Guide to the Military’s BLENDED RETIREMENT SYSTEM

is the essential guide to the Department of Defense’s new retirement initiative. The guide clearly describes the key features and benefits of the new approach, including the tax-deferred TSP account, matching contributions from the DoD, and investment choices and strategies for building a retirement portfolio.

Spotlight on TSP

Choose the investment style that’s right for you. The TSP offers 18 investment options, including 5 lifecycle funds and 13 individual funds. You can choose from a range of investment strategies, such as stock, bond, and index funds. Each lifecycle fund includes a mix of stocks, bonds, and cash, designed to meet your retirement needs.

TSP INVESTMENT CHOICES

In this section, you’ll learn about the various TSP investment options, including lifecycle funds, individual funds, and Roth accounts. You’ll also discover how to choose the right investment style for your retirement goals.

EXPLORING RETIREMENT INVESTMENTS

In this section, you’ll learn about the different types of retirement investments, such as stocks, bonds, and mutual funds. You’ll also discover how to evaluate investment options and make informed decisions about your retirement portfolio.

TAKING AIM AT A TARGET RETIREMENT DATE

This section will help you determine the amount of money you need to save for retirement and the annual contributions you’ll need to make. You’ll also learn about retirement planning tools and resources, such as retirement calculators and financial advisors.

CHOOSING INVESTMENTS

In this section, you’ll learn about the different types of retirement investments, including stocks, bonds, and mutual funds. You’ll also discover how to evaluate investment options and make informed decisions about your retirement portfolio.

HOW MATCHING WORKS

This section will help you understand how matching contributions work and how they can help you reach your retirement goals. You’ll also learn about the different types of matching contributions, such as matching contributions from your employer and matching contributions from the DoD.

DEFINED BENEFIT PLANS

In this section, you’ll learn about the different types of defined benefit plans, such as pensions and annuities. You’ll also discover how defined benefit plans work and how they can help you reach your retirement goals.

DEFINED CONTRIBUTION PLANS

This section will help you understand how defined contribution plans work and how they can help you reach your retirement goals. You’ll also learn about the different types of defined contribution plans, such as 401(k) plans and 403(b) plans.

LIFECYCLE FUNDS

In this section, you’ll learn about the different types of lifecycle funds, such as stock, bond, and index funds. You’ll also discover how lifecycle funds work and how they can help you reach your retirement goals.

VIRGINIA B. MORRIS AND KENNETH M. MORRIS

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THE FINANCIAL EDUCATION COMPANY

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To Our Military Members and Their Families:

On behalf of the Defense Credit Union Council and our member credit unions, we would like to take this opportunity to express our sincere gratitude for your selfless service to our nation. To show our appreciation, we are pleased to provide you with this copy of Guide to the Military’s Blended Retirement System to help you understand the new Department of Defense Blended Retirement System and how it applies to you.

As a proud partner and charter member of the Department of Defense Financial Readiness Campaign, we felt it essential not simply to describe the Blended Retirement System but to provide insights on fundamental retirement planning as well. We also explain why saving is so important and offer practical information for meeting both your immediate and long-term financial goals. We want you to succeed in building a financially secure future!

While the booklet is designed to be informative and to answer questions you may have about the BRS, we highly recommend that you meet with a Personal Financial Manager on your installation as well as with a certified financial planner to discuss your individual financial goals and concerns. In addition, we suggest you make use of all the resources mentioned in the guide and that you look to these reliable sources to gain timely and actionable information.

We wish you all the best as you plan for your retirement. Once again, thank you for your steadfast commitment and courageous service to our great nation!

Sincerely,

Anthony R. Hernandez
President and CEO

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A Retirement Marathon

Ready, set, go on retirement savings.

If you’re up for the challenge, you can get a head start on long-term financial security from the minute you join the armed forces. The key is having the discipline to save part of your pay every month—right from the beginning—and for as long as you stay in the service.

Think of retirement savings as a race in which you’re competing against yourself. The goal is to save the money now that you’ll need after you stop earning income.

What makes the effort hard, though, is the distance. You’re probably wondering why you have to worry now about something that could be 30 or 40 years in the future? There’s a simple answer. It’s the power of compounding.

HOW COMPOUNDING WORKS

As you save, your account balance grows larger when earnings on that money are added to the original amount. That means future earnings are figured on the new, larger base and then added to it, making it larger still.

Compounding is sometimes described as having a snowball effect. If an account with a balance of $1,000 gains value at a long-term average rate of 5%, it will be worth about $1,629 after 10 years, $2,653 after 20 years, and $4,322 after 30 years. And if you add $1,000, or a little over $83 a month, to the account each year, it will be worth $14,836 after 10 years, $37,373 after 20, and $74,083 after 30 years.

(* Calculation based on annual growth rate of 5% with annual contribution at beginning of each year.)

ON YOUR MARK

All successful competitors have a strategy for reaching their goals and a commitment to seizing every opportunity to get ahead.

For retirement savers, the big opportunity is access to an employer’s tax-deferred savings plan that lets you postpone taxes on your earnings. That means your account can compound faster.

There are other routes to the goal, such as a tax-deferred individual retirement account (IRA). But for getting off to a fast start, an employer plan is the way to go.

GET SET, GO

You might hesitate to put money into a retirement savings plan when you’re already stretching to cover expenses like supporting a family, buying a home, or keeping up-to-date with your bills.

One approach to paying current costs while saving for the future is to dedicate a percentage of your current income to both short-term and long-term goals. In a perfect world that would be 16% or more, but saving 5% is better than nothing. You can always increase the percentage later on as you’re promoted and your income rises.

For short-term savings, you can consider insured investment accounts that have the potential to grow better than nothing. You can always increase the percent-

HURDLES AHEAD

The perserverance that pushes you to finish a race is like the commitment it takes to be a winner in the retirement marathon. The main difference is that when you’re saving for retirement you’re apt to encounter hurdles that don’t show up on a marathon course, like high inflation and market downturns, which can slow your pace.

But if you plan ahead to deal with them, they won’t throw you off your course.

BLENDED RETIREMENT SYSTEM

The retirement system is set up so that once you turn 50, you qualify to make larger contributions to tax-deferred accounts, whether you participate in a new employer’s plan, your own IRA, and other investments you might make.

In fact, the retirement system is designed to help meet future needs that you can’t predict, like high inflation and market downturns, which can slow your pace.

But if you plan ahead to deal with them, they won’t throw you off your course.

GETTING IN SHAPE

To be competitive in any race, you need to be in great shape physically and mentally. In a retirement savings marathon, it’s the mental conditioning that’s critical. You have to resist the impulse to buy extra things you’d like to have now to gain something you’ll absolutely need later. It’s a trade-off that gives you an extra edge, especially down the home stretch.

If you’re burdened by debt, saving is almost impossible and you’ll find yourself lagging behind. But if the money you’re paying in interest on credit cards and loans can go into savings instead, you’ll be prepared for the long run.

There’s just one good reason to postpone saving for a long-term goal; including retirement. That’s using some of your income first to build an emergency fund large enough to cover three to six months worth of living expenses. It’s like having disaster insurance for your financial security.

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For short-term savings, you can consider insured accounts, such as certificates of deposit (CDs). Long-term savings, on the other hand, are generally better off in investment accounts that have the potential to grow substantially over time, even if they may sometimes lose value, especially in the short term.

HITTING YOUR STRIDE

If you start your savings regime early and make a habit of saving during your career, you progress toward accumulating substantial assets should be right on track.

Sooner or later demands on your current income will begin to ease, at least somewhat. The mortgage may be mostly or fully paid off, and your children will strike out on their own.

You’re likely to be earning more. That means you can gradually contribute a higher percentage to your long-term account through your employer’s plan, your own IRA, and other investments you might make.

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But if you plan ahead to deal with them, they won’t throw you off your course.
You’ve got a fighting chance to make ends meet while you’re in the armed forces because you’re being paid for the job you do. That’s also true if you spend part of your life in a civilian career. But where will your income come from when you’re ready to stop working and want to take life a little easier?

