Photo attributed to Philip Brewer by a Creative Commons license

Straight Talk About Your 401(k)

2013 is upon us. For some of us, retirement looms directly ahead, but for many of us, it's so far in the future that it may as well be invisible. The Catch 22 of this is that the people who are nervous and panicky about not having enough to retire are in a worse place to be able to do anything about it than the twenty-somethings who don't even have retirement on their radar. Let's do the math.

A 25 year old who is able to save $100 per month will have $391,615 in her 401(k) when she retires at age 67, assuming a 5% rate of interest. That same 25 year old, if she waits until she is 35 to begin putting $100 in her retirement account, will have $182,158 when she retires. In other words, that initial ten years is enough to actually double her retirement account! If like many Americans, she doesn't start really saving for retirement until age 50, at $100 per month, she'll be left with only $46,162 – not anywhere near enough savings to live on for the next 10 to 30 years. So, what can you do?

Welcome to Compounding Interest

The reason that those first ten years matter so much is compounding interest. Each year that your 401(k) makes that rate of 5% (or more; we're using 5% as a fairly conservative rate), the next year's rate multiplies the new amount. In other words, if you put $1200 in your retirement account this year ($100 per month), and it makes 5%, next year that extra sixty dollars you made means that you're starting with $1260. And the following year, when you put $1200 in for a total of $2460, you multiply the whole amount by 5%, and you have $124 extra for a total of $2585. Wow! In your second year of putting $100 in per month, it is already making more than one month's additional amount every year. If you stay on track, by year 9, your 401(k) will be making more than six months of input every year! That ability to multiple itself is how you can grow a healthy retirement fund without breaking the bank.

Even if you stop putting money into your 401(k) after 10 years, due to the power of compounding interest, your retirement account will continue growing on its own and be worth $94,899 at age 67. That's almost a hundred thousand dollars, just by putting $100 per month in for ten years when you're young! Now, that amount won't get you far into retirement, but it does show you exactly how important starting your retirement savings plan early can be for your eventual retirement. Would you rather start saving a small amount now? Or have to save a huge amount of your paycheck later because you've cheated yourself out of years of compounding interest?

How Am I Supposed to Save For Retirement When I Live Paycheck to Paycheck?

If you're like 76% of Americans, you live paycheck to paycheck, and the thought of saving for retirement… well, that's seems like tomorrow's problem, doesn't it? Fortunately, even those who live paycheck to paycheck can save to a 401(k). The sneaky secret for starting a process of saving for retirement is the paycheck. If your paycheck showed up missing 1% this week, what would you do? Well, if you get paid a different sum each pay period, you probably wouldn't even notice the loss! In other words, if you were to speak to your payroll department and have them divert 1% to your retirement account, you probably won't even notice the difference.

You're thinking, "one percent? How is that supposed to help?" The way it helps is by showing you that you actually do have a little bit more money than you need to live on. So, 3 months down the road when you contact payroll and tell them that you want that 1% deduction turned into a 2% deduction, you won't notice that either! At this rate, by the end of the year you will be saving 4%, which may not be enough for a grand retirement yet, but it's a start.

Sneaky Secret Number Two: Don't Give Yourself a Raise

Every year or every couple of years, depending on where you work, you probably get a raise. Even though you survived living paycheck to paycheck on, say, $700 per week, once you get your 3% raise, you invariably find that you soon learn to live on $721 just as easily as you did on $700. In fact, most people will agree that the raise is so small that it's almost as if nothing has changed. If nothing has changed, why have a raise at all? The answer is, to fund your 401(k). Three percent doesn't do much to change your standard of living, but if you told payroll before that first raise check, to put that 3% into your retirement account, suddenly you're starting to make real progress on your retirement! After three years of denying yourself a 3% raise, plus that 4% you gave yourself in the first year, you will find you're putting 13% into your retirement account. And that's not bad. A 35-year old putting 13% of a $30,000 salary will have $592,015 by age 67.

If you're over 45, you aren't going to want to stop there. You'll want to sneak another few percentage points out of your paycheck by denying yourself a couple more raises.

The maximum that you can put into your 401(k) is $17,500 in 2013, and $23,000 for people over the age of 50 so they can make "catch-up" contributions. Ideally you will raise your contribution rate up to the point where you can put that maximum donation in.

Starting right now, and by applying the sneaky tricks of learning how to live on 1% less every few months and denying yourself raises, you will find it isn't as hard as you thought to reach those maximum contribution levels. And it's going to mean the difference between a comfortable retirement, and one where you're still living paycheck to paycheck. Good luck!

Megan J. Wilson is a personal finance and business writer for HomeMatters. She loves hiking, gardening, and traveling with her husband and son.