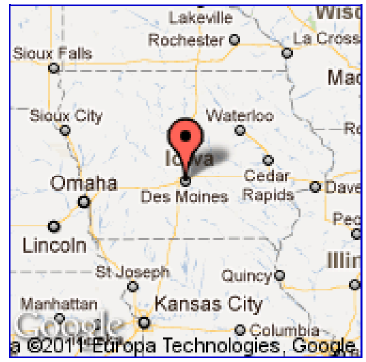
401k study: Help can improve performance by 3 pct.

By DAVID PITT, AP Personal Finance Writer – 2 days ago

Map



DES MOINES, Iowa (AP) — Sometimes it pays to get help. A new study of 401(k) accounts provides further evidence that workers who get help pocket higher returns than those handling their own investment choices.

The study by human resources consultant Aon Hewitt and investment adviser Financial Engines shows that workers who received some form of help experienced annual returns on average of 3 percent better than workers who handled their own accounts.

But it's important to clarify what's meant by "help." Workers who used target-date mutual funds, professionally managed accounts or accessed online advice were all deemed to have used help for purposes of this study. Their behavior from 2006 through 2010, and how it affected account risks and returns, was studied.

Target-date funds automatically set the mix of stocks and bonds according to a worker's risk tolerance and years until retirement. Managed accounts are those with professional manager so the accountholder doesn't have to make ongoing investment decisions.

Based on the returns estimated in the study, the difference that 3 percent could make over 20 years is striking. If two accountholders — one who sought help and one who did not — invested $10,000 at age 45, the person who got help could have $71,400 saved by age 65. That's 70 percent more than $42,100 of the worker who handled their own affairs.

The study looked at eight large 401(k) plans representing more than 425,000 individual participants with $25 billion in assets.

It should be noted that Financial Engines' services include managed accounts and advice services. Aon Hewitt offers companies retirement plan options including self-directed brokerage accounts and financial planning help services.

The difference in performance can be attributed to common mistakes made by 401(k) accountholders managing their own investments.

GETTING OUT

Getting scared and pulling money out of stocks when the market tumbles, and then failing to reinvest before the market recovers hurts many retirement investors. This behavior was very damaging in 2008, when the Standard & Poor's 500 index fell nearly 39 percent. Unfortunately many stayed out and missed the 26 percent recovery in 2009.

"When markets are as volatile as they are now there is a substantial opportunity to make some very bad mistakes," said Christopher Jones, chief investment officer for Financial Engines. "Particularly if you're a near retiree. That can be very damaging."

TOO MUCH OR TOO LITTLE RISK

Choosing an inappropriate level of risk for a worker's age and years until retirement is another common error. Leading up to the market collapse in 2008, many workers within five years of retirement carried too much risk, keeping a large portion of their money in stocks. When the market dropped, on average, 401(k) investors lost a third of their account balance. Those who were close to their planned retirement didn't have time to make up the losses and in many cases had to continue working.

Younger workers who are too cautious and shy away from stocks can cut their earning potential significantly over time.

COMPANY STOCK

Another common costly mistake is investing too much money in the employer's company stock, Jones said. Many workers believed their own company stock was less risky than other choices. When the market plunged in 2008, many of these stocks fell as much as 70 percent. This led to a devastating loss for heavily invested workers.

REBALANCING

Failure to periodically rebalance a portfolio can also hurt returns. By rebalancing, investors adjust the allocation between stocks and bonds in their portfolios to ensure their investments reflect their appetite for risk. For instance, in a market where stocks surge, a portfolio can become too heavily invested in stocks unless the accountholder moves some of that money from stock funds into bonds or other assets.

Failure to rebalance after a market surge or drop leaves a portfolio at risk to underperform.

COMPLACENCY

A large segment of 401(k) accountholders have historically been complacent about their investments, failing to do anything with their account for years.

"Rather than do something wrong they're just not doing anything," said Pamela Hess, director of retirement research at Aon Hewitt. "With all the volatility in the last few years, I think folks don't know what to do and a lot are just doing nothing."

More workers with 401(k) accounts are using some form of help, Hess said. An earlier study of 401(k) accounts indicated about 25 percent of workers used help with their investments in 2009. As of the end of 2010, about 30 percent of workers were using help.

Hess points out it, however, that still means about 70 percent of workers don't get help.

"This study really quantifies the fact that he gap between doing things on your own and what you can get with professional help does in fact get substantially wider during periods of volatility and economic stress," Jones said.

While acknowledging that some forms of help including managed accounts carry higher costs, Jones said the difference in performance outweighs the increased cost.

Managed account fees typically range from 0.20 percent to more than 1 percent of the account balance. Target-date fund fees can range from around 0.18 percent to more than 1.5 percent of assets.

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