**HOW MUCH WILL YOU NEED?**
The reason to think about retirement income now is that your cost of living—what you pay for housing, food, clothing, medical care, and all the other things you spend money on—isn’t going to be much less after you retire. In fact, you’re likely to need at least 80% of your preretirement income, and perhaps as much as 100%, to live comfortably.

For example, someone earning $50,000 a year will probably need at least $40,000 a year to maintain the same lifestyle after retirement. And that amount will increase a little every year thanks to inflation, which means that over time your dollars gradually buy less. So you need more income just to keep pace.

You’re entitled to benefits from Social Security because FICA taxes are deducted from your paycheck. The amount you’ll receive depends on your earnings in your 35 highest-paid years and how old you are when you start collecting.

While you can count on this income, it’s a mistake to think it’s all you’ll need. The average monthly benefit paid years and how old you are when you start collecting. When you’ve collected your final paycheck, you’ll ideally be able to tap into some or all of the five primary sources of retirement income.

- **Social Security**
- **Employer-sponsored savings plans**
- **Individual retirement accounts (IRAs)**
- **Other individual assets**
- **Employer pensions**

But the amount you can expect from each source depends on your work history and the amount you’ve saved and invested.

**RULE OF 72**
You can use the Rule of 72 to figure out how much inflation will increase your costs. Just divide 72 by the current rate of inflation. The result shows how many years it will take for prices to double. For example, if inflation is averaging 3%, most things will cost twice as much in 24 years.

\[
\text{Years for Price to Double} = \frac{72}{\text{Inflation Rate}}
\]

Some employers provide lifetime income to employees who have had the required amount of time on the job. For example, members of the armed forces who have 20 years of service collect a pension. But in the civilian world, employer pensions are increasingly rare.

**THE WORK OPTION**
Before they retire, many people expect to continue to work part-time to make ends meet. But a 2015 survey from the Employee Benefit Research Institute (EBRI) found that while more than two-thirds (67%) of people expect to work after they retire, fewer than a quarter (23%) actually do.
Employers have the option—though not the obligation—to offer a retirement plan to their employees. These plans generally take one of two forms: a defined benefit (DB) plan or a defined contribution (DC) plan.

**DEFINED BENEFIT PLANS**

A DB plan, commonly known as a pension plan, pays retired employees a lifetime income, usually on a monthly basis. The amount of the pension is typically calculated using a formula that includes the number of years on the job and the employee's final pay, or sometimes the average pay for the most recent three years. As a result, employee's final pay, or sometimes the average includes the number of years on the job and the pension is typically calculated using a formula that provides income to you and other retired participants, and pays the benefits when they're due.

As a rule, the more you earn and, even more important, the longer you remain in the job, the larger your pension is likely to be.

To be vested in the DoD pension plan, you must serve in the armed forces for 20 years. To be vested in a DB plan, you must earn COLAs. A COLA increases the amount you receive and helps combat the effects of inflation that would otherwise erode your buying power. In contrast, corporate pensions, which are much less common than government pensions, rarely include COLAs.

**DEFINED CONTRIBUTION PLANS**

In a DC plan, you, as an employee, are an active participant. Your employer establishes the plan, but it’s your responsibility to contribute a percentage of your pay to an account that’s been set up in your name within the plan. You’re also responsible for spreading your contributions among the investment alternatives the plan offers, a strategy known as asset allocation.

Some employers match your contribution, up to a cap, such as 5% of your base pay. For example, if you contribute 3% of your pay, your employer adds another 3%. If you contribute 5%, your employer adds 5%. So if your plan includes a match, it’s smart to contribute at least enough to qualify for the maximum you can receive. Contributing less means you’re leaving free money on the table.

Even if you contribute more than 5%, your employer matches only the maximum, or 5%. But that shouldn’t stop you from contributing 10% or more if you possibly can. Larger contributions help to build your account more quickly so it can become a substantial financial resource later on.

When you’re ready to retire, the value of your account will determine the amount of income you’ll have available to withdraw. Unlike a pension, however, the amount isn’t guaranteed. Rather, DC retirement income depends on three factors:

- The combined amount you and your employer have contributed to your account
- The return, or what you’ve earned, on the investments you’ve chosen
- The number of years your money is invested and can benefit from compounding

**BEING VESTED**

When you’re vested, you have the right to a pension or to the matching funds your employer has added to your DC account. You earn that right by working at least the minimum length of time required by the plan even if you leave for any reason before you actually retire. But, if you leave before you’re vested, you forfeit your rights to the pension or to some or all of the match.

To be vested in the DoD pension plan, you must serve in the armed forces for 20 years. For pension plans offered by corporations and institutions in the private sector, federal ERISA rules require that you are either 100% vested after five years on the job or 20% vested after two years and fully vested after seven years. The vesting period for an employer’s matching contribution varies among DC plans. That’s because employers have the right to choose one of three time frames: instant vesting, 100% vesting after three years, or 20% annual vesting starting at the end of the second year, reaching 100% vested after six years.

However, vesting isn’t an issue with the money that you contribute to the plan and any earnings on those contributions. They always belong to you, no matter how long you’re in the plan.

**AUTOMATIC ENROLLMENT**

With some DC plans, it’s your responsibility to enroll, decide on the percentage of your pay you’ll contribute, and select among the investments offered in the plan. With other DC plans, however, all eligible employees are automatically enrolled, as they are in a DB plan.

Employers who use automatic enrollment choose the initial percentage of pay that participants will contribute to their accounts—often 3% initially—as well as the way the money is invested. There are three eligible choices, known as default investments: a target date or lifecycle fund, a balanced fund, or a managed account.

If you’re automatically enrolled, you can increase the percentage you contribute and adjust how your contributions are invested, either initially or at any point in the future. You also have the choice of opting out, but doing so will almost certainly undermine your retirement income.

**HAY A COLA?**

Once a pension is calculated, the base amount is fixed. But government pensions, including those from the DoD, provide an annual cost of living adjustment, or COLA. A COLA increases the amount you receive and helps combat the effects of inflation that would otherwise erode your buying power. In contrast, corporate pensions, which are much less common than government pensions, rarely include COLAs.
The Blended Retirement System (BRS), which launched on January 1, 2018, retains the strengths of a pension-based system while adding a robust defined contribution plan that actively encourages—and also rewards—saving for retirement.

SAVING, FRONT AND CENTER
With its focus on tax-deferred saving, the blended system modernizes the DoD retirement plan. It also makes the system more equitable by addressing the long-term needs of all service-members, not just those who make the military their career.

To achieve this objective, the DoD has enhanced the role of the Thrift Savings Plan (TSP), making it a key element of retirement planning. Here’s a brief summary:

• You’ll be part of the blended system, with a TSP account established in your name.
• You’ll make contributions to the account from your base pay.
• The DoD will automatically contribute 1% of your monthly base pay to your account starting on your 61st day of service.
• After you’ve completed two years of service, you’ll be eligible for matching contributions from the DoD.

WHAT’S YOURS IS YOURS
Vesting in your TSP account works differently from vesting in the military’s pension system.

Your contributions to your TSP account, plus any earnings those contributions generate, are always yours, regardless of how long you serve.

HOW MATCHING WORKS
The DoD matches 100% of the first 3% of basic pay that a member contributes to a TSP account, plus 50% of additional contributions, up to 5% of basic pay. That’s the same match available to civilian employees in the Federal Employee Retirement System (FERS).

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After two years of service, you’re fully vested in the automatic 1% contributions that the DoD has made, plus any earnings on those contributions.

At that point, you also begin to qualify for matching contributions. You’re immediately vested in the matching amounts the DoD adds to your account and any earnings they produce.

All your vested assets are portable, which means you can take them with you when you leave the military. The only amount you risk forfeiting is the 1% the DoD adds to your account during your first two years of service. But that happens only if you leave the military before beginning a third year.

You can move your assets to another tax-deferred account if you don’t want to leave them in your TSP account. What you don’t want to do is take your TSP savings in cash. If you do, you’ll owe income tax plus a potential 10% tax penalty.

TIME FOR A BONUS
As a way to encourage retention, the DoD will offer a bonus, officially known as career continuation pay, to everyone enrolled in the BRS who stays in the military for at least eight years. The only condition for receiving the bonus is that you must agree to serve a minimum of three additional years. The bonus can be paid in installments to reduce the income tax you might owe if it were paid all at once.

