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Planning for the Future by Taking An Active Role in Managing Your 401(k)

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A recent research report confirmed that the vast majority of 401(k) participants rarely, if ever, change their initial investment choices. Often these choices are grossly out of balance or totally inappropriate considering one's investment objectives, time horizon and risk tolerance. For example, many participants have all their assets invested in a money market fund. At the other end of the spectrum are investors that act as if their 401(k)s were a Las Vegas casino. These investors trade far too frequently, chase the latest trends and take excessive risks in the most volatile areas, such as emerging market stocks or commodities. These tactics inevitably backfire.

Each extreme — too passive and out of balance or too active and risky — squanders the potential to retire comfortably. After all, a 401(k) plan is the primary retirement vehicle for many Americans. There is a better way.

Asset Allocation Funds

Often the best solution is "one stop shopping." Many plans offer one or more Asset Allocation Funds as an investment option. These funds offer outstanding diversification, are professionally managed and are simple to use.

Asset Allocation Funds typically cover all the bases. The better funds not only invest in stocks and bonds, but may include commodities, real estate, currencies and other hard-to-invest-in asset classes. These investment choices can both add return and lower risk because they are non-correlated, an industry term for "zigging" when other things are "zagging."

Furthermore, Asset Allocation Funds are typically actively managed and may exploit investment opportunities across a wide array of investment markets. This includes opportunistically adding exposure to equity, fixed income or international markets.

Typically, Asset Allocation Funds are created based on target retirement date or risk level. There are aggressive, moderate or conservative choices — pick your personal risk level and you're done.

Asset Allocation Funds are the best option for those who wish to take the prudent, but hands off approach, to their 401(k) investment strategy. Professionally

managed and rebalanced, Asset Allocation Funds allow your investment strategy to age with you, actively becoming more conservative as retirement approaches.

Building Balance Yourself

The first step in managing your 401(k) yourself is to determine your asset allocation target. This is the percentage of assets that should be in each key investment category: stocks, bonds and international investments.

Many 401(k) plans have good planning tools on their websites, which is a great place to start. By entering your age, objectives and risk tolerance, you'll receive a pie chart with recommended allocations in each investment category.

Another approach is to build this chart yourself. The "Rule of 100" is a good way to determine the percentage of your assets that should be invested in equities. 100 minus your age should be your equity percentage; for example, a 35-year old investor should have a 65% equity percentage ($100-35=65$) and the remaining 35% should be invested in fixed income.

Some financial planners do believe that given increased longevity and more active retirements, the Rule of 100 may be too conservative. If so, the equity allocation would become too small too early and limit the potential growth of assets that may be necessary for a long and active retirement. More aggressive investors may in fact want to use a Rule of 110, or even 120, as the equity percentage. This will keep more of your money working longer — but will also add some risk.

When it's time to pick the individual funds, in general, broader is better. Look for equity mutual funds that have a wide investment mandate, one that can own larger, mid and smaller stocks. It's also better to use a core equity fund that can hold both growth and value equities, which prevents you from becoming exposed when one style goes in or out of favor.

In fixed income, the same rules apply — it's best to look for a multi-sector fixed income fund. Typically these funds own many slices of the bond market — mortgages, corporates, high yield — diversifying one's risk from any single fixed income market investment.

Lastly, don't forget about international funds. Generally, 20 to as much as 40% of your equity allocation should be invested in non-US equities. International investing not only diversifies against a period of poor returns for US equity markets but also takes advantage of many countries and regions that have faster growing economies.

Many plan participants, overwhelmed with the number of investment choices and a lack of understanding, choose to place a small investment in every mutual fund offered. Fight this urge. An optimally diversified portfolio can be constructed with a maximum of five to seven key investment choices in the correct proportions.

Once you have constructed a sound 401(k) investment plan, be sure to stick to it and let time be your friend. Success is about time in the market, and not market timing. That is, the longer that you are invested, the higher the odds of achieving your investment objectives. Jumping in and out of the market rarely works and can seriously backfire if you panic your way out of the equity market in a time of

stress. Work with volatility and time and remember that you are adding to your 401(k) with every paycheck!

Jerome J. Jacobs, CFA, joined Argent Wealth Management in 2006. He is responsible for investment strategy, asset allocation and investment manager selection. Jerry has over 25 years of investment experience, most recently as the Senior Investment Strategist of Putnam Investments. He serves as a Board Member of Career Collaborative and as a member of the Investment Committees for Pine Street Inn and the Inner City Scholarship Foundation. He has a B.S. in Economics from the Wharton School of the University of Pennsylvania and is a Chartered Financial Analyst. For more information, please visit www.argentwm.com.