10 BIGGEST MISATKES TO AVOID

WHEN MANAGING YOUR 401(K)

A 401(K) is one of the most commonly used vehicles to save for retirement. Unfortunately, managing one isn't so simple. If you really want to maximize all of the benefits of a 401(k), you can start by understanding which mistakes to avoid.

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MISTAKE # 1:

NOT MAXIMIZING YOUR FULL EMPLOYER MATCH

One of the best features of a 401(K) is when an employer matches your contribution into the account. How powerful is the match? Well think about this:

John earns $130,000 a year. He contributes 3% of his pay to his 401(k). His employer matches up to 5%. If John is 35 years old and plans to work until he's 65, he can expect to accumulate approximately $883,609 when he retires. (Using an 8% rate of return)

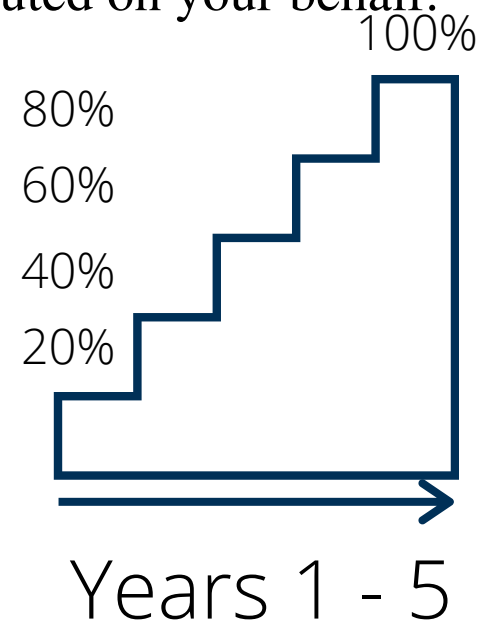
Now, instead of only contributing 3%, he increases his contribution to 5%, maxing out his employer match. Keeping everything else equal, John's expected 401(K) balance at retirement is $1,472,681. Almost $590,000 more!

If you can afford to increase your contributions to meet your employer match, your future self will thank you!

MISTAKE # 2:

LEAVING YOUR COMPANY BEFORE BECOMING FULLY VESTED

A vesting schedule determines when employer-matched funds are yours to keep if you decide to leave the company. It's common for 401(k)'s to have a graded vesting schedule. For example, a vesting schedule could be that for every year you continue to work for your company, you become vested (take ownership of) 20% more of whatever the employer has contributed on your behalf.



If you find yourself ready to make an employment move, don't forget to factor in the cost of leaving early when it comes to your vested 401(K) balance.

MISTAKE # 3:

FORGETTING ABOUT THE RULE OF 55

You started saving for retirement early in life. You are now 55 years old and have enough saved to retire comfortably. But you feel trapped because you don't want to withdraw your money and get penalized 10% as an early withdraw penalty.

Generally, taking withdrawals from an Individual Retirement Account prior to age 59 1/2 is subject to a 10% tax penalty. However, 401(k) plans are an exception to this. If you retire, quit, or get laid off from your job anytime during or after the year of your 55th birthday, you can pull money out of your 401(k) without penalty!

So don't let your age keep you from pulling that retirement trigger! It also could be a new goal for those wanting to get to retirement ASAP!

MISTAKE # 4:

LETTING YOUR PORTFOLIO "RIDE"

Picking and managing your investments inside of a 401(k) can seem like a burden. Which investments do I pick? What is my risk tolerance? What is this guaranteed fixed account all about?

I understand the last thing you want to do is to go through this pain ever single year. Especially if your your investments have performed well over the previous year. The last thing you want to do is screw up a good thing, right?

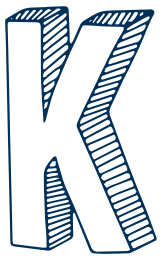
As your 401(k) balance gets bigger, managing is a task you're going to want to take head on. Investment markets can do some crazy things and some years those crazy things may put your portfolio out of sync. Letting it ride could be setting you up for a lot more risk down the road then you intended.

You're going to want to assess your investment allocation, your risk tolerance, and your investment timeframe every year. Then you are going to want to make changes based on that information.

If you feel like this is outside the scope of something you feel comfortable doing, look for help!

Finding a professional you trust for advice is a great place to start. If that is not an option, do your best to research simple portfolio managements steps you can take on your own.

The bigger your account balance, the closer you are to retirement, and the less time you have to "recover" means you need to be more diligence with the management of your 401(k).



MISTAKE # 5:

ABUSING THE 401(K) LOAN FEATURE

If you find yourself in serious need of some quick short-term cash, a loan from your 401(k) plan could be one of the first places you look. This is the real world, and sometimes we need money, fast. Borrowing from your 401(k) can be financially smarter than taking out an extremely high-interest personal loan.

When you borrow from your 401(k), you are not taxed on that money. And you essentially end up paying yourself back through future contributions into the plan. But abusing this feature could wind up costing you down the road.

Let's suppose you take a loan and then change jobs. If you have an outstanding loan balance, you will be required to pay that loan in full. If you don't, the full unpaid loan balance will be considered a taxable distribution and you could also face a 10% federal tax penalty!

Don't let 401(K) loans restrict your ability to take advantage of new job opportunities down the road.