For active duty members, the Secretary of your service branch determines the size of your bonus, which is calculated by multiplying your monthly base pay by a minimum of 2.5, up to a maximum of 13. The Secretary also sets timing of this one-time extra payment, which could be at any point between your eighth and twelfth year of service.

Unsurprisingly, members with the skills the Secretary is most interested in retaining are likely to be offered higher amounts.

Similar incentive payments are available to Reserve members.

BALANCING GOALS
It always pays to contribute the full 5% of base pay to your TSP account so that you qualify for the full DoD match. The only reason to contribute less is if you’re putting money aside to create or replenish an emergency fund as a cushion against unexpected financial problems. For example, you might need this money if your spouse lost a job or your car needed major repairs.

Another resource you can tap into if you’re facing a financial challenge is a loan from your TSP account. In the first few years, when your account balance is small, the amount you can borrow may not be enough to meet your need. But as your balance grows, borrowing in this way may be preferable to taking a commercial loan.

TSP loans do have to be paid back with interest. And, while the loan is outstanding, growth in your account is stalled. But as long as the loan is just a temporary interruption, you should be able to get your savings back on track.

TAKING A LUMP SUM
The blended system will pay retired members a pension annuity in regular monthly installments. But the BRS will also offer members the option of choosing a partial lump-sum payout at retirement.

Members taking a lump sum agree to a reduction in their monthly pension benefit until they turn 67. (That’s the age at which you’re eligible to collect your full Social Security benefit and so considered full or normal retirement age.) After 67, their full benefit is restored to the amount they would have been paid if they had not taken the lump sum.

OPTING OUT
You do have the right to opt out of participating in the TSP and not make contributions—but only after you complete financial literacy training. And you will be automatically re-enrolled every year at the default rate. If you’re still unwilling to contribute, you’ll have to opt out again. You should take the hint. Participate.
Defined Contribution Plans

These popular plans help kickstart your retirement savings.

Once you’re convinced you should start saving now to have the income you’ll need in retirement, it’s time to take advantage of your employer’s retirement savings plan. In your case, as a member of the armed forces, you’re eligible for the federal government’s Thrift Savings Plan (TSP).

While details of retirement savings plans vary, all offer essentially the same key features: tax-deferral, investment choice, and portability.

TAX-DEFERRED GROWTH

In all DC plans, the money you and your employer contribute to your account compounds tax deferred. This means no tax is due on your earnings until you begin withdrawing from the account years later. At that point, you pay tax on the withdrawals at the same rate you pay on your other ordinary income.

When taxes are deferred, earnings can accumulate faster since money you would otherwise have to use to pay taxes can keep growing in your account.

The only downside is that earnings in a DC account aren’t guaranteed. This means in some years the value of your account may be flat or even shrink. But over the long term, you can expect compounding to help your account grow larger, potentially substantially larger.

There is, however, a trade-off for tax deferral. With few exceptions, you give up access to your account value until you’re at least 59 1/2. If you withdraw earlier, the tax you’re deferred is due when you file your tax return for that year. You’ll also owe a 10% tax penalty. That’s because tax deferral is an incentive to save for retirement. So if you use the money for something else, it will cost you.

There’s another concession you make for tax-deferred growth: You must begin withdrawing from your TSP or other DC account when you turn 70 1/2. If you don’t, you’ll face significant penalties.

SAVING OR INVESTING?

There’s an important distinction between saving and investing.

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In a retirement savings plan, these assets are usually mutual funds that invest in stocks for growth, bonds for income, or a combination of stocks and bonds.

TRADITIONAL OR ROTH

All employers that provide retirement savings plans offer traditional tax-deferred accounts. In addition to tax-deferred earnings, you benefit by contributing pretax income, or earnings before income taxes are deducted. This reduces the amount of income that’s reported to the IRS and so the income tax you owe. Think of it as a bonus for doing the right thing.

Some employers, including the DoD, also offer a tax-free Roth alternative. If you choose this option, you contribute after-tax dollars, so there’s no reduction in your current income tax. But, when you eventually withdraw from a Roth, no income tax is due on the amount you take out, provided you’re at least 59 1/2 and your account has been open for five years or more. This means more money in your pocket later on, perhaps more than you would have saved by contributing pretax income.

The only complication in choosing a Roth is that any employer matching funds go into a tax-deferred account that’s identically invested rather than into the Roth. You won’t accumulate less, but you’ll eventually have to convert the tax-deferred account to a Roth or coordinate withdrawals from these accounts.

PORTABILITY

Portability—the ability to take your retirement plan assets with you when you leave the service and take a civilian job—is a major selling point for DC plans.

Portability gives you the flexibility to consolidate your retirement accounts for easier recordkeeping. All you have to do is notify your new employer (if that plan accepts transferred assets) or the trustee of an IRA into which you want to move the assets.

When you authorize a direct transfer from your existing retirement account to a new plan or IRA, the tax-deferred status of the account value remains intact. All you have to do is choose among the investment products available in the new account.

Alternatively, you can stick with your TSP account, since its investment options are hard to beat. Your account will continue to accumulate tax-deferred earnings.

What you don’t want to do is cash out. Not only will you owe taxes on the lump sum you receive and the 10% tax penalty. You’ll also have to start saving for retirement all over again, beginning with a zero balance.

MENU CHOICES

When you’re part of a retirement savings plan like TSP, your employer offers a menu of investment choices. This menu lets you choose a combination of investments that put your money to work in different ways. This strategy, called diversification, has the potential to help reduce the risk of losing money or falling victim to inflation while, at the same time, increasing return.

One of the menu choices is designated as the default investment for participants who are automatically enrolled in the plan. Default investments are designed to provide a diversified mix in a single package.

A target date fund, for example, includes a number of different funds under its umbrella. Some of these funds focus on growth and others on providing income. As time goes by and investors in the fund approach retirement, the balance among the funds gradually shifts from an emphasis on growth, which carries higher risk, to an emphasis on reducing risk and generating income.

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Defined Benefit Plans

A pension provides long-term financial security.

If you serve in the active component of the armed forces for 20 years or more, are a member of the Reserve component with the equivalent of 20 years of service, or have a qualifying medical disability, you’re eligible for a lifetime government pension when you retire.

The income you receive depends on your retirement pay base and your length of service—common factors in calculating a defined benefit pension. In addition, you’re entitled to a cost of living adjustment (COLA) in years when rising inflation triggers more than a minimal increase in the Consumer Price Index (CPI).

Unlike civilian pension payments, which typically don’t begin before you reach a specific age, such as 65, military pension payments begin as soon as you leave the service. There is an exception, though. Reserve members are generally not eligible to receive their pensions until they turn 60, regardless of the age at which they retire.

WEIGHING THE ODDS

As valuable as a pension can be, if you’re not planning on a military career of at least 20 years, you won’t be eligible. Currently only 49% of officers and 17% of enlisted men and women reach that milestone.

Job satisfaction is one consideration, both from your perspective and your family’s. If you’re excited about the next 10 or 15 years of career challenges and opportunities as you rise through the ranks, you might feel confident that you’ll have a pension to count on.

But if you see military service as a good transition into a civilian job that really interests you, it’s less likely that you’ll qualify for the security a pension can provide. That makes it even more critical to contribute as much as you can to your TSP account. Those savings plus retirement savings you accumulate in your civilian life can compensate for not having a pension.

If you anticipate making military service your career, it’s probably smart to analyze, to the extent you can, how your branch of the service is likely to evolve over the next decade and how potential changes might affect your career. For example, if there’s a continuing trend toward downsizing, how likely are you to face involuntary separation? Are your skills the ones that are likely to be the ones in greatest demand as the force modernizes?

IN THE VANGUARD

Military pensions have a long history in the United States. In 1776 the Continental Congress passed a resolution to ensure that those disabled in the fight for independence would receive a pension of half their monthly pay for life or as long as the disability lasted. Over time, the program expanded to cover military widows and orphans, veterans in financial need, and ultimately all those who served for at least 20 years.

The dollar amount, known as the retirement pay base, on which a military pension is calculated depends on your base pay and the date you joined the uniformed services.

