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401(k) Missteps

Don't sabotage your own retirement savings

Every day we see participants make mistakes with regard to their retirement savings. There is currently a strong focus in the media on external factors affecting your 401(k) account, but not near as much talk about the things within your immediate control as a plan participant. Typical 401(k) trips and stumbles drastically reduce your ability to build financial wealth for your future. Make sure you keep in step!

Step 1 – Don't Leave Money on the Table

An Employer Matching Contribution feature is instituted to help incentivize employees to save for their own retirement, but all too often, employees fail to save at a rate to receive the full matching contribution. An Aon Hewitt report shows that in 2015, 23 percent of employees left money on the table by contributing below the employer match threshold.[1] This is in essence, free money…don't miss out on it! Make sure you contribute at least up to the matched amount.

Step 2 – Increase Contributions when possible

Research shows the average deferral rate of employees at somewhere between 6.8 and 7.7% depending on the source, however most experts, like Steve Utkus of the Vanguard Center for Retirement Research, recommend a savings rate of 9-15% depending on your current income level. "It is plan contributions that have the largest impact on outcomes."[2] If you are deferring less than 9%, try stretching to increase that amount by a percent or two a year. Many Plans allow you to change your deferral percentage mid-year or even more frequently, so you may be able to make changes in your contribution rate if your financial situation should suddenly change.

Step 3 –Your 401(k) should not be a Piggy Bank

Make sure to avoid unnecessary distributions. All too often, 401(k) participants change jobs, take a withdrawal, and pay taxes (plus an early withdrawal tax if under 59 ½ or terminated when less than 55). This cycle causes participants to start over on the retirement savings curve. A 2016 Fidelity study shows one in five workers cashing out their 401(k) when they change jobs. Instead, avoid taxation and either roll the funds over into your new employer's plan or an IRA.

In retirement, consider leaving funds in your employer's plan as many IRAs have higher fees. Distributions in retirement should be limited to just the amount needed thereby avoiding paying tax too early and keeping more in your account earning more for you.

Another misstep is a hardship withdrawal. Hardship withdrawals not only deplete your retirement savings and cause a taxable event, but also prohibit you from contributing to

[1] Aon Hewitt, "2016 Universe Benchmarks: Employee Savings and Investing Behavior in Defined Contribution Plans," apital-consulting/thought-leadership/retirement/2016-universe-benchmarks.jsp
[2] Steve Utkus, "Carpe Diem – How to seize better retirement outcomes," https://vanguardinstitutionalblog.com/2017/02/24/how-to-seize-better-retirement-outcomes/

your account for six months. A better alternative is a plan loan. Remember though, that if a loan is not repaid, it becomes a taxable event. In addition, most plans require loans to be repaid in full shortly after a termination of employment. If you are unable to pay the loan, it will become a taxable event.

Step 4 – Avoid Reacting Too Strongly to Market Fluctuations

Fluctuations in the stock market have tested our willpower over the past several years, but staying the course proved to be most financially sound advice. Many investors made the mistake of moving to money market funds when the market dropped. The problem with this fear-induced move is that these investors missed the subsequent market upswing. They are selling their investments at low prices and then rebuying them at high prices when the market comes back up. Morningstar analysis shows investors fail to capture 2.5% of market returns due to poor market-timing moves[3]. Market conditions may cause you to reevaluate and possibly tweak your investment strategy, but a sound investment philosophy doesn't change with day to day market swings.

Step 5 - Utilize Free Education and Financial Guidance Tools

Mostly likely, your plan provides online tools for retirement plan and investment education. Also, free guidance is typically just a phone call away. Take advantage of these opportunities to discuss your contribution and investment strategy with retirement professionals.

Step 6 - Setting and Forgetting for Too Long

Investment performance over any time period may shift your account values to an asset allocation that no longer exactly matches your chosen philosophy. Consider rebalancing your account every year or two. This method of selling the highs and buying the lows gets your account back to your chosen allocation.

If chosen soundly at the onset, your investment philosophy doesn't change over time, but your time horizon does and therefore a thorough review of your asset allocation is warranted every few years to ensure your philosophy still matches both your risk tolerance and your changing time horizon.

Conclusion

Saving for retirement is greatly simplified with a 401(k). Make the most of it by practicing these few simple steps to help secure a better financial future.

[3] Timothy Strauts, "Bad Timing Costs Investors 2.5% a Year," http://www.morningstar.com/cover/videocenter.aspx?id=650699