# Take your 401(k) for a tuneup

Many workers are looking at 401(k) plan balances that have shrunk to a fraction of their former size as the stock market decline enters its fourth year. The question facing them is how to invest whatever money they have left in these corporate-sponsored retirement accounts.

“People are somewhat shellshocked,” said W. James Beatty, first vice president for investments in the Portland office of Merrill Lynch. “They’ve been traumatized by three straight years of losses and are nervous about investing in stocks.”

The temptation, especially in the wake of the market free-fall earlier this week, is to shun equities altogether. Why not just say to heck with it and run for the safety of bonds and cash?

The answer is that with interest rates at 40-year lows, the returns on fixed-income investments are microscopic. And even though inflation is tame, it still exists, so you wind up losing money in terms of purchasing power.

The secret to success, investment professionals insist, is to formulate an asset allocation plan for your entire portfolio, including your 401(k) plan, and to adhere to it no matter what happens in the short term.

This may entail ignoring the nightly news and the stock tables while you try to pretend that the gut-wrenching cycles of ups and downs (and downs and downs) are not happening.

“The beginning of the year is a good time to reassess your goals and see how close you are to meeting them,” Beatty said. “Ideally, everyone should have an asset allocation model,” which sets targets for how much of your money to have in different asset categories such as stocks, bonds and cash.

A reasonable asset allocation model for middle-of-the-road investors in their 40s might be 60 percent stocks and 40 percent bonds, he said.

Because of the long market slide, Beatty said, “It’s likely that your asset allocation model is out of whack.” This means it’s time to readjust your asset weightings, something the pros dub “rebalancing.”

Say your 401(k) plan balance has shrunk from $150,000 to $100,000. The stock portion of your balance has slid from $100,000 to $50,000, while the bond portion has doubled from $25,000 to $50,000. So, your current allocation is 50-50. To rebalance to get to a 60/40 stock/bond ratio, you would sell $10,000 of your bond holdings and put the proceeds into stocks.

Within the equity portion of your 401(k) holdings, the Merrill Lynch model calls for 10 percent to 15 percent of that to be in international stocks, 10 percent in small- and mid-cap stocks, and the balance divided evenly between large-cap growth and large-cap value stocks.

Balance all around Beatty suggested that in addition to adjusting how you allocate your existing holdings in your 401(k), you also revise the way you earmark your new contributions to reflect your current asset allocation model.

Sometimes, the simplest approach is best and adjusting things just once a year is fine,

thank you. Fiddling with your holdings more frequently means you can “micromanage your assets to the point where it doesn’t make a lot of sense,” he noted.
Intellectually, rebalancing is a straightforward proposition, especially if you agree with Beatty and others who believe that “stocks are going to have their day again.” But, emotionally, it may be difficult if not impossible to plow more money into an asset category that seems to have many more losing days than winners.
If rebalancing your 401(k) plan is hard to do when you’re sitting on some gains, imagine how tough it would be if all you had were losses (and you didn’t even have the consolation of being able to deduct them, the way you could in a taxable account). This could be the predicament of aggressive investors close to retirement who put all their money into tech stocks at the height of the market — and then watched the value of their holdings evaporate.
Ideally, people in this situation should be lightening up on speculative stocks and concentrating instead on fixed-income investments and dividend-paying stocks. But what if the only way to accomplish this is to sell all of those technology dogs at a loss?
Then the thing to do is wait until there’s a sustained market rally, suggested Daniel Sharp, president of Sharp Investments, an investment advisory firm in Beaverton.
“The time to rebalance wouldn’t be at the end of a round of panic selling but during the one or two good selling points a year that occur even in bad markets,” he said.
Down in the depths Sharp said the biggest challenge that many workers face is discouragement over the recent performance of their 401(k) plans.
“What a lot of people do when they see their balances going down is to stop making contributions, especially during tough economic times like these when money is tight,” he said.
But especially if your company matches your contribution, not contributing to your retirement plan is like leaving money on the table. Not only do you acquire more shares when prices are down, but you also get the added bang of the company match.
“In good times and in bad, you need to keep socking your money in there because it will make a huge difference down the road,” Sharp said.

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