



Mutual Funds 7/8/2008 12:01 AM ET

## 5 big holes in your 401(k) nest egg

Yes, the stock market's down, and your retirement account is likely down with it. But common problems can leave your plan leaking money even in the best of times.

By [Tim Middleton](#)

You'll get your quarterly statement on your 401(k) any day now, and chances are it's going to be a mess.

Yes, performance has been awful. That, however, is the market's fault, not yours. There is probably a big problem with your retirement-savings plan, though, and it's not what it offers -- it's what it doesn't offer.

You're likely penalized by this problem whatever your circumstances. Lower-paid workers seldom have access to an option that benefits them uniquely. Older workers can be locked into a lousy plan even though federal rules are supposed to give them an escape clause.

And nearly everyone faces too many choices that duplicate each other and too few that allow thorough diversification -- for example, putting money into commodities, the only investments that have done well this year.

Jim Corbeau of Maas Capital Advisors in Hillsboro, Ore., says the typical 401(k) plan he reviews has "lists of 30-plus funds, including five-plus in one asset class, such as U.S. large-cap growth, but that miss six or more of the asset classes we use."

In general, he adds, plan options "look like they were plucked from last year's Morningstar list of top funds," rather than representing options for a well-rounded portfolio.

You should be so lucky as to have access to Morningstar's top funds. More likely you're stuck with a bundle of junk your boss's broker or insurance agent couldn't sell to anybody else. And unless you work for the largest corporations, your fees are probably way too high. But those are the usual 401(k) complaints.

Much less well-known are the following five 401(k) money pits. One of them could be eating away a portion of your retirement nest egg without you even knowing it.

### The useless tax deduction

One of the most powerful incentives to encourage retirement savings is the tax deductibility of contributions. You contribute pretax dollars. You pay taxes on that chunk of your income, plus the gains, when you take it back out after retirement,

But what if a tax deduction means little to you? Many workers, including those in entry-level positions, pay very little in income taxes. Is there a better way for them?

Chris Long, the president of Long & Associates in Chicago, says yes: the Roth 401(k). As with the Roth individual retirement account, contributions are not deductible -- you pay the tax now -- but the proceeds aren't taxed when they are taken out at retirement. Even a modest nest egg is powerful when it's tax-free.

"The Roth IRA option is especially valuable to lower-paid employees who will get little or no benefit from the immediate tax deduction for traditional 401(k) options," Long says.

The problem: Only about 20% of 401(k) plans give you the Roth option, according to the Profit Sharing/401(k) Council of America.

### The same old, same old

I surveyed dozens of financial advisers in recent weeks, and their most common complaint about 401(k) plans is the overabundance of options that invest in the same thing: large-capitalization U.S. stocks.

Recently, of course, large-cap stocks have been leading the market down.

"I rarely see good choices for small-cap U.S. stocks and very rarely see any choice for small-cap foreign stocks," says Tom Adams, a planner with Mentor Capital Management in Elmhurst, Ill. Real-estate-investment trusts, which have a low correlation with both stocks and bonds, are also rare.

Commodities, easily accessed through exchange-traded funds, are virtually never offered, nor are specialized funds such as bear market portfolios. We could all have benefited from putting some money in these over the past year.

### Ever hear of inflation-protected bonds?

The 401(k) industry thinks a bond is a bond.

"Many times a 401(k) will have 15 to 20 stock fund choices and one bond fund," fumes Lucas P. Hail, an adviser with Foster & Motley in Cincinnati.

### Video on MSN Money



#### ▶ [Should you borrow from your 401\(k\)?](#)

With Americans facing record debt, record high gas prices and difficulty getting cash from home-equity loans, 401(k) 'hardship' withdrawals are tempting.

That one all-purpose bond fund is probably doing lousy this year because of stagflation. But you could avoid that malady with what are called Treasury inflation-protected securities, which grow your money to beat inflation. But few plans offer a TIPS fund.

European interest rates are much higher than those in the United States, making foreign bonds appealing, but they, too, are generally absent. And when junk bonds soar in the next economic cycle, most retirement investors will be left without access to them.

#### **Turning your nest egg into a debit card**

Many employers are proud to offer their workers low-cost loans via their 401(k) balances.

"A product called ReservePlus goes one step further and makes the 401(k) loan amount available via debit card," notes Cheryl J. Sherrard, the director of financial planning at Rinehart & Associates in Charlotte, N.C.

This "convenience" is a particular abomination because, she says, "it generally means they have tapped out all their other resources and this is the last place to run."

Borrowers rationalize that they are paying interest to themselves, but they are forsaking higher investment returns, plus all the extra dollars compounding would have provided. Loans against 401(k) accounts are among the stupidest ideas Congress ever had, and that's saying something.

#### **Rolling over rollover rights**

Especially at small and midsize plans, investment options are lousy and expenses outrageously high; anything over 1.0% in fund expense ratios is suspect. But the Employee Retirement Income Security Act, or ERISA, which lays out 401(k) rules, does give older workers, who tend to have the biggest balances, an escape clause into individual retirement accounts.

"Technically, ERISA allows an employee, once they reach age 59 1/2, the ability to roll out of the current 401(k) and into an IRA while still allowing payroll contributions to the 401(k)," says Greg Plechner, a principal of Greenbaum and Orecchio of Old Tappan, N.J.

These are called in-service rollovers, but because administrators hate to lose assets, your plan may discourage or even forbid them. If you qualify for this exemption and you're stuck in a lousy, expensive plan at work, you have leverage to demand your rights. Start with your plan's investment committee.

Like cubicles, 401(k) plans are cheap and ugly, reminding employees how little they are valued. But because the fates have conspired to put you in charge of your personal pension plan, you owe it to yourself to do it well. If the company plan stinks, say so. And don't be afraid to squawk to the U.S. Department of Labor. That's where the 401(k) buck stops.