

BUSINESS

Focus on time, strategy in revaluating 401(k)

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401(k) ADVISER

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Despite the recent stock market rally, the past 18 months has been the most difficult environment 401(k) participants have ever faced. For many, losses have

been so deep that a comprehensive evaluation of everything that affects your retirement finances is in order.

Such an evaluation should focus on three key issues: time, savings rate and investment strategy.

Time: This is the most crucial of the three factors. For those close to retirement, consider how flexible you can be with your retirement date. Putting off retirement may not be the most desirable strategy, but it can be one of the most effective.

If you work longer, it increases the amount you're able to save and the time your savings has to recover. It also reduces the number of years you will be in retirement, therefore reducing the amount you will need to have saved.

If you're 10 or more years away from retirement, time is on your side and you should be focused on your savings rate and investment strategy.

Savings rate: While it's tempting to reduce or eliminate saving for retirement during tough economic times, increasing the amount you save can have a profound impact on the amount waiting for you at retirement.

By increasing your savings rate during a down market, you average down your cost so when the market recovers, your account gets back to break-even faster.

If you stop investing and the market averages a 10% return from here, it should

take about eight years to recover what has been lost in the past 18 months. If you keep investing in the stock market, buying at depressed prices, you could cut that recovery time significantly.

For instance, if you buy 100 shares of a stock fund at \$100, and it drops to \$80, the stock must go to \$100 for you to break even. However, if you buy 100 shares at \$100, and again at \$90, and again at \$80, your average cost is \$90. As a result, your stock fund only needs to travel from \$80 to \$90 for you to break even.

The simplest way for most people to increase their 401(k) savings rate is through a feature called automatic salary deferral escalation. This feature increases the amount you save by 1% each year without you having to lift a finger.

If auto-escalation is not available in your plan, mark your calendar so that every year you raise your savings rate by 1%. If you are under 40, have a goal of saving 10% of your pay. If you're over 40, that number may have to be even higher.

The maximum 401(k) contribution level has been increased in 2009 to \$16,500 if you are less than 50 years old, and \$22,000 if you are 50 or older.

Investment strategy: While human nature tells us to stop doing what causes us pain, like investing in the stock market lately, I believe in the resiliency of the world economy and that buying stocks at depressed prices will lead to above-average long-term returns.

As you get closer to retirement, however, moving a higher percentage into bonds is a must. But given the 18-year life expectancy of the average 65-year-old, getting out of the stock market altogether is likely to prove expensive when the market comes roaring back.

If you're within three years of retirement or at risk of losing your job, calculate how much of your current retirement assets you'll need to cover living expenses over the next three years, and set aside at least that amount in a low risk bond fund. This recommendation is based on our outlook that the U.S. economy is likely to struggle well into 2010. The balance of your account can stay invested in equities, giving yourself the opportunity to recover some of what you've lost.

If you're a long-term investor, consider rebalancing back into the stock market if your stock-to-bond ratio has gotten overly tilted toward bonds. This will have the same effect of investing new money into the depressed stock market and accelerate your recovery.

Finally, if there was ever an example of the wisdom for limiting your exposure to company stock in your 401(k) plan, the past 18 months has provided it. Diversify your stock fund holdings between U.S. and foreign, growth and value, and look to add an element of inflation hedge to your portfolio.

Retirement investing is a long-term proposition. Those with a plan, who have the patience to endure the unexpected, are most likely to finish the race with their objectives met.

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