COUNSELING PARTICIPANTS ABOUT THEIR 401(K) IN A VOLATILE MARKET

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Sometimes it seems like our investing lives are just one big roller coaster ride. The markets gyrate this way and that way, and it can be quite unnerving for retirement plan participants, particularly as they near retirement. Human resources professionals may struggle with what they should be telling participants that is accurate and helpful in keeping them on track for a successful retirement. What is the right message and how should they frame the discussion with participants?

As a participant myself since 1987, and as someone who has been through quite a few up and down markets, I have spent a lot of time thinking about these questions. I have come to realize that participants think about volatility and down markets very differently than investment professionals and in ways that, while understandable, are not helpful in meeting their long-term retirement goals.

Here are a few ideas from a veteran roller coaster rider that may help retirement plan participants make better long-term decisions and be more likely to reach a secure retirement.

1. Remember it's a retirement plan

In the excitement of a volatile market it can be easy to focus on what is happening today. It sounds simple, but participants sometimes forget that their 401(k) is a retirement plan because for most participants, retirement is many years away. Participants should be reminded that:

- **The goal is to provide income in retirement.** Participants should focus on whether they are on track to have sufficient funds to replace the income they will be giving up when they retire, not on whether the market is up or down today, this week or this month. Put that way, downward moves in the market can be viewed as an opportunity to help reach the retirement goal (because the next deferral will buy more of the target date or other investment fund). When there are downward moves, remember what Warren Buffet said: We want "...to be fearful when others are greedy and to be greedy only when others are fearful."

- **The key word is plan.** Saving for retirement takes a long-term plan. It is not something to do from time to time. It is an on-going activity and it is important to establish a plan (say replacing 80% of your pre-retirement income) to measure success. This will help participants get closer to their goals and stick to their plans knowing, like many things in life, there will be good days and not so good days. When participants view their savings through the perspective of the plan, they are less likely to trade and potentially get out of the market based on short-term market changes.

- **Even those nearing retirement have many years to invest.** Many participants view retirement as a point-in-time event. One day they are working and invested and the next they are retired and need access to their money. It is true that there is a point in time when we are no longer working or collecting a paycheck and must rely on our savings, pensions and Social Security for future income. But participants need to remember they don't need all of their retirement money at once. Retirement for many of us will be a journey of 15-30 years. So when we retire we'll need money for current living expenses which should be invested to avoid losses and create liquidity. If we've been saving, we will also have money, that we will need years down the road. This is money that should continue to be invested to grow.

2. Are participants investing appropriately?

When markets are volatile, it is certainly a good time for participants to review their plans and determine if they are invested appropriately or if things have changed in their lives that might warrant investment changes. This is a question for all participants, but it has additional urgency for those nearing retirement. It never hurts to remind participants of the importance of being/remaining diversified. Participants who are truly diversified (target date fund, managed account or a broad array of asset classes from the core menu) will tend to experience less volatility over time and are more likely to be ready for retirement. Most record keepers offer an array of on-line tools as well as help through their call centers for participants to determine if they are invested suitably. Talking with a professional can provide assurance to participants that even when markets are volatile, participants are on-track for success.

3. Risk

Investment professionals and individual plan participants think about risk very differently. For the investment professional, risk is the variability of returns and, more specifically, the downside variability of returns. Participants, often think of risk as simply the potential to lose money today. Over the years there have been a number of studies that demonstrate that most people regret a loss much more than they appreciate a gain. This is a very powerful controller of participant behavior and can have negative long-term consequences if participants react to market volatility rather than focus on their long-term goals.

So it is good to remind participants about the long-term and that focusing on short-term volatility may increase the risk they will not have enough money in retirement. In fact, the very real risk that many participants face is not the potential to lose money today. Rather it is the potential to run out of money during an extended retirement. The participant who makes this mistake will probably not have enough time to make up for the shortfall and will see their lifestyle permanently impaired.

4. Savings Rates are More Important Than Investment Returns

Study after study shows that most participants don't save enough in the plan to reach their long-term retirement goal. Therefore, one of the most important messages we can tell participants is that their plan has to include an adequate level of savings. For most participants, this means saving a minimum of 10% between the employee and employer contribution and preferably closer to 15%. Of course, that is easier said than done, which brings us back to the need to always focus on the long-term and have clear goals or a plan.

5. Ignore the Headlines

Investment has become entertainment for the media. Watching the talking heads on TV is not an investing strategy. Encourage participants to ignore short-term thinking and recommendations from the investment entertainers.

6. Consider professional help

Many participants are more likely to achieve their goals when they have the help of a professional. Most plans offer either target date funds or managed accounts. These provide participants with professionally selected and managed portfolios that usually dampen the volatility of the markets while providing long-term investing toward retirement goals. Participants invested in their professionally managed portfolios are more likely to stay the course than participants who choose their own portfolios.

Conclusion

Participants are likely to reach their long-term goal if they follow these simple rules: have a plan, focus on the long term, save appropriately, stay invested and consider professional help. When participants show concern about the volatility of the markets, remind them that by following these simple rules they can have peace of mind and get closer to their retirement goals. That's some good news we all can use.

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