Base pay is what you earn excluding the housing and subsistence allowances that are part of your overall compensation and any additional benefits or special pay. If you joined the military any time after July 31, 1986, your retirement pay base is determined by your average base pay during the 36 continuous months it was the highest—your High-3.

As with most pensions, those with the highest earnings and the longest tenure reap the largest benefit though there is a ceiling, or cap, at the top of the pay scale.

JOINING THE RESERVES

Another route to a military pension is combining the years you spend on active duty with enough time in the Regular Reserve component to satisfy the requirement of 20 years of qualifying service.

In that case, the monthly amount to which you’re entitled is calculated differently from the formula that involves years of service. But the end result—regular monthly income during retirement—provides similar financial security.

The more time you spend in Active Service, including active duty, active duty for training, and annual training, the more quickly you can accumulate the retirement points you need.

SURVIVOR BENEFITS

Another feature of the military retirement system, the Survivor Benefit Plan (SBP), provides lifetime income, including a COLA, for surviving spouses of retired servicemembers who have served long enough to qualify for a pension.
Automatic Enrollment

When you join the armed forces after January 1, 2018, you’ll be automatically enrolled in the Blended Retirement System (BRS). After 60 days—about the length of basic training in most branches—regular contributions will begin to flow into a Thrift Savings Plan (TSP) account that’s been established in your name.

Part of the contribution comes from a payroll deduction from your base pay each pay period, and 1% comes automatically from the DoD.

**GETTING AN EARLY START**

One of the main benefits of automatic enrollment is that you get an early start on investing for retirement. It would probably be tempting, if it were up to you to enroll, to put off signing up. In fact, planning for something that’s not likely to happen for forty or fifty years might seem like a waste of time.

But waiting is a big mistake. That’s because the longer you’re part of a plan like the TSP, the longer you have to benefit from the power of compounding.

**AUTOMATIC ENROLLMENT**

When you’re automatically enrolled in a retirement savings plan, your employer chooses the rate at which contributions will be deducted from your pay. That’s called the default rate. The employer also chooses how your contributions will be invested. That’s called the default investment. In the BRS, the default rate is 3% of base pay, and the default investment is a TSP lifecycle (L) fund.

For example, if your base pay is $1,500 a month, or $750 each pay period at the time you’re initially enrolled, you’ll contribute $22.50 ($750 x 0.03 = $22.50) twice a month. That’s $540 per year. Then, as you move up in rank over the years, and your pay increases, the amount you contribute will increase as well.

For the first two years you’re in the BRS, the DoD contributes an automatic 1% of your base pay. Using the same $750 per pay period, the DoD would add $7.50 ($750 x 0.01 = $7.50) twice a month to your account. As you begin your third year of active duty, the DoD will also begin to match your contribution at a rate of 100% of the first 3% of base pay and 50% of additional contributions up to 5% of base pay.

For example, if, at the two-year mark, your base pay has increased to $1,900 a month, or $684 each pay period, the DoD would add $28.50 plus the automatic 1% ($950 x 0.01 = $9.50). That’s a combined total of $66.50 a pay period or $1,596 a year.

**CAN YOU SPARE $28.50?**

If your first reaction is, “Hey, I need that $28.50 today not 50 years from now!” you’re not the only one who thinks that way. Retirement is a very long way off and it may be hard to keep up with your bills on what you’re earning.

But consider this: If $1,596 a year was added to your account every year for 45 years, and the earnings compounded at an average annual rate of 6%, you’d have an account worth about $451,000.*

And this: If you had used the $28.50 to buy pizza, you’d have an empty box.

**COMPOUNDING IN TSP**

In a bank savings account, compounding occurs when the interest you earn on your principal, or account balance, is added to that principal. The result is a larger base on which future interest is figured. So over time the dollar value of your account increases. Of course, if you take money out, you shrink the principal and slow down the accumulation process.

Compounding works a little differently in an investment fund like those available in the TSP. The contributions you and the DoD make every pay period are used to buy shares in the fund. All the earnings those shares produce are likewise reinvested to buy more shares. So over time the number of shares you own always increases. That’s the good news.

But investment accounts are different from savings accounts. If you have $100 in a savings account, the value of the account is $100 plus any interest you earn. The value of an investment account, though, depends on two things: the number of shares you own and what each of those shares is worth, as measured by the share price.

What can make you nervous as a new investor is that share prices change. They can and often do go up, but they can also go down before they go back up again. Since you have lots of time before you’ll need to withdraw the retirement money in your account, you can ride out those ups and downs. That gives compounding plenty of time to work in your favor.

**PIZZA TODAY**

If you spend $28.50 on pizza today it’s gone. And you only get to enjoy the one you just ate. But if you save $28.50 a month, the earnings compounded at an average annual rate of 6%, it could be worth over $451,000 after 45 years.*

* This simplified hypothetical example assumes 45 years of equal-dollar contributions. The DoD matches contributions through 26 years of service but not longer.
Spotlight on TSP

You can find the information you need to make smart decisions.

The federal Thrift Savings Plan (TSP) provides access to a user-friendly retirement savings plan for members of the armed forces and other government workers. And the DoD gives you a head start by enrolling you in the plan and setting up an automatic 3% contribution from your earnings each pay period that goes into the default investment, a lifecycle fund.

But it’s up to you to explore all the investment options and contribution levels to take full advantage of the plan.

INVESTING MADE SIMPLE

One of the great benefits of automatic enrollment is that it simplifies decision making. The initial rate at which you contribute and the way your money is invested are set. Choices like that, especially if you’re making them for the first time, can be intimidating. And if you’re afraid of making a mistake, you may decide it’s easier to do nothing about investing—which is the worst choice you can make.

But it’s also good to know that with the BRS, you’re not locked in to either the default contribution rate or investment choice. You have the right to contribute at a higher or lower rate. Of course, if you want your account value to grow larger, higher is the way to go. Similarly, if you would rather put your money into the individual funds offered in the TSP, you can make the switch whenever you’re ready.

CHOOSING A ROTH

One change you might consider right away is having your contributions go into a tax-free Roth account rather than the default tax-deferred account. All you have to do is authorize the change on the TSP website using the automated ThriftLine or by talking to a TSP representative.

Unlike contributions you make to the default tax-deferred account, those you make to a Roth don’t reduce your current taxable income or the income tax you owe. But the most important difference is what a Roth account will let you do in the future. You’ll be able to take totally tax-free withdrawals after you’re at least 59½, provided your account has been open at least five years. Chances are your income and your tax rate will be higher then than it is now. So tax-free income could mean substantially lower taxes, and more money in your pocket, during retirement. And while withdrawals are required from the default tax-deferred account every year after you reach 70½, withdrawals are never required from a Roth account.

If you want to take advantage of both tax deferred and tax-free withdrawals, you can split your contributions between a traditional and a Roth account any way you choose—for example on a 50-50 or 25-75 basis, or using some other proportion. The only limitation is that the combined total contributions will be allocated to them on the percentage basis you have designated.

The G (for government) Fund invests in a portfolio of US Treasury securities. The F (for Fixed Income) Fund has 84% of its assets in stock funds, while the C (for Common Stock) Fund has 74% of its assets in the G Fund to preserve account value for servicemembers invested in this 2010 and was converted to an income fund, eventually L2060. The other four funds (F for Fixed Income, C for common stock, S for small and mid-sized company stock, and I for international stock) are index mutual funds. An index fund is designed to mirror the performance of a specific stock or bond index by owning all, or a representative sample of, the securities in the index. The L Funds, which are funds of funds, include all five individual investments (G, F, C, S, and I), the contributions will be allocated to them on the percentage basis you have designated.

The L (for lifecycle) Funds (L2020, L2030, L2040, L2050, and L2060) offer a number of advantages. One of the great benefits of automatic enrollment is that it simplifies decision making. The initial rate at which you contribute and the way your money is invested are set. Choices like that, especially if you’re making them for the first time, can be intimidating. And if you’re afraid of making a mistake, you may decide it’s easier to do nothing about investing—which is the worst choice you can make.

