

## MSN Money

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### Mutual Funds

#### 7 ways to boost your 401(k) returns

Following these fairly simple rules will make your retirement fund work harder for you -- and boost your returns big time over the long haul.

By [Timothy Middleton](#)

This is the time of year when most of us are opening 401(k) and 403(b) statements. And we're probably a lot less grumpy than we were three years ago, because the markets have risen nicely for two years in a row.

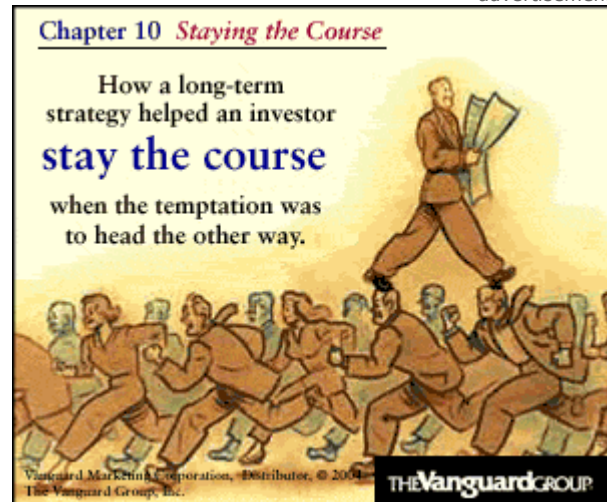
But doing well isn't as good as doing better, and most of us can wring extra money from our accounts with only a little extra effort. Save harder; diversify better; watch expenses; stick to your plan. Here are seven common-sense steps you can take to fatten your retirement kitty.

- **Max out your contributions:** Be sure to contribute enough to capture the employer match. "If you contribute 3% of your salary and your employer provides a matching 3% contribution, you have received an instant 100% return on your contribution," notes Pam Dolvin Poldiak, a financial planner in Roanoke, Va.

Beyond that, however, strive to contribute as much as the law allows. "Many of my clients are surprised to find that they can contribute up to \$18,000 to their 401(k)s this year," says Cheryl Costa, of Family Financial Architects in Natick, Mass.

That's the maximum for people over 50; younger workers are limited to \$14,000.

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## Step out on the limb a bit

- **Take the right kind of risk:** The rules of risk are different in investing for retirement. The biggest risk of all is that you'll outlive your assets. So investments regarded as the most conservative, such as stable value funds and Treasury bills, should account for a very small percentage of assets.

Ronald Rogé, a financial adviser in Bohemia, N.Y., has six models around which he builds client portfolios. The most conservative is 40% equities and 60% fixed income. The most aggressive is 80% equities with the balance in bonds and cash.

An equity-heavy portfolio is more volatile than one tilted toward bonds, but if it's well diversified, those risks are reduced. "People assume they are diversified because they are in an index-type fund. But diversifying means being in different asset classes," says James Shagawat, a principal of Baron Financial Group in Fair Lawn, N.J.

Here's a model portfolio that most employees can construct with their plan at work.

Model 401(k) portfolio	
Security	% of plan assets
Domestic big-cap stocks (like S&P 500 stocks)	30%
Domestic small-cap stocks	20%
International stocks	20%
Domestic high-quality bonds	25%
Stable value or short-term bond	5%

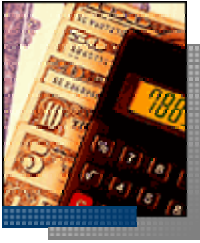
If your plan offers funds investing in real estate investment trusts, emerging markets stock and foreign bonds, 5% positions in these useful diversifiers can be added by cutting other international stocks to 15% of assets and domestic bonds to 15%.

## Putting money in cheaper groups

- **Rebalance:** When any category becomes 5% larger than your target allocation, trim it and spread the proceeds among the other groups to restore the balance. This kind of rebalancing will probably only be needed once every few years, but a sudden rally in any market could skew your allocation in as little as a year.

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"Rebalancing can boost returns without increasing risk," notes Jean Fullerton, a planner with Lodestone Financial Planning in Manchester, N.H. It forces you to take profits when one asset class is hot and plow the money into cheaper groups.

Increasingly, the planner notes, "Some 401(k) plans offer options to automatically rebalance." But if yours doesn't, do it manually.

- **Dump that company stock:** Many plans offer stock in the employer's company as an option, and some employers make the company match in their own stock.

But a lot of your net worth is already tied up in that investment, because that's who pays you. In an Enron-type meltdown, you could lose your nest egg as well as your job.

"I would limit the allocation to a fairly small percentage of your total," says Paul Winter, founder of Five Seasons Financial Planning in Salt Lake City. Many advisers recommend limiting company stock to 10% of total investment assets, not just retirement assets.

### Go cheap

- **Cut expenses to the bone:** An alarming number of 401(k) plans, especially at small companies and not-for-profits, are operated by insurance companies and brokerage firms and offer lackluster investment options and extremely high fees.

But even high-cost plans usually offer at least some index funds. Rick Miller, a planner with Sensible Financial Planning of Cambridge, Mass., estimates that investors can slash expenses by one percentage point by switching to index funds from actively-managed portfolios.

In mutual funds, cutting expenses boosts net returns correspondingly. Over a span of decades, a one-point increase in returns is huge. An investment of \$10,000 grows to \$174,585 over 30 years when it earns 10% annually. Reduce that to 9% by paying that extra point in fees and the kitty shrinks to \$132,739.

"If expenses are too high (above 1%), tell your plan sponsor to change providers or you will file a complaint with the Department of Labor," recommends Hal Schweiger of Capital Asset Advisors in San Diego.

### **Don't die broke**

- **Keep the tax man on your side:** "The 401(k) is going to be taxed at ordinary income rates when the money comes out, so have the bulk of ordinary income items in it, such as real estate investment trusts and bonds," says Raymond Nasser, a financial adviser in Midlothian, Va.

Viewed strictly from the tax point of view, equities are best owned in taxable investment accounts and Roth IRAs. Their dividends and capital gains are taxed at lower rates than ordinary income.

Qualified distributions from Roth, or non-deductible, IRAs aren't taxed at all, so Roths are a great supplement to company pension plans. This year you can contribute up to \$4,000 (\$4,500 if you're over 50).

- **Don't chase performance:** Scott Dauenhauer, president of Meridian Wealth Management in Laguna Hills, Calif., notes, "Even in the past five years, investors who followed simple, long-held principles weathered the storm just fine." Those principles include thorough diversification, careful cost control and this: "Don't chase returns," he warns.

Buying last year's best idea means you're not following your asset-allocation strategy, and that's where the real money is made in investing. "Ninety percent of performance is attributable to asset allocation," notes A. Todd Black, a planner with Dogwood Capital Management in Cumming, Ga. "An investor should expend the most energy and research in putting together a viable allocation."

The goal in retirement investing is to accumulate and preserve wealth, not to make a killing. Leave that to speculators. They usually die broke, anyway.

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