



## 401(k)s need re-adjusting

### **401(k) ADVISER**

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Anyone who has flown is familiar with the warning, "Be careful, luggage may have shifted during flight." Given the divergence in financial markets over the past six years, a similar message is appropriate for 401(k) participants, "Warning, 401(k) may have shifted during life."

With time flying by as we deal with busy family and career matters, many have been too busy to notice that their 401(k) accounts have shifted dangerously. Without proper precautionary steps, your retirement assets could take an unanticipated tumble.

If you've followed the advice offered in this column over the past 10 years, you've adopted a diversified strategy for your 401(k) plan investments. While that's a great start, it's important to understand there's more to smart investing than adopting a diversified portfolio and walking away.

The past six years have seen market returns so diverse that a portfolio that was once well-balanced could have shifted, leaving the investor exposed to much more downside risk than was originally intended.

What do I mean by "diverse" returns? Here are some examples:

Since January 2000, \$10,000 invested in U.S. small-cap stocks, as measured by the Russell 2000 Index, has outgrown \$10,000 invested in U.S. large-cap stocks, as measured by the S&P 500 Index, \$14,464 to \$9,337. And \$10,000 invested in stocks that fall into the "value" category, as measured by the Russell 3000 Value Index, has outgrown \$10,000 invested in stocks that fall into the "growth" category, as measured by the Russell 3000 Growth Index, \$14,295 to \$6,629 over that same time period.

If you were fortunate enough to have a portion of your 401(k) account allocated to emerging market, or "hard asset" funds

over some or all of the past six years, the performance differential has been even greater. So different in fact, there's a good chance an allocation to either of these aggressive investment categories is no longer nearly as small as you may have intended it to be.

Therein lies the potential problem.

As much as you enjoy the outstanding performance of certain components of your retirement portfolio, don't get greedy and ignore the over-weighting that can result.

Remember how convinced everybody was six years ago that technology stocks would continue to rise indefinitely? This led to the horror stories of people losing as much as 70% of their 401(k) assets because they were too heavily invested in tech stocks when the tech bubble burst in 2000.

### **Returns are cyclical**

Investment returns are cyclical, with all investment categories going through periods of stellar returns, followed by periods of disappointing results due to myriad economic and behavioral factors.

Unfortunately, the duration of these periods of out-performance is impossible to predict.

Building a diversified portfolio will help reduce the ups and downs, but rebalancing your holdings periodically is another important investment strategy you should employ to keep risk at reasonable levels.

The two most common methods of rebalancing a portfolio are equally acceptable.

One method requires you to closely monitor your 401(k) account's exposure to its various funds and reallocate assets anytime a fund becomes more or less than 5% the weight of your initial target allocation. This rebalancing strategy requires a fair amount of effort, so many prefer a simpler rebalancing strategy.

The other common rebalancing method is to simply pick an arbitrary date, say Jan. 1, and rebalance your holdings on that date every year. This method can often be accomplished automatically by using your 401(k) provider's "auto-rebalance" function on their Web site.

What specific action might you need to take these days?

Given their recent out-performance, 401(k) investors should check to make sure they have not become too heavily invested in small-cap, "value," emerging market, REIT, energy-related, or "hard asset" funds.

Rebalancing requires that you sell enough shares of the funds that have done well to bring your exposure down to your original target, then buy shares of funds that have become under-weighted due to their relatively poor performance. Because of their lagging results, current candidates for additional assets include categories such as large-cap, "growth," and bond funds.

To give you an idea of what some reasonable target allocations look like, look at the model allocations provided.

This quarter's column marks the 10th anniversary of my "401(k) Adviser" column. I would like to thank everyone who has faithfully read along over the years and wish you all a Merry Christmas, blessed holiday season and prosperous New Year.

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