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TAKING AIM AT A TARGET

Lifecycle funds, including the TSP’s L Funds, are sometimes described as target date funds. That may provide a clearer sense of what they’re designed to do. Each L Fund is focused on a particular target date that’s part of its name and adjusts it portfolio. For example, the L2050 Fund is designed to mirror the performance of a specific stock or bond index by owning all, or a representative sample of, the securities in the index. The L Funds, which are funds of funds, include all five individual investments (G, F, C, S, and I), the contributions will be allocated to them on the percentage basis you have designated.

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TSP INVESTMENT CHOICES

If you stick with the default investment, your contributions plus the automatic 1% and the matching contributions from DoD you’ll qualify for after completing two years of service will go into a lifecycle (L) fund, called the L2050. It’s one of a series of L Funds, now including L2020, L2030, and L2040 and eventually L2060.

If you prefer to use one or more of the five individual investment funds (G, F, C, S, and I), the contributions will be allocated to them on the percentage basis you have designated.

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PRODUCING RESULTS
Achieving the investment result you want depends on several factors. You have direct control over some of the most influential ones, including how much you contribute to your account, how many years you contribute, and which investments you choose.

RISK AND RETURN
As you make investment choices, it also helps to understand the direct relationship between risk and return. As with other things in life, the more risk you’re willing to take, the greater the return it’s possible to achieve.

CORE INVESTMENTS
Most investors focus on three categories of investments, called asset classes.

- Stocks and the funds that invest in stocks, described as equity investments. In the TSP, Funds C, S, and I are stock funds, Fund F is a bond fund, and Fund G, which invests in relatively short-term US Treasury securities, in some ways resembles a cash equivalent fund.
- Bonds and the funds that invest in bonds, described as fixed-income investments. You can put your contributions into any or all of the individual funds, divided among them in any proportion you choose. Or, you can stay in the default L Fund for your entire time in the armed forces. The automatic and matching DoD contributions to which you’re entitled are invested the same way your own contributions are.
- Cash and cash-like investments, sometimes called cash equivalents.

INFLATION RISK
Inflation risk is a greater problem with cash equivalent investments and fixed-income investments that pay a low rate of interest. In this case, you don’t lose money but your money loses its buying power because your investment earnings don’t keep up with inflation, or the regularly increasing cost of goods and services.

WHY WAIT?
What keeps many people from achieving their financial goals is fear of losing money if they invest. All investments do, in fact, carry some risk.

For one thing, a gain on amounts you invest, which is called your return, isn’t guaranteed, as interest on a certificate of deposit (CD) or savings account is. Return can actually be negative in some years.

But you have to balance this possibility against the long-term history of positive results provided by stocks, bonds, and cash equivalents. While it’s true that past performance doesn’t guarantee future returns, you can be sure that if you don’t put your money to work by investing it, it won’t grow quickly enough to meet your goals.

THE AGE FACTOR
When you make investment decisions, your goals are a major factor, but so is your age. The younger you are, and the longer you have until you’ll reach retirement age, the more investment risk you may want to take. In your TSP account, this means emphasizing stock funds, specifically the C, S, and I Funds or opting for the L2050 Fund.

- The added risk is offset by the potential to increase your return, which builds the value of your account.
- Equally important, you can afford to take the greater risk because you have a long time to make up for any negative returns, which you’re likely to experience from time to time.

On the other hand, as you grow older, you may want to reduce your exposure to risk and preserve your account value by shifting some assets from more risky to less risky investments. But it’s often a good idea to continue to hold stock funds, since the growth they can provide is one way to replenish the amounts you withdraw. It’s also a way to help ensure that you don’t outlive your money.

CONTRIBUTION POWER
If you contribute as little as 1% of base pay to your TSP account, you’re entitled to contribute up to 100% of any special, incentive, or bonus pay you receive, including all or part of your career continuation pay. There’s no DoD match for these contributions, but the cash infusions increase the balance on which earnings can accumulate.

Special rules apply to tax-free combat pay deposited to your TSP account. If the money goes into a tax-deferred account, the contribution will be tax free when you withdraw. But earnings on the contribution are tax deferred, so they’ll be taxed as you withdraw them. However, if you deposit the money into a Roth account, both the contribution and earnings on the contribution are tax free at withdrawal.

If you contribute combat pay, though, you’ll probably want to consult an experienced tax adviser to ensure that your contributions don’t exceed the legal limit and that you report withdrawals correctly when you file your tax return.
How Mutual Funds Work

To make smart decisions, you need to understand your choices.

It’s possible, even likely, that in the first few months you participate in the BRS you don’t spend much time thinking about choosing investments. A 3% contribution from your base pay plus 1% from the DoD will be going into your tax-deferred L Fund. Case closed. And it may stay that way.

But as you learn more about the power of investing to help you meet your long-term goals, you may want to consider the possibility of making future contributions to the individual funds that are available in your TSP account.

An ideal time to do this may be after your second year of service, when the DoD will begin to match year of service, when the DoD will begin to match a 3% contribution from your base pay plus 1% from the DoD will be going into your tax-deferred L Fund. Case closed. And it may stay that way.

As a TSP participant, you accumulate shares in either the L Fund or the funds that you have selected. That happens when the combined contributions from your pay and the DoD is used to buy shares in your name each pay period.

The higher the average annual return on your investments, the larger your TSP account balance will be. While it would be nice to be able to expect a return of 15% or 20% a year, that’s frankly wishful thinking. But is there a way to anticipate a reasonable rate of return? Though you should heed the caution that past results don’t guarantee future returns, it helps to look at historical returns. They’ll give you a sense of what’s possible.

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Lifecycle Funds

An L fund provides a turn-key approach to retirement investing.

Each fund that the TSP offers has an investment objective—whether growth, income, or preservation of principal. But no funds are more specific about their objective than the family of lifecycle, or L, funds. Their collective goal is to build and then preserve an account value that will help provide the income that fund investors need for a financially secure retirement.

Each L Fund’s time horizon is the number of years until the fund’s investors plan to begin withdrawing from the fund, usually after they turn 62 but sometimes later. The time horizon largely determines how the portfolio is allocated—specifically the weights assigned to the five individual TSP funds it holds.

For example, in the L2050 Fund, 84% of the assets are in stock funds (C, S, and I), 12% in the government fund (G), and 4% in the fixed income (F) Fund.

But in the L2020 Fund, with its short time horizon, the emphasis has shifted so that 47% of the assets are in the C, S, and I Funds, 48% in the G Fund, and 5% in the F Fund.*

*Allocation targets as of January 2018

SHIFTING THE FOCUS

An L Fund’s portfolio is typically adjusted in a gradual, planned reallocation four times a year, at the end of each quarter. The fund is also rebalanced each business day to ensure its assets are in line with the allocation it intends. Rebalancing occurs in response to changes in market conditions, such as an exceptionally strong stock market performance or an increase in interest rates.

The pace of the reallocation is known as the fund’s glide path and determines the allocation at the designated, or target, date.

The logic for adjusting the allocation is that a stock-heavy portfolio, even if it is well diversified, tends to be more volatile than a portfolio with larger allocations to the G and F Funds. Volatility increases the risk of your account losing some of its value, especially in the short term. That becomes less and less appealing as the time you’re planning to start withdrawing from your account approaches. That’s why L Funds shift their allocations over time away from stocks and into government funds.

But you have to remember that returns on government securities, while not volatile, expose you to inflation risk and the possibility of inadequate income. The longer you live in retirement, the greater this risk becomes.

BEYOND THE TARGET DATE

When your retirement is years in the future, one question you may not think to ask is what happens when your L Fund reaches its target date. The answer is that it converts to an income fund and keeps your assets invested as you and other fund owners withdraw money over time.

For example, the current TSP Income fund, formerly the L2010 Fund, has 80% of its assets in fixed income and government securities and 20% in stocks. Even more conservative lifecycle funds eliminate stock holdings entirely at the target date. On the other hand, some more aggressive lifecycle funds maintain substantial stock holdings for 30 years or more beyond the target date, only gradually reducing the allocation to 20%.

It’s an important difference, since the way a fund is invested has a major impact on the amount that’s likely to be available each year for the rest of your life.

