Don’t “Save” for Retirement! I’d Invest $500 a Month in Shares for a $25,000 Passive Income

Description

Building a nest egg large enough to produce a generous passive income in retirement is likely to be a key goal for many people.

Previously, it may have been possible to simply save money each month to achieve this aim. However, low interest rates over recent years, and especially after the 2020 market crash, mean that a cash savings account is unlikely to be helpful in building a retirement nest egg.

As such, now may be the right time to start buying shares on a regular basis. Even modest amounts invested in a diverse range of stocks could produce a generous income in older age.

Avoiding savings accounts

While having some cash on hand is always a good idea due to the potential for unforeseen circumstances, relying on savings to produce a retirement nest egg could lead to significant disappointment. They offer extremely low returns at the present time, as policymakers across the world have sought to stimulate the economy through a loose monetary policy.

In many cases, savings accounts may even struggle to keep up with inflation over the long run, as policymakers become more concerned about economic growth than a rising price level. As such, beyond having some emergency cash, avoiding savings accounts could be a sound means of improving the potential for a large retirement nest egg.

Making a passive income from shares

In place of savings accounts, a diverse portfolio of stocks could lead to a far more generous passive income. The stock market has a long track record of producing high single-digit returns that could provide growth to modest amounts of money invested on a regular basis.

Now may be an opportune moment to start investing in shares due to their low valuations. Many sectors have not yet fully recovered from the 2020 stock market crash. This could mean that they offer wide margins of safety that translate into high capital returns in the coming years. They may be able to catalyse a portfolio so that it produces a higher growth rate, and a larger nest egg, than investing in an index tracker fund that mirrors the performance of, for example, the FTSE 100 or S&P 500.

Building a $25,000 income

Even if an investor matches the performance of the wider stock market, they could invest a modest amount each month to produce a worthwhile passive income in retirement.

For example, assuming the same 8% annual total return managed by the stock market in recent decades, a $500 monthly investment could be worth $750,000 within 30 years. From this, a 3.5% annual withdrawal would produce an income of over $25,000. This could provide greater financial freedom and flexibility in retirement versus relying on cash. It could even allow an investor to retire earlier than would otherwise have been the case.

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