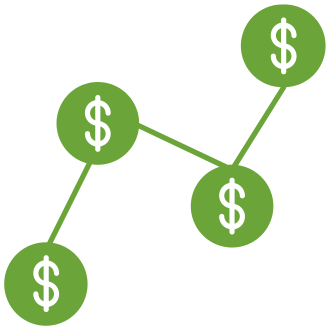
MISTAKE # 6:

Ignoring Net Unrealized Appreciation (NUA)

Do you own your employer's company stock inside your 401(k)? This could be a great way for employers to allow their employees to take on an ownership mentality. But when it comes time to move your money, beware of NUA rules.

NUA is the difference between the original cost basis and current market value of shares of employer stock.

Ex: John owns his companies stock inside his 401(k). When the stock was contributed to his 401(k) account, it was worth $100. 10 years later, it's worth $600. John's NUA in this stock is $500.



Now let's assume that John wants to withdraw his 401(k).

Typically, whenever you withdraw money from a qualified retirement account, like a 401(K), that money is taxed as ordinary income. However, with NUA rules, any gain on John's stock would retain a capital gains tax structure.

John could withdraw his $600 stock and would have to pay ordinary income tax on his $100 contribution portion immediately. But the $500 of growth would get taxed as a Long Term Capital Gain if he sells that stock at some point in the future, even after he withdrew the stock from his 401(k).

Where people get in trouble is when they rollover their 401(k) to an IRA, and inside their 401(K) they have company stock that would qualify for NUA. If they roll that company stock into an IRA, they will forfeit the capital gain tax structure on any gain imbedded within that stock. And any future withdraws from that IRA would all result in ordinary income taxation. If you're confused, it's ok. We're here to help!

MISTAKE # 7:

MISSING OUT ON THE ROTH OPTION

Roth 401(k) options are becoming more and more common within 401(k) plans. The biggest difference between a traditional 401(k) and a Roth 401(k) is taxes.

A Traditional 401(k) would allow you to contribute money BEFORE those dollars would be subject to Federal and State income tax. Roth 401(K) money would incur Federal and State income tax upfront, but would get to grow and be distributed tax free later on.

With all the uncertainty of future tax law, I think it's prudent to consider diversifying your retirement money. Utilizing a Roth 401(k) option is a great way to do this. You could dedicate whatever % of your contributions to a Roth and the rest would go toward the Traditional side.

Also note that any matching contributions from your employer will go into the Traditional side. Only you can contribute into a Roth 401(k).

MISTAKE # 8:

NOT GIVING YOURSELF A RAISE

The future cost of what you will eventually spend your retirement dollars on are going up. Inflation is always lingering. You need to account for this buy continuing to increase your contribution rate.

If you get a raise at work, that's great! Now, increase your 401(k) contribution to reflect that. You're getting a year end bonus? Perfect, now bump up your contribution percentage.

It doesn't matter if you're a new graduate or are a few years away from retirement. Continuously increasing the amount of your contributions, while still maintaining a livable wage, is ideal.

I have yet to run into a single person who wished they saved LESS for retirement. But if you ever get to that point, it's not the worst position to be in.

MISTAKE # 9:

NOT HAVING A PLAN FOR YOUR 401(K) WHEN YOU LEAVE YOUR CURRENT JOB

It's not uncommon for a professional to switch companies from time to time. In fact, its' more normal now to have moved jobs several times than it is to have worked for the same company over many decades.

When you leave your employer, you have to make a decision on what you should do with your 401(k). Most people have three primary options.

1.) Leave your money in your old 401(k).
2.) Roll it over into an IRA.
3.) Roll it over into a new 401(k) with your new company.

There is no right or wrong answer. But your reasoning for whichever you decide should align with whatever your financial plan lays out. For example, if you're doing backdoor Roth IRA contributions, you probably don't want money in an IRA (*see pro-rata rules).

MISTAKE # 10:

NOT CALLING *PHARMD FINANCIAL PLANNING* FOR HELP!

Chances are, you're reading this because you are not an expert at 401(k) management. Fortunately, every mistake on this list can be avoided by teaming up with a true Fiduciary, which is exactly the standard we uphold for our clients.

Why should you consider working with PharmD Financial Planning?

1. We're not paid to sell you financial products or "manage" your assets. Instead, we lead with advice and guidance. We are our clients problem solving partner.

2. Competency. Derek has advanced qualifications and credentials that allows him to do in-depth planning and implementation.

3. Transparency. We charge a flat $4,500 annual fee that encompasses all of our work together. There is no conflict of interest between our advice and your pocket book.

Call PharmD Financial Planning to schedule your complimentary consultation to learn more! **507-200-0233** or visit **pharmdfp.com**

Derek Delaney

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About me

My name is Derek and I am the Founder of PharmD Financial Planning. I specialize in helping families attain retirement independence. I am happily married with two kids. I enjoy golfing, music, and spending time with family.

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Experience

Financial Planner

- PharmD Financial Planning I 2021 - Present
- Profinium Wealth Management I 2016 - 2021
- Thrivent Financial I 2014 - 2016

Education

North Dakota State University

- Bachelor Degree: Finance & Accounting I 2007 - 2011

Certifications

- Certified Financial Planner ™
- Chartered Financial Consultant
- Enrolled Agent
- Certified Student Loan Professional

Featured In

- MarketWatch
- ThinkAdvisor Magazine
- Advisor Magazine
- The Wall Street Journal

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