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Investment Strategies

Dangers of ‘set and forget’ — avoid pitfalls in retirement planning

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As Littleton-based engineer Rick Watson edged closer to retirement, he felt confident knowing his 401(k) was in order, and would provide him with the security needed to leave full-time work.

But at 55, Watson checked in on how his money was performing, and uncovered a cruel shock that set back his retirement plans by 10 years.

Watson learned he had made key mistakes:

- He only saved to his employer’s match, rather than to his own needs.
- His funds weren’t diversified enough, especially to withstand the market crash in 2008.
- And a significant chunk of his earnings was being spent on fees, unbeknownst to Watson.

With his retirement age abruptly pushed from 62 to 72, Watson found himself in the precarious situation becoming more familiar to Americans.

So, what went wrong? There are three main areas that have the potential to disrupt a retirement plan: contributions, asset allocations and fees. Consumers and employer plan providers should closely watch, and understand all three areas. A 401(k) shouldn’t be viewed as a “set-it-and-forget-it” security net, but rather, must be regularly maintained to ensure optimal performance.

Keep these things in mind:

- Contributions — While most plan participants are “saving to the match” (saving to the percentage an employer will match a 401(k) contribution), it may not guarantee a sufficient retirement fund on its own. It’s essential to conduct a retirement needs analysis to determine the total amount to be saved each month.

For example, the average employer match in a 401(k) plan is 3 percent of an employee’s salary. Consider William, 45. He earns \$95,000 per year and has a retirement account

balance of \$250,000. He wants to replace 75 percent of his current income in retirement at 65. If he saves only 3 percent of his own money and receives the same in matching contributions from his employer, in 20 years his account balance reaches \$1,569,121, assuming an 8 percent rate of return.

However, given William's life expectancy of 86, he would run out of money at 78. A needs analysis would tell him that to retire at age 65, he needs to save 15 percent (\$1,187 per month) of his own money along with his employer match.

- Asset allocation — Most individuals choose their investment funds upon enrolling in a 401(k), and never move them again. While a retirement savings plan doesn't need to be monitored weekly or even monthly, it's wise to check on 401(k) performance at least every six months. Namely, diversification should be watched closely. (More closely in particularly unstable market conditions.)

For example, investing in two high-performing funds five years ago, and neglecting to make changes since, could have resulted in overexposed risk during the economic downturn and significantly lowered equity.

When allocating assets, it's also important to understand and consider risk tolerance (the degree of uncertainty and fluctuation that an investor is comfortable with). Typically, a younger person who has more time until retirement will have a higher risk tolerance than an older person with less time.

However, more mature investors are finding that they're behind in their retirement savings and thus encounter a problem: They want to be conservative to protect their investments, but also need to be more tolerant of risk for potential larger payoffs. Attitude toward risk is a very personal decision, and should be weighed and discussed with plan advisers as well as family.

- Fees — It's crucial to understand what fees come with a 401(k) plan to understand how much money must be saved to hit a retirement savings goal.

For example, variable annuity 401(k) plans, the most expensive retirement vehicles, can include fees around 5 percent. That means that an individual using that plan would have to earn 5 percent before the investment starts to grow at all.

On average, 401(k) plan fees are between 3 percent and 3.5 percent. The law requires only that the fees be "reasonable" and doesn't set specific permissible levels.

The larger issue is the disclosure of these fees to participants. Fees usually are broken down into three categories: investment expenses, administration charges and adviser fees. But there also can be hidden charges such as contract fees, early redemption fees, revenue sharing commissions and more.

In the past year, the Department of Labor has proposed a series of fee-related regulations designed to enhance fee disclosure. In the meantime, plan sponsors should take their plan out to bid every few years — even if they don't plan to move it — to ensure the competitiveness of their fees.

Finally, individual participants should feel confident asking their providers about their fee breakdowns.

- All or nothing — An investor who's saving enough but isn't properly allocated is in as much danger of a failed retirement as an individual who is properly allocated, but excessive fees are eating up his returns. Contributions, asset allocation and fees all must be considered and addressed to ensure a healthy retirement savings outcome.

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