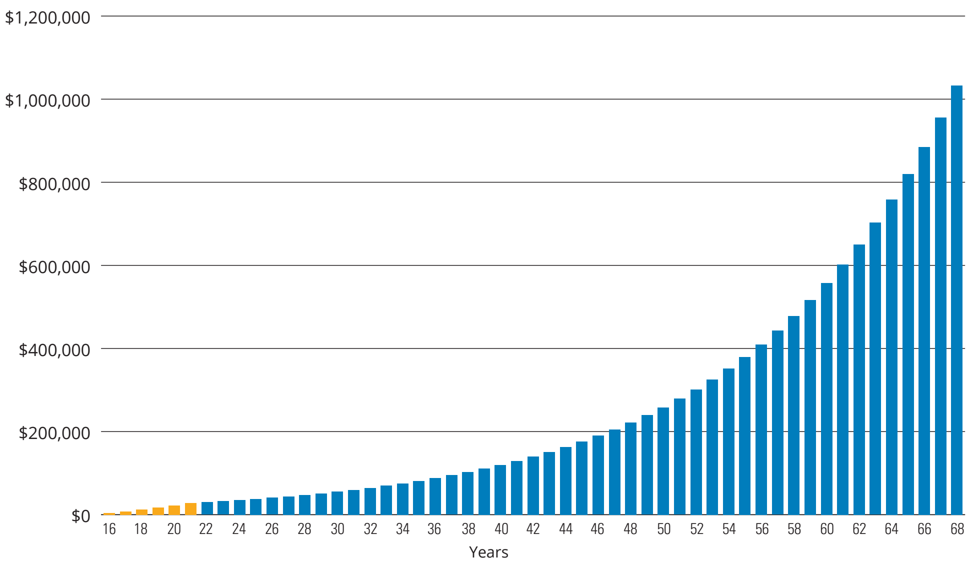
Contributing $3,500 annually at such a young age might seem daunting, but it could be more manageable than you think. With an average hourly rate of $18 for a summer job according to Indeed,[1] working 40 hours per week for 12 weeks would yield $8,640 before taxes. The IRS allows contributions of up to $7,000 in earned income for 2024, making it feasible to set aside a significant portion of summer earnings.

FIGURE 2 shows how consistent and early annual contributions of $3,500 to a Roth IRA from ages 16 to 21 could significantly grow a retirement fund by age 68.

FIGURE 2

Compounding Can Grow Small Contributions Into a Sizable Nest Egg

Hypothetical $3,500 Contribution From Ages 16 to 21 With 8% Returns Until Age 68



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Parents Can Help

Parents can encourage their teens to save by offering matching contributions or gifting contributions to help reach the desired amounts. This not only increases the financial benefits, but also teaches valuable lessons about saving and investing. Note that the amount the parents contribute is still subject to the child's earned income that they declare to the IRS (IRS rules don't specify where contributions come from as long as they don't exceed the child's earned income for the year).

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Benefits of a Roth IRA

One of the main advantages of a Roth IRA is the ability to withdraw funds tax-free in retirement. For young investors, who are likely in a very low or zero tax bracket, this means investing for retirement now can have a beneficial tax impact later.

You can withdraw your contributions to a Roth IRA at any time tax-free and penalty-free, though the earnings on those contributions may be subject to a 10% penalty and subject of income taxes under most circumstances. For a withdrawal to be completely tax-free, the account must have been open for at least five years, and the account holder must meet one of the following conditions: you reach age 59½ or older; you become disabled; you're using the funds for a first-time home purchase (up to a $10,000 lifetime limit); or the withdrawal is made to a beneficiary of your estate after your death.

Instilling Good Financial Habits

Early and consistent investing in a Roth IRA helps encourage good saving habits in young people while also growing their retirement funds. Starting during teenage years provides lots of time to develop these crucial habits and can help put young investors on a path to financial independence.

For more information on investing in a Roth IRA, talk to a financial professional.

[1] Based on 3,500 salaries reported, updated as of 9/14/24. Source: Indeed.

Important Risks: Investing involves risk, including the possible loss of principal.

Investment options offered through IRA providers vary and any fees and expenses will differ.

This information should not be considered investment advice or a recommendation to buy/sell any security or tax advice. In addition, it does not take into account the specific investment objectives, tax, and financial condition of any specific person. Investors should consult with their own financial professional for additional information.

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