MAKING SMOOTH MOVES

If you change your mind after investing your assets, you can move money out of an L Fund and into individual TSP funds at any time by making an interfund transfer (IFT) request. The only exception is that after you’ve made two IFTs in a month, additional transfers in that month must go into the G Fund. However, making multiple changes in quick succession rarely if ever improves the performance of your portfolio.

Transfers work the other way as well. If you allocate your contributions to individual funds when you begin to contribute to your TSP account, you can always move your account balances into an L Fund at any point in your career.

Any transaction fees you incur for an IFT are nominal, unlike the high fees and significant penalties charged by some other retirement investments you may be offered, such as fixed, variable, or index annuities.

A STANDALONE CHOICE?

The customary approach to investing in an L Fund is to make it your only TSP investment. Because the fund is regularly and professionally reallocated to suit the approximate number of years until you begin withdrawing, you avoid the responsibility of having to do the reallocation yourself.

As an alternative, you might want to use an L Fund for part of your portfolio while diversifying into other funds. For example, suppose you’re willing to take on more investment risk to realize a potentially higher return than the L Fund may provide, especially as it nears its target date.

In that case, you might allocate part of your contribution to the appropriate L Fund and the rest to a combination of stock funds.

It’s a good idea to discuss investment decisions with an experienced professional, such as an accredited military financial counselor, who can help you evaluate the risk involved so you can determine what’s best for you.
Investing for Growth

A growing account value requires nurturing.

When you invest for growth, your goal is to increase the value of your account. You want it to be worth more—ideally significantly more—than the amount you and the DoD contribute to it. While there’s no guarantee you’ll be as successful as you’d like to be, choosing appropriate investments is an essential first step.

What are those investments? When you participate in the TSP, they’re the three stock funds—C, S, and I. When you invest outside the TSP, perhaps in an individual retirement account (IRA), they include individual stocks, other stock mutual funds, exchange traded funds (ETFs) that invest in stocks, and real estate investment trusts (REITs) that invest in commercial real estate.

THE EQUITY ADVANTAGE

When you buy shares of a stock, you have an equity, or ownership, interest in the corporation that issued them. As a part owner, however tiny your share of the company, you stand to benefit if it’s profitable. Often, though not always, a profitable company pays out a portion of its gains to shareholders, or owners, as a quarterly dividend.

What’s more, the stock prices of a successful company tend to increase over time because investors want to buy shares. Since there is only a limited supply, demand drives the price up. If a stock’s price goes up, you can sell your shares for more than you paid for them. That gives you a profit, known as a capital gain.

The alternative to selling is to hold on to your shares as their price goes up. Their growing value provides the increase in account value you were seeking. And if you reinvest all your dividends and capital gains, you’ll provide an additional boost to your quest for growth.

Of course, stock prices sometimes go down instead of up, and dividends are sometimes cut. You have to anticipate that. But offsetting this risk is the fact that, over long periods of time, stocks in general, though not every individual stock, have always provided a financial gain.

INDIRECT OWNERSHIP

You get the same potential benefits by owning stock mutual funds and ETFs as you do by owning stocks. But instead of direct ownership, you own these stocks indirectly. That’s because what you actually buy are shares in a fund or ETF that owns a portfolio of individual stocks.

The advantages of using funds and ETFs is that you don’t have to make the hard decisions about which stocks to buy, what to pay for them, and when to sell them. Those decisions are made for you.

What’s more, there’s a great variety of funds. This makes it relatively easy to find funds that match your objectives and your attitude toward investment risk.

In addition, mutual fund and ETF share prices tend to change more slowly than the share price of individual stocks. This reduces volatility risk, or the possibility that a price will drop suddenly, exposing you to a potentially big loss if you were to sell when the price was down.

The reduced risk occurs because each fund owns dozens, or sometimes hundreds or even thousands, of different stocks. While some of the underlying stock prices may change quickly at any time, it’s much less likely that all of them will drop at the same time.

INDEX FUNDS

You can take two approaches to building the value of your investment portfolio with stock mutual funds. One is to invest in index funds like the funds offered in the TSP. The other is to invest in actively managed funds.

An index fund portfolio holds the investments that a market index tracks. For example, the TSP Fund C is invested in an index fund linked to the S&P 500 index that owns the 500 large and medium-sized US companies in that index. TSP Fund S is invested in an index fund that tracks the Dow Jones US Completion Total Market. That index includes several thousand mid- and small-company US stocks that aren’t included in the S&P 500.

An index fund’s objective is to replicate the performance of its underlying index. That’s why index investing is also called passive investing. The portfolio is determined by what the index measures, not by an active manager.

ACTIVELY MANAGED FUNDS

In an actively managed fund, a professional manager chooses the
One aspect of retiring that makes many people uneasy is whether they’ll have enough money to cover their needs and do the things they enjoy. They won’t be paid every two weeks or every month. Yet they’ll still need to pay their living expenses.

Social Security helps to cover some of those costs, as does a pension if you have one. But the real difference between living comfortably in retirement and struggling to make ends meet is the amount of income you’ll have from the investment assets you have accumulated. That income generally includes the earnings your investments produce each year plus a percentage of the total value of your assets.

**INCOME INVESTMENTS**

Most investments that are described as income investments pay interest, typically at a rate that’s fixed when the investment is issued, or made available for purchase. For example, corporations sometimes raise money to fund expansion or other projects by issuing bonds for investors to purchase rather than selling stock. Local, state, and federal governments also raise money by issuing bonds.

To encourage you to buy their bonds, these issuers promise to return your principal—the amount you invested—at the end of the bond’s term and pay you interest for the use of your money. It’s similar in some ways to buying a certificate of deposit (CD), where you earn interest for the CD’s term and then get your money back.

This sounds like a good deal to many investors, especially those who are new to investing or worried about losing money with stocks. Bonds have a fixed value, and though their prices do change during their term, change tends to happen fairly slowly and rarely dramatically.

So why does the TSP L2050 Fund, the default investment for people entering the armed forces now, have only 16% of its assets in interest-paying funds and 84% in stock funds?

**IT’S ALL ABOUT EARNINGS**

Compared to equity investments, interest-paying investments have a more limited potential to provide growth in value. Since the price of a stock has the potential to double or more over a period of several years, and many stocks provide dividend income, the return on stocks over time may be substantially greater than the return on most bonds.

If early in your career you put more than a small percentage of your twice-monthly contributions into income funds, especially the G Fund, you run the very real risk that your earnings won’t keep up with inflation. This can undermine your potential to increase your account value.

**HOW BOND FUNDS WORK**

There is an important difference between owning individual bonds and owning a bond fund. With an individual bond, you know the interest rate you’re earning and when the bond’s term ends. That’s called its maturity date, and it’s when you get your principal back.

A bond fund, like other mutual funds, holds many different investments—in this case a portfolio of individual bonds, each with its own interest rate and maturity date. So when you buy a bond fund, you’re not promised either earnings at a specific rate or return of principal.

Instead, when you buy shares in a bond fund, you receive income distributions from the interest paid by the bonds in the fund’s portfolio pay. You also receive your share of any capital gains the fund realizes from selling bonds for more than it paid to buy them.

The fund will buy back any shares you want to sell. You might do that, for example, if you decide to move some assets from your bond fund to a stock fund.

Like stock funds, bond funds can be index funds or actively managed funds. The TSP Fund F is an example of the former. Its assets are held in a separate account that tracks the Bloomberg Barclays US Aggregate Bond Index, and its portfolio changes each time the bonds in the underlying index change. Fund G, though also an income fund, isn’t invested in a mutual fund. It owns a portfolio of US Treasury issues.

**NEARING RETIREMENT**

When you’re within ten or fewer years of leaving the work force for good—which could be up to forty or more years after you’ve left the armed forces—you’ll probably want to move some of the assets in your TSP portfolio from the C, S, and I Funds to the F and G Funds to reduce the risk to your portfolio of a stock market downturn.

Even then you may want to leave some assets in the stock funds for their growth potential. While the G Fund, in particular, protects your principal, it provides very little growth in value. And since there is a very real possibility that you’ll live 15 or 20 years after you stop working, it may be smart to continue to invest for some growth for as long as possible.
Allocate and Diversify

Successful investing isn’t something you can do by the seat of your pants.

