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The Cost of Not Getting Help with Your 401(k)

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The first full week of January started the year off right, with net inflows into equities being the fourth highest since 1992 when net inflows were first calculated. Is this an indicator that 2013 is going to be a good year? Only time will tell. The real question is, will you seek professional investment advice or go it alone to ensure that 2013 is a good year for you?

According to a four-year study of large defined contributions by Aon Hewitt and Financial Engines[i], 401(k) participants who received professional investment help (Help Participants)—by utilizing target dated funds, managed funds, and online advice—outperformed those who did not (Non-Help Participants) by approximately 3 percent, net of fees. That gap may seem insignificant at first glance, but over a 20 year period, the difference could result in 70 percent greater wealth for the Help-Participant. This is due to the fact that most people buy and sell stock based on emotion rather than logic, causing them to frequently buy and sell at the wrong times.

Let's explore where the Non-Help Participants went wrong.

1. Non-Help participants had inappropriate risk levels. Near-retirees took on too much risk, while young employees did not take enough risk. Many older participants gambled on the risk-return trade-off, presuming that they would obtain higher returns if they took on higher risk. However, many of these employees were not rewarded with the returns they desired, perhaps because they selected inefficient portfolios.

2. Non-Help participants selected inefficient portfolios. The efficiency of a portfolio is measured by calculating the risk-adjusted returns. Given an estimated amount of risk, one should expect a certain level of return. During the bull portion of the study period, Non-Help participants did not get the added return for taking the additional risk. Help-Participant portfolios outperformed Non-Help Participant portfolios 87 percent of the time during the four-year study period.

3. Non-Help participants misjudged market timing. In 2008 and early 2009, many near-retirees panicked and pulled out of equity funds, thereby missing out on the bull market of 2009.

Surprisingly enough, younger participants were more likely to get help than the near-retirees, despite the fact that near-retirees tend to have larger account balances and, thus, more to lose. In addition, age appeared to be a major determinant of the type of help utilized. Younger Help-Participants were more likely to use target funds and near-retirees were more likely to use managed funds.

The good news is that more people are seeking help with 401(k)s, and there are more places to get help managing a 401(k) both inside and outside of the company. HR professionals can assist you with in-house options. One option to manage a 401(k) outside of the company is to set up a self-directed account without moving the funds from your plan. The money stays in the company 401(k), and you can potentially increase your diversification beyond the limited line-up of funds provided by most employers. The most important issue is getting the help, not whether the help comes from within the company or outside the company. The question is no longer "How much does the help cost?" It's "How much does it cost not to get help?"

[i]Help in Defined Contribution Plans: 2006 Through 2010 by Financial Engines and Aon Hewitt. September 2011.

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