

No matter how bad you think it is, a 401(k) is usually good

Columnist: By TODD H. BRAND
PublishDate: Sunday, 5/22/2005
Sections: Business
Page: E7
Body Text:

Not everybody has access to a great savings plan through their employer. It is doubtful that will ever be the case. As an investment consultant, I frequently find investors who, for various reasons, feel their 401(k) plan is not worth participating in. I've never been able to substantiate that claim. Sure, there are plans that have high costs, few fund choices, underperforming investments, poor educational materials, scandal-tainted fund offerings-- you get the picture.

But, while any or all of those characteristics may be present in your 401(k) plan, you can probably find a way to improve your financial future by participating in the plan anyway. Here are some tips:

1. Look up the operating-expense ratio on each fund in the plan. This can most easily be found in the fund's prospectus or online at www.morningstar.com where you can search for the name of the fund and click on "fees & expenses." Many plans will have high-cost funds mixed in with a few lower-cost funds, often called index funds. As a general rule, if a stock fund has an annual expense greater than 1.5 percent (0.8 percent for a bond fund), use that fund only if you cannot easily get a less expensive alternative elsewhere in your other investments.

2. Look at the asset allocation of the entirety of your investment net worth. The cost of your investments is a major contributor to their net performance. If your 401(k) plan does not represent 100 percent of your invested savings, you might consider purchasing only the lower-cost funds available in your plan, and completing your asset allocation with investments in your spouse's plan, your IRA, your brokerage account, etc.

3. Your 401(k) plan is a better alternative than nothing at all. If you don't contribute, those funds are taxable as income to you and their growth -- assuming you don't just spend the money -- can be taxable to you as well.

4. Never leave a company match on the table. This is some of the only truly "free money" you may ever receive. If your company matches even a small amount, say 10 percent of your contributions, that can often-times make up for poor investment choices. Always contribute up to at least to the level on which the match is offered.

5. You probably will be able to roll your plan to a new employer plan in the future, if your current employer is not your last employer.

6. Hold assets in your 401(k) that would be highly taxable to you if you were to hold them outside of your tax-deferred account. Some examples would be real estate

funds, high-yield bond funds and corporate bond funds. This allows you to buy more of your stock funds in accounts where they might grow and be taxable at the lower dividend and capital gains tax rates. This should be done within the context of your asset allocation.

7. Don't just take someone's opinion of the plan at face value, because 401(k) plans can be easily misunderstood. Talk to your employee benefits person or ask to speak with the investment adviser to the plan. You will probably learn something valuable.

8. If indeed, you determine that your plan is poor, contribute up to the maximum amount that the company pays a match and, if eligible, contribute to a Roth IRA or regular IRA outside of the plan.

9. You can improve your plan if you contribute an extra 1 or 2 percent. Remember, you're trying to secure your own future. Whether the plan is stellar or not, you need to do the best that you can do. A 401(k) plan is a powerful investment vehicle and even a substandard plan can help you reach your goals.

One of the best features of a 401(k) plan is quite simple: your money goes toward your future without going through your pocket. It's much harder to save outside of a disciplined payroll reduction plan. We all know how easily money slips through our fingers once it's in our hands.

None of the above strategies can fix a bad plan. But they can help improve your retirement situation.

Reporter's Tag:
Todd H. Brand is president of AMG Brand/Russell, Inc., an independent investment consulting firm in Chesterfield.