401(k) TODAY
PENSION DYNAMICS CORPORATION
Volume 12 Number 4 "The Latest News on Saving and Investing" Fourth Quarter - 2009

Alternative to 401(k)s tax trap in disguise

by Stephen J. Butler

Barbarians are at the gate. Time magazine last week had a cover article called "Retire the 401(k)" wherein they cite that "the average balance is $45,519." How stupid do they think we are?

This misinformation would be laughable if it wasn't part of a growing insurgency seriously bent on doing away with the favorable tax treatment for 401(k) plans. What they want to replace it with is something that seizes the current tax savings and applies them to the funding of a national defined benefit plan (a plan that guarantees a specific retirement benefit for each year of employment.) These are the plans offering hopeless expectations that have bankrupted the auto industry and that will soon be gutting the budgets of state and local governments.

As for that $45,519? It is the average balance which means it includes the accounts of brand new participants who have next to nothing. How about the balance that counts, the one for participants in their 60s who are about to retire? That average balance is $150,000.

But wait, that's not all. For participants with $150,000 in their current 401(k), that participant has another $150,000 in roll-over Individual Retirement Accounts or 401(k) accounts left at a succession of previous employers. Widely-touted, misleading statistics ignore the accumulation of IRA money that resulted from 401(k) accumulations, because this figure can't be determined from available government information. When we factor in all that the average 401(k) participant can accomplish, 30 years of 401(k) contributions add up to $300,000. Participants got that far with nothing more than $200 per month invested in stock funds.

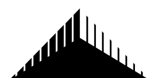
The Time article points out that the average employee changes jobs every seven years. Assuming a 40-year career with six job changes, third-grade arithmetic tells us that the average employee might be accumulating that average $45,519 and rolling it over about six times during a career. Ignoring any further earnings once the money is rolled, the total of the roll-overs alone is about $250,000, not far from my $300,000 guesstimate.

An employee's 401(k), then, can take credit for one or more of the following: 1) the current plan, 2) previous 401(k) money left at former employers, and 3) roll-over IRAs. According to McKinsey and company, anyone in their 60s has five times more money than would have been their retirement nest-egg of the pre-401(k) era. (a McKinsey and Company statistic.) Why? Because average job tenure has always been seven years, and retirement plans were operated with vesting schedules that denied any benefit at all to those who left before 10 years.

Moreover, 99 percent of all Americans work for companies with less than 500 employees. Most small companies never had any retirement plan, so a voluntary 401(k) opportunity was a godsend.

The 401(k) plan is an accident of legislative history. No one predicted the amazing success of today's $3 trillion testimonial to self-discipline and a confidence in the markets. Any effort to dismantle this engine and replace it with a dysfunctional "promise" of guaranteed retirement incomes is hopelessly misguided.

Times' article and others like it are the public relations products of an ill-advised self-serving scheme out of Boston that would put a handful of academics in charge of the nation's retirement program.

Pension Dynamics Corporation 2300 Contra Costa Blvd. Ste 400

Pleasant Hill, CA 94523-3955 Phone: (925) 956-0505 Fax: (925) 956-0506

PENSION DYNAMICS CORPORATION

401(k) TODAY

Volume 12 Number 4 "The Latest News on Saving and Investing" Fourth Quarter - 2009

Fluctuation can't derail disciplined investors

by Stephen J. Butler

HIS MONTH marks the 10th anniversary of this column. It seems like just yesterday when I was asked to contribute after gaining notoriety from a cover article in Money magazine titled, "Beware, Retirement Plan Rip-Off." That eight-page article illustrated how hidden fees charged by 401(k) providers ranged by as much as 600 percent from the highest to the lowest for the same level of service.

A year later, Money had a short anniversary article that dubbed the original as possibly the most important article ever published in the magazine, saving investors as much as $1.5 billion per year.

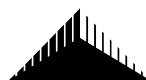
Events of the past two years just confirm the value of maintaining a jaundiced view of the financial services industry. If there is ever a recurring theme in my "weekly requirement" of a column, it is the healthy skepticism only possible for someone working in retirement plan administration, a backwater in the sea of financial services. For 30 years, annual retirement plan reporting has had me sitting at the turnstile of thousands of plans, and gaining at least some perspective as to what works and what constitutes a disaster. Remember all those limited partnerships that went broke back in the '80s? Remember the market-timing services that were the vogue until they missed the 25 percent single-day loss in 1987? Remember those managed accounts of the brokerage firms that charged 3 full percentage points per year and fell way below any market averages? I have seen everything that didn't work.

While it may be called "the lost decade" by some, we could not have had a better learning experience than the last 10 years has offered. The period followed a four-year stretch in the late nineties when the market rose by more than 20 percent four years in a row, and then we endured the last two years when the market had the most precipitous decline since The Great Depression. Anyone staying the course (my advice to avoid "the noise" back in 1999) has lived through two major crashes in this period, has seen two "snapbacks," and has made money as we speak. Someone diversified over several investment types, including small cap and foreign funds (my 2000 suggestion that diversification creates the "path of minimum regret"), has actually made an annual average 6 percent over the past 10 years.

Anyone wishing to protect against the downside would have done well to move about a third of their assets to a combination of bond funds (Vanguard short term corporate, GNMA and High Yield) that were mentioned in several columns years ago. Having a third of one's money in that bond-fund mix and the rest in stock funds would have reduced the impact of the recent market downdraft. Today, that same allocation, including a diversified mix of stock investment types, is up substantially, by more than 20 percent for the year to date. Someone inclined to panic back in March would have been reading my cheerful column about Warren Buffett and his impression of feeling "like a mosquito in a nudist colony" as he made multibillion dollar purchases in some of this year's basket-cases.

Speaking of Mr. Buffett, last week's purchase of Burlington Northern Railroad was his bet on the resilience of the American economy, because railroads make money when the economy heats up. The market, I can promise, "will fluctuate," but the next 10 years will offer major rewards for those with self-discipline and a pragmatic approach to the simple rules of investment success.

Pension Dynamics Corporation 2300 Contra Costa Blvd. Ste 400



Pleasant Hill, CA 94523-3955 Phone: (925) 956-0505 Fax: (925) 956-0506