When You're Serious…

by Bradley R. Newman, CFP®

The Real Concerns In Your 401(k)

Over the past year, the vast majority of the news regarding 401(k) plans has been focused on plan fees and the fees of their underlying fund options. This s a direct result of the Department of Labor (DOL) issuing its final regulations for annual fee disclosures under ERISA Section 408(b)(2) in February of 2012.

While a focus on reducing plan costs, specifically costs that add no direct value to plan participants, is definitely a positive step, cost is only one issue among the myriad of variables that will impact how effectively you can utilize your 401(k) as a tool to help you reach your retirement goals. In addition to being aware of plan and fund costs, here are a few of the issues that are often overlooked; each of which will cost you real dollars in the form of either poor investment performance or taking on unnecessary volatility.

Is Your Allocation Appropriate?

One of the most consistent mistakes we see is an asset allocation that has remained static while someone's circumstances have evolved; think of someone who is approaching retirement within the next ten years. What is the end result? You could be taking on more risk than is necessary to reach you goals. If you only need a 6% return to meet your goals, why have a portfolio structured with the inherent risk of returning 8%; at this point you are simply taking on unnecessary risk.

The most prudent approach is to adapt your approach as your situation changes by reducing your volatility as much as possible while still generating the returns that will allow you to meet your goals. As you progress towards retirement, your biggest concern should not be squeezing every last ounce of return out of your portfolio, it should be to protect yourself from the major potholes that could be lurking around the corner; remember your older co-workers or colleagues who were burned by the 'Tech Bubble' and 'Financial Crisis'.

Are You Adjusting For Market Conditions?

Please understand that we are not talking about day-trading, but rather how to maximize returns and minimize losses over an extended period of time with regular, but subtle, portfolio adjustments based on market conditions. Recent examples of times to make adjustments have been:

- The collapse of the financial sector in the fall of 2008
- The implosion of the foreign markets that began in the spring of 2011
- The rising interest rate environment that we are entering

Disciplined allocation adjustments are about controlling and managing risk, while maintaining appropriate diversification. In the most basic terms, that means overweighting asset classes that are providing attractive returns with lower levels of volatility, while underweighting asset classes with lower returns and higher levels of volatility. Ultimately, the real goal is to overweight the asset classes that can provide the level of return needed with the lowest level of volatility possible.

A disciplined strategy will provide clearly defined limits, both minimum and maximum, for each asset class and will prevent you from moving too far into or out of any one asset class, but will allow you to overweight or underweight asset classes based on their current levels of attractiveness and risk.

Is Your Fund Selection Suitable?

That's not a question that most investors can readily answer.

Your best option for quantifying your fund selection proficiency is to compare the funds you utilize against a group of their peers. By reviewing the historic comparisons of how a particular fund has performed versus the other funds in its peer group (large cap value, large cap growth, etc.), you can determine if a particular fund has a proven track record of success, failure or intermittent periods of each.

Understand that past performance is no guarantee of future result, but you should be pleased if your funds regularly rank in the top quartile of their peer group. However, if your funds are consistently in the bottom half of their peer group, you should be ready to make some significant changes to your line-up.

Where Do You Start?

The first step is to be aware of the issues that exist. Suffice it to say that the issues are numerous and only a few of the most common have been touched on here; however, there are resources that can be purchased and independent experts that can be hired to provide an arms-length evaluation of plan options and provide recommendations specific to your situation.

The next step is to understand that this is not a 'once-and-done' exercise. While a comprehensive review should be done at least annually; unless there are extraneous factors or market conditions, it typically should not need to be done more than quarterly.

Bradley R. Newman, CFP® is with Roof Advisory Group, Inc., an independent investment management and financial advisory firm based in Harrisburg. The firm is a fee-only Registered Investment Advisor that provides portfolio management and financial planning services for individual and institutional clientele. The firm's email address is invest@roofadvisory.com.