If you’re serious about meeting your financial goals, you need to make strategic investment decisions. You can start by allocating your portfolio, which means dividing your principal among different categories of investments, usually on a percentage basis. The core categories, called asset classes, include stocks and stock funds, bonds and bond funds, and cash equivalents. Each asset class shares a set of defining features that distinguishes it from the others. For example, all stocks and stock funds give you equity in the company issuing the stock.

As a next step, you diversify, or achieve variety, within each asset class. That’s important because smaller categories within each broad asset class typically behave differently from each other even though they all share the defining features of that class. For example, all bonds mature after a specific number of years. But bonds with one-year terms are much less vulnerable to inflation than bonds with 30-year terms.

Allocation is a strategic move because it positions you to benefit from investment performance while helping to protect you against investment risks.

Here’s why. No one asset class consistently provides the strongest return year after year. And different classes tend to produce their strongest returns at different times. That’s the result of a number of factors, including what’s happening in the markets themselves and in the overall economy. For example, if corporations have strong earnings and increase their dividends, they attract investors. That drives up their stock prices, increasing return. But if earnings falter while interest rates are rising, stock return may decline while bond return rises.

What’s more, a class that has been a strong performer for a year or two often turns out to be a weak performer in the next year. While this pattern is predictable, its timing isn’t. So it makes sense to own some stocks and some bonds all the time. Then you stand to benefit regardless of which one is performing better.

While allocation positions you to have a profit, it also helps to reduce investment risk. If you have all your money in stocks while stocks are doing well, what will happen in the next phase of the investment cycle when stock prices falter? You could have major losses. But if you always have some money in bonds, the gains in that asset class can help offset periodic losses in stocks.

Remember, though, that there is always a risk with investing. Allocation is a strategy—it doesn’t guarantee a profit or protect against losses in a falling market.

 Turns out, there’s a way to get the best of both worlds. You can allocate some money to stocks and some to bonds. Why? Because stocks and bonds can behave differently from each other. For example, if bonds are doing well, prices could be rising. But if stock prices are declining, this could result in a strong performance for bonds but a weak performance for stocks.

That’s why diversification is so important. It helps to spread your risk across different asset classes. That way, if one asset class is doing well, another might be doing poorly. This helps to balance out your overall portfolio performance.

_allocation is also commonly referred to as asset allocation. This is the act of dividing your investments among different asset classes, such as stocks, bonds, and cash, to achieve a desired level of risk and return. The purpose of allocation is to take advantage of the different performance characteristics of each asset class. For example, stocks typically provide higher returns than bonds, but they also come with higher risk. By allocating your money across different asset classes, you can create a portfolio that meets your individual needs and goals.

_allocation is also useful in retirement planning. As you approach retirement, you may want to reduce your exposure to stocks and increase your exposure to bonds, as you become less willing to take on risk.

_allocation is just one aspect of a well-rounded financial plan. It’s important to consider your overall financial situation, including your risk tolerance, investment horizon, and financial goals, when making allocation decisions. By working with a financial advisor or doing your own research, you can create a portfolio that aligns with your individual needs and goals.

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Other Ways to Invest

You’re not limited to one way to invest.

A rule of thumb for achieving long-term financial security is to save 10% to 15% of your pretax income. After you’ve contributed enough to your TSP account to qualify for the full match, you may want to explore other investment opportunities.

At the top of the list is a low-cost individual retirement account (IRA). It’s a good way to gain exposure to a broader range of investments than the TSP offers and further diversify your portfolio.

With an IRA you can take advantage of tax-deferral, just as you can with TSP.

In addition, you may want to open a taxable account. Your dividends, interest earnings, and capital gains are taxed in the year they’re paid. But the rate at which those taxes are calculated is always lower than the tax rate that applies to your regular income.

IRAs: DOING IT YOUR WAY

IRAs are personal retirement plans. You choose where to open your account—with a mutual fund company, bank, or brokerage firm—and how to invest your money. The financial institution you choose is the custodian of your account.

The only requirement for being able to contribute each year is that you have earned income, which is money you’re paid for work you do. What’s important, too, is that you can contribute to an IRA even if you’re participating in the TSP or another employer plan at the same time. It doesn’t have to be one or the other.

There are two types of IRAs: traditional, tax-deferred IRAs and Roth IRAs. The earnings in both types are tax-deferred, which means you don’t have to withdraw money to pay taxes on your earnings. As a result, your full balance can compound and your account value can grow more quickly.

When it comes to withdrawals, however, the two types of IRAs are quite different. With a traditional IRA, you’ll eventually have to begin taking money from your account and pay tax on those withdrawals. You can relax though—that doesn’t start until you’re 70½. That’s a lifetime from now.

With a Roth IRA, no tax is ever due on the earnings, even when you take them out, provided you are at least 59½ and your account has been open at least five years. And you’re never required to take withdrawals if you don’t want to or don’t need the money.

TAKING ADVANTAGE OF AN IRA

An IRA can be a valuable tool for managing your investments.

While you usually can’t withdraw from an IRA without penalty before you turn 59½, you can take out money if you need it for certain specific needs. These include buying a home, paying a child’s college tuition, or covering medical expenses. You’ll owe income taxes, but no penalty. And, if you have a Roth IRA, you can withdraw up to $10,000 tax free to buy a first home.

You can roll over, or move, money from your TSP account or other employer plan into an IRA when you leave your job for any reason. There are no penalties, no taxes due, and no loss of tax-deferred status. Like money in an employer plan, up to $1 million in an IRA is protected against creditors. The same is true of all the money in your TSP account. What this protection means is that you can’t be forced to withdraw to pay off any debts except federal tax liens.

DEDUCTIBLE IRAs

You may qualify to deduct your contribution to a traditional IRA—though not a Roth IRA—and reduce your current income tax. To qualify you must either not be eligible for an employer plan or have a modified adjusted gross income (MAGI) that’s less than the limit the government sets for the year. Of course, while you’re in the armed forces you are eligible for an employer plan.

But you may qualify for a deduction based on income. In 2018, those limits are $63,000, phased out at $73,000 if you pay taxes as a single filer and $101,000 to $121,000 if you’re married and file a joint return.

2018 INCOME QUALIFICATIONS

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TAXABLE ACCOUNTS

You might wonder why you’d bother with a taxable account when you can take advantage of tax deferral on other accounts. There are several reasons:

1. When you invest in a taxable account, you can invest as much as you are able and choose any investments you prefer, not just those offered by a plan sponsor. This may be an advantage in reaching your goals.

2. Dividends and capital gains are taxed at a lower rate than regular income, while all withdrawals from traditional tax-deferred accounts are taxed at the same rate as your regular income.

3. You can use the money for any goal that’s important to you, at any time you need the money.

4. You are never required to take withdrawals from taxable accounts, which gives you more flexibility in managing your retirement income.

5. You can make tax-exempt investments, such as municipal bonds, in a taxable account so no taxes are due on the interest they pay. But if you buy these investments in a tax-deferred account you actually owe tax on the interest.

WORD TO THE WISE: REINVESTMENT

If you own mutual funds in a taxable account, you can choose to take the earnings the funds distribute and any capital gains as cash. But at least until you retire, and probably longer, it’s always smart to reinvest so you can continue to build your account value.

With an IRA you can take advantage of tax-deferral, just as you can with TSP.

In addition, you may want to open a taxable account. Your dividends, interest earnings, and capital gains are taxed in the year they’re paid. But the rate at which those taxes are calculated is always lower than the tax rate that applies to your regular income.

There are two types of IRAs: traditional, tax-deferred IRAs and Roth IRAs. The earnings in both types are tax-deferred, which means you don’t have to withdraw money to pay taxes on your earnings. As a result, your full balance can compound and your account value can grow more quickly.

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Powering to the Finish

Retirement saving provides the extra kick you need to reach your goal.

You should expect a flurry of financial decision-making when you transition from military life to the civilian world, which could happen in your 20s, 30s, 40s, or 50s.

Whether you resign or retire from your branch of service, you’re likely to begin a new job where you can build on the retirement savings you’ve accumulated in your TSP account.

