U.S. News & World Report

How to Set Up Your First 401(k)

401(k) decisions at your first job can impact your ability to retire.

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Jan. 22, 2019

NEW EMPLOYEES HAVE MANY expenses competing for their limited paychecks. Student loan bills, food, rent and utilities can easily consume a starting salary. But 20-somethings have one very important thing going for them. Young people are in the best position of their lives to start saving for retirement.

Here's how to set up your first 401(k):

- Decide how much to contribute.
- Get a 401(k) match.
- Consider a Roth 401(k).
- Scrutinize autopilot settings.
- Pick diversified 401(k) investments.
- Keep 401(k) fees low.
- Balance retirement saving with other expenses.
- Roll over your 401(k) when you change jobs.

Consider each of these tips to establish a 401(k) plan and begin building a nest egg for retirement.

Decide How Much to Contribute.

Money you tuck away for retirement in your 20s has decades to compound. Make savings automatic, beginning with your first paycheck, and try to ramp up your contributions whenever you get a raise. "Our goal for new employees just getting into the workforce is we want to get them to save 10 percent of their gross wages as soon as possible," says Mark Berg, a certified financial planner and founding principal of Timothy Financial Counsel in Wheaton, Illinois. Those who can't afford 10 percent right away can start smaller. "We try to target 4 to 5 percent initially and then as they get raises we'll add a percent or two to the amount they are putting in," Berg says. If your company has a waiting period before new employees are allowed to join the 401(k) plan, make note of that date and begin participating as soon as you are eligible.

Get a 401(k) Match.

An employer match is a powerful incentive to participate in a 401(k) plan. A company match of 50 percent of contributions up to 6 percent of pay for an employee earning $50,000 annually can boost retirement savings by $1,500 each year. If your employer doesn't offer a 401(k) match, it's still worthwhile to invest in a 401(k) for the tax break. Young employees can contribute up to $19,000 to a 401(k) in 2019 and defer income taxes on the amount contributed until retirement.

Consider a Roth 401(k).

Some companies offer a choice between a traditional and Roth 401(k). Traditional 401(k) deposits give you a tax break for the year you make the deposit, but income tax is due when the money is withdrawn. Roth 401(k) contributions are made with after-tax dollars and withdrawals in retirement are tax-free. The Roth option can be a good deal for young people who are currently in a low tax bracket. "People who potentially will retire in a higher tax bracket than they are in right now should use a Roth," says Clark Kendall, a certified financial planner and president of Kendall Capital Management in Rockville, Maryland.

Scrutinize Autopilot Settings.

Many large companies now automatically enroll new employees in retirement accounts unless they opt out. The most common default investment is a target-date fund. But the default investment strategy may not be right for everyone. Pay attention to how much is being deducted from your paycheck, how that money is being allocated and what fees you are being charged.

Pick Diversified 401(k) Investments.

Each 401(k) plan has a small selection of investment options. Choose the mix of stock funds, bonds and cash that fits your personal risk tolerance. If your portfolio loses money in your 20s, you have plenty of time to recover before retirement. Many people gradually shift their holdings to less risky investments as they get closer to retirement. Also, make sure you don't overinvest in your own company by holding too much company stock. "We recommend not to have more than 5 percent invested in any one company stock," says Donald Nicholson Jr., a certified financial planner for Donald W. Nicholson & Associates in Wilmington, Delaware.

Keep 401(k) Costs Low.

Pay attention to the fees and expenses associated with the investments offered by your company, which can cut into your returns dramatically over time. Investment fees are deducted from your returns, regardless of how the investment performs. "If the provider offers low-cost index funds, indexes are a nice, low-cost way to build a diversified portfolio," Berg says. Your 401(k) plan is required to send you an annual fee disclosure statement that lists the costs associated with each fund in the 401(k) plan. Check this statement each year to see if there is a lower cost way to invest for retirement.

Balance Retirement Saving With Other Expenses.

It can be difficult to save for retirement when you also have student loan payments. While it's a good idea to pay off credit cards or other high interest debt as soon as possible, student loans with low fixed interest rates don't necessarily need to be prioritized above retirement savings. "If you borrow money at 3 percent and can invest it at 4 percent, then you want to do that all day long," Kendall says. "If you borrow at 3 percent and invest at 2 percent, you are eventually going to go bankrupt." Also aim to accumulate an emergency fund of at least three to six months' worth of living expenses outside of your retirement account in case you lose your job or incur an unexpected expense.

Roll Over Your 401(k) When You Change Jobs.

When you move on from your first job, don't cash out your retirement account. 401(k) withdrawals before age 55 are hit with a 10 percent early withdrawal penalty and regular income tax on the amount withdrawn. Instead, consider leaving the cash in your old 401(k), moving the money into your new employer's 401(k) or transferring your nest egg to an IRA. All three options allow you to avoid penalties and continue tax-deferred growth. Also, some employers require workers to remain with the company for a certain number of years before the employee may keep the 401(k) match. Find out how your company's vesting schedule works and consider sticking around until you can take your employer's retirement contributions with you.