401(k)arma

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"Men may not get all they pay for in this world; but they must certainly pay for all they get." –Frederick Douglas

The advent of the 401(k) account took place as the American workplace was assuming a new look. No longer did the "company man" stay with the same employer for 30-40 years and receive a modest pension upon retirement. Since the late '70s the average American worker has increasingly moved from job to job, city to city, industry to industry. Women came into the workforce in ever-increasing numbers and a portable retirement savings vehicle seemed tailor made for the era.

The original 401(k) plan—and its non-profit cousin, the 403(b) plan—"Could be explained to employees in just a minute," insists Ted Benna, who first discovered Section 401(k) of the Internal Revenue Code, thanks to the Revenue Act of 1978. The original 401(k) program that he developed had only a "guaranteed fund" option and an equity fund option.[1]

Today the 401(k) plan is hated as much as it's loved. There are valid reasons on both sides, but the fact is that a 401(k) account is a viable way for you to amass a considerable sum that can be used to fund a comfortable retirement… that is, if you take advantage of it.

[1] money.msn.com/retirement-plan/article.aspx?post=eb9632ff-1d35-44ad-bf77-349f8492a081

Even after passage of the Pension Protection Act of 2006, which gave employers the power to enroll new hires automatically into their 401(k) programs, up to 20% of new employees opt out.[2] In fact, 30% of all American employees don't participate in their companies' 401(k) program at all.[3] Could it be that these people are setting up a brokerage account on their own and funding it with after-tax dollars every payday? Doubtful.

Other complaints include the belief that many funds available in 401(k) programs have high management fees (on average, 401(k) investors spend $83 per every $10,000 they invest[4]) and proper that diversification is difficult. Both charges are largely true. Employer education about the plans is a relatively new phenomenon that, so far, hasn't done much to quell some employees' fears about investing. But the five following mistakes may be the most injurious to the retirement that you, the 401(k) investor, are planning for yourself:

• **Don't get help.** A study by Aon Hewitt and Financial Engines revealed that 401(k) participants who get help with their 401(k) investment decisions see 3% better returns than participants who invested without any help.[5] Whether you're using target-date funds, professionally managed accounts, or simple advice you find online, your chances of improving your 401(k) returns stand to be much better with help.

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[2] smartmoney.com/retirement/planning/401ks-when-opting-out-makes-sense-1319035249518/
[3] ehow.com/list_6833102_benefits-buying-stocks_.html
[4] online.wsj.com/article/SB10001424052970203370604577265691525975740.html
[5] http://www.memphisdailynews.com/news/2011/sep/27/401k-study-help-can-improve-performance-by-3-pct//print

• **Being cautious, especially when you're young.** Two important tools you have at your disposal are capital and time. If you're a 22-year-old just starting your career, you may not be earning much money. But the time horizon you have recommends that you be aggressive, investing primarily in equity funds through your 401(k). From 1926 to 2010, a common stock investment provided an average annual return of 10.3%.[6] And that 84-year period was wrought with wars, market crashes, recessions, depressions, stagflation—hardly a consistent stretch of economic boom times. Today too much money—4% of all 401(k) funds—is in money market accounts,[7] which typically yield below .03%.[8] That's no way to invest. Generally speaking, you should subtract your age from 100 and the difference represents the percentage of your portfolio that should be put into equities. If you really feel the need to "invest" in a money market account, take after-tax dollars to your local bank or credit union.

• **Panicking.** You don't have to be an expert in behavioral finance to understand the concept of "herding." It's a concept we saw in full flower during the economic meltdown of September 2008. Remember that? One day the Dow Jones Industrial Average went down 500 points. The following day, it dropped 600. Selling begat selling. The Dow went from 13,000+ in the summer to the 8,000s in a matter of weeks… on its way to 6,600 the following March.[9] On September 17, 2008 alone $140 billion was withdrawn from money market funds; crippling short-term lending and affecting long-term markets like stocks even more.[10] But those who invested, say, $10,000 into a Dow Jones Industrials

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[6] ehow.com/list_6833102_benefits-buying-stocks_.html
[7] http://www.ici.org/policy/retirement/plan/401k/faqs_401k
[8] http://www.forbes.com/sites/feeonlyplanner/2011/10/11/whats-in-your-401k/
[9] http://finance.yahoo.com/q/bc?s=%5EDJI&t=5y&l=on&z=l&q=l&c=
[10] http://useconomy.about.com/od/criticalssues/p/US-Economy-Collapse.htm

Index Fund a year before the financial meltdown—when the Dow reached its previous all-time high—would today have more than $11,463.[11] Good reward for patience.

• **Touching the money.** In 2010, 28% of 401(k) participants had outstanding loans against their accounts[12] and had an estimated $5.8 billion in penalties on retirement account withdrawals.[13] That's a disturbing trend that's continued, as exemplified by a nearly 30% increase in the number of 401(k) participants taking out loans during the fourth quarter of 2012.[14] Taking out loans on your 401(k) account means you have less money working for you in your 401(k) account. Cashing out a 401(k) instead of rolling it over to a new employer's plan or an IRA turns every dollar into 65¢, at best, and seriously hinders your ability to retire comfortably.

• **Loading up on company stock.** Perhaps the most dangerous move you can make is to invest much, if not all, of your 401(k) contribution in your company's stock. You're already deriving 100% of your after-tax pay from your company, so why rely on the same source for so much of your retirement funding? There's loyalty, of course. But think about a company like Enron: The people who were wiped out by that company's fall were both the employees and the stockholders… and all too often they were the same people.[15] A 401(k) account allows and encourages you to diversify. Don't blow that opportunity.

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[11] http://www.bostonglobe.com/business/2013/02/06/stock-market-returns-pre-crisis-highs-but-there-little-euphoria/V4mOmsJfT3AQeXqQekJb9O/story.html
[12] http://www.zerohedge.com/news/2013-01-15/rip-retirement-28-americans-are-raiding-their-401k-plans
[13] http://www.forbes.com/sites/janetnovack/2013/01/15/11-ways-to-tap-retirement-cash-early-without-a-10-penalty/
[14] http://www.shrm.org/hrdisciplines/benefits/Articles/Pages/401k-Loan-Taking.aspx
[15] money.cnn.com/2001/11/26/401k/q_retire_enron_re/