MANAGING YOUR ACCOUNT

One of the first decisions you may make is what to do with the balance in your TSP account—though there’s usually no need to act quickly. You’ll have three options.

Option 1: If your balance is at least $200, you can leave it in the TSP. Your balance will continue to compound, and you can reallocate your account holdings just as you could when you were contributing. And you’ll still benefit from being part of an extremely low-cost plan. However, you won’t be able to make additional contributions unless your new job is with the federal government.

Option 2: You can roll over your account value to an individual retirement account (IRA) when you leave the military or at any point in the future. The preferable method is to authorize a direct transfer from the TSP to the IRA trustee or custodian. You’ll want to choose a custodian that offers the types of investments you want to make and charges modest fees.

Option 3: You can have your account value transferred from the TSP to a new employer’s plan, but only if that plan accepts transfers. You’ll want to be sure the new plan offers comparable investment alternatives at comparable cost.

Look for an adviser who holds the CFP designation from the Certified Financial Planner Board of Standards, the CFP® designation from The American College, or is a fee-only adviser who is a member of the National Association of Personal Financial Advisors (NAPFA). The advice won’t be free, but it can be invaluable.

THE LUMP-SUM QUESTION

There’s one feature of the BRS that doesn’t require an immediate decision, but which you’ll need to address if you serve long enough to qualify for a pension. That’s the option of taking a lump-sum payment at the time you retire of either 25% or 50% of your pension benefit. In exchange, you agree to a reduced monthly benefit until you turn 67.

To calculate your pension benefit, or the total of the monthly amounts you would receive in retirement, the DoD uses your pay base, determined by your High-3 base pay and years of service, and your projected lifespan.

The lump sum you are entitled to will be 25% or 50% of that projected benefit, reduced by a factor called the discount rate, which the DoD sets. If the discount rate is high, your lump sum will be less than if the discount rate is low. But either way, the actual lump-sum amount you receive will be smaller than the percentage of your pension benefit you’ve selected.

One downside of taking the lump sum is that you’ll owe income tax on the full amount you receive, which could jump you into a higher income bracket and increase the rate at which the tax you owe is calculated. However, you may choose to take the payout in installments over several years, which would reduce the tax due each year and perhaps the total tax you owe.

As in other cases where you’re making an irrevocable decision about a retirement option, you’ll probably want to seek professional advice from a military financial counselor or a private-sector adviser with comparable credentials.

Terms of Retirement

When retirement assets are moved between accounts by plan officials, it’s technically a transfer. When you handle the move yourself, it’s a rollover. But in common usage, when money is moved from one tax-deferred account to another, it’s described as a rollover. Similarly, when you take money out of your account, it’s technically a distribution but is universally known as a withdrawal.
CALCULATING YOUR PENSION

The amount of your pension as a Reserve member depends on your equivalent years of service and is calculated in three steps.

1. Equivalent years are determined by dividing the total points you accumulate over the 20 or more years of qualifying service by 360.

2. The result is multiplied by the pension multiplier—2% under the BRS—to find your retired pay multiplier.

3. Your retired pay multiplier is multiplied by your retirement pay base to find your monthly pension amount.

You can increase your pension if you join the Retired Reserves when you retire. That way the base pay for your rank that applies when you turn 60 will be higher than the amount for your rank at the time you retired. Remember, though, that as a member of the Retired Reserves you could be called back to active duty or the Ready Reserves.

SOMETHING TO CONSIDER

As a Reserve member who may be part of a civilian employer’s 401(k) or similar retirement savings plan, you’ll want to be aware of a potential complication of participating in the TSP. That’s because you’re entitled to contribute up to the annual cap that Congress sets for these plans—$18,500 for 2018—across all TSP, 401(k), 403(b), or 457 plans in which you participate. (An employer’s matching contribution doesn’t count against the cap.)

If you contribute more than the cap, you face a potential tax penalty for each year the excess remains in your account. And keeping track of your contributions is strictly your responsibility. Employers don’t monitor what you may be adding to a different retirement account.

One approach if you find yourself in this situation is to contribute just enough to the TSP to qualify for the full match and then set a dollar limit for your civilian employer’s plan so that you reach but don’t exceed the cap. If you have an equal amount withheld from your employer’s plan each pay period, you may also qualify for that employer’s full match, if there is one.

CAREER CONTINUATION PAY

As a Reserve member participating in the BRS, you’ll qualify for career continuation pay at some point between your eighth and twelfth year of service. The Secretary of your branch determines the timing and the amount you’ll receive.

If you’re in the Active Guard Reserve or a Full Time Support member, you’re eligible for this bonus at the same rates that apply for active component members—between 2.5 and 13 times your monthly pay base. As a condition of receiving the bonus, you must agree to serve the required additional time in the Select Reserve.

If you’re serving in other Reserve categories, you’re eligible for continuation pay calculated with multipliers between 0.5 and 6 times your monthly pay base.
Asset allocation is a strategy for investing in different asset classes, such as stocks and bonds, to help manage investment risk without sacrificing the potential for a strong return. But asset allocation does not guarantee investment gains or protect against losses in a falling market.

Base pay is the amount you earn each month. It does not include housing and other allowances that are part of your total compensation or any additional benefits or special pay. Base pay is also known as basic pay.

Blended Retirement System (BRS) is the military retirement system that took effect on January 1, 2018. It combines a pension with a retirement savings plan that features an automatic DoD contribution of 1% of base pay for all service members plus a matching contribution of up to 5% of base pay if you contribute to a Thrift Savings Plan account.

Career continuation pay is an incentive payment available to all BRS participants at some point between your eighth and twelfth year of service at the discretion of the Secretary of your service branch. As a condition of the payment, you agree to serve three additional years.

Compounding occurs when investment earnings are added to investment principal, creating a new, larger base on which future earnings are calculated.

Diversification is a strategy for managing risk and enhancing return that involves buying a number of different investments within each asset class. But diversification does not guarantee a profit or protect against losses in a falling market.

Index is a list of investments that share one or more relevant characteristics, such as asset classification, market capitalization, or investment objective, and whose changing collective performance is an indication of how that segment of the market is performing.

Individual retirement account (IRA) is a retirement savings plan you set up with a financial institution. Your IRA earnings grow tax-deferred and are reinvested to help build your account value. You can choose between a traditional tax-deferred account and a tax-free Roth account.

Lifecycle funds are intended to provide a source of retirement income starting at a specific future time, such as 2040 or 2050. Each lifecycle fund gradually shifts its investment emphasis from growth to income as the target date approaches.

Portability means that you can move investment assets you have accumulated in one retirement savings plan to another plan without losing their tax-deferred status. For example, when you retire or leave the service for any reason, you can move assets in a TSP account to an IRA or to another employer’s plan if the plan accepts transfers.

Retirement pay base is the amount on which your pension is calculated in the Blended Retirement System. It depends on your High-3, or average base pay during the 36 continuous months it was the highest and the date you joined the armed forces.

Return is the gain or loss on your investment principal. It is determined by the change in an investment’s price over a specific period, such as a year, plus any earnings the investment provides.

Tax-deferred means that any taxes that would otherwise be due on earnings in a retirement savings account are postponed until you withdraw money from the account. In some accounts, taxes are also deferred on contributions you make to the account. Annual withdrawals are required from tax-deferred accounts after you turn 70½.

Tax-free Roth is a retirement savings account in which earnings are tax deferred and withdrawals are tax free provided you are at least 59½ and your account has been open at least five years. Contributions are never tax-deferred. Withdrawals are required after 70½ from an employer plan Roth account but not from a Roth IRA.

Vesting means you are eligible to receive income from your employer’s retirement plan or plans, based on having completed the required years of service. Vesting periods differ in different types of plans.
GUIDE TO THE MILITARY’S BLENDED RETIREMENT SYSTEM

is the essential guide to the Department of Defense’s new retirement initiative. The guide clearly describes the key features and benefits of the new approach, including the tax-deferred TSP account, matching contributions from the DoD, and investment choices and strategies for building a retirement portfolio.

Guide to the Military’s BLENDED RETIREMENT SYSTEM

• Choosing Investments
• How Matching Works
• Defined Benefit Plans
• Defined Contribution Plans
• Lifecycle Funds

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