nj.com The Star-Ledger

Your Money: The best way to invest your pay raise

Published August 27, 2014
By **Karin Price Mueller/The Star-Ledger**

Q. I recently got a raise, and while I could use the cash, I know I should save more for retirement. Is my 401(k) a better choice (I save 4 percent of my salary now) or should I open a Roth IRA?
— More to invest

A. It's great to hear you want to invest more, but exactly where isn't an easy answer.

And the answer that's right for you won't necessarily be the right one for your neighbor, or your brother-in-law.
"Saving more money is always a great thing," said Jerry Lynch, a certified financial planner with JFL Total Wealth Management in Fairfield. "Over the long term, saving a few extra percentage points can mean the difference of retiring in comfort, or pushing back retirement a few more years."

So where do you put it?
Lynch says it's smart to have funds in a taxable account — one that won't be subject to penalties if you decide to cash out if you ever want to buy a home, start a business or just get out of a jam.
"Even cash earning zero percent can be a godsend and the most important part of any financial plan." he said. "Cash is king."
But if you already have three to six months of living expenses set aside in an emergency fund, and you have no need for other big-ticket costs in the near future, you'll want to think longer term.

Take a look at your whole financial picture. If you have credit card balances or other high-interest debt, this could be a good place to steer your extra money, said **Claudia Mott, a certified financial planner with Epona Financial Solutions in Basking Ridge.**
"With interest rates on credit cards exceeding 20 percent in some cases, using the proceeds from your raise to eliminate these debts would create a source of additional savings once the balances are gone," she said. "And think about how much you are saving by not paying all that interest."
If your emergency fund is in place and you don't have to focus on paying down debt, increasing your 401(k) contribution may be the best use of your raise if you aren't already making the maximum contribution, Mott said.
For 2014, individuals can contribute up to $17,500 in an employer-sponsored plan and those over age 50 may make a catch-up contribution of an additional $5,500.

Mott said adding to your 401(k) is appealing for two reasons.
"First, your contributions are pre-tax, which means you report less income on your return, thereby reducing the amount of tax you pay," she said. "Second, the growth and earnings in your 401(k) are tax-deferred so you will not pay any tax until you have to take required minimum distributions at age 70½."

A Roth IRA would be another option once you have taken full advantage of the pre-tax retirement savings option with your employer, she said. Roth IRA contributions are made with after-tax dollars and are therefore not tax-deductible, but withdrawals are not treated as taxable income like those from a traditional IRA or 401(k).

For 2014, the maximum contribution that can be made to an IRA is $5,500 with an additional $1,000 for those over age 50.
However, there are income limits.
"If you are single, the amount you can contribute is reduced if your income is greater than $114,000 or $181,000 if you are married and file jointly," she said. "This could put a crimp in your plans depending on your income."

E-mail your questions to askbiz@starledger.com