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Are 401k's Finally Recovering?

Two recent studies indicate that most defined-contribution-plan participants have the same or higher balances in their accounts now, than before the stock market began to tank. Such reports should be taken with a grain of salt, however, say experts, who also advise HR leaders to continue educating employees on the importance of prudence and diversification – in good times and bad.

By David Shadovitz

Like the major stock indices they're so closely aligned to, 401(k) accounts have been rallying too, according to recent reports by Fidelity Investments and Vanguard Group.

But, while experts agree that 401(k) plans have come a long way since the stock market hit its low point in March 2009, some note the real picture may not be nearly as bright as the leading mutual-fund providers suggest.

In a report entitled Recovery in 401(k) balances released on Dec. 2, Vanguard Group of Valley Forge, Pa., said 60 percent of plan participants had the same or higher balances in their accounts in September 2009 as they did in September 2007, before the market began to tank.

For the remaining 40 percent with lower accounts, most were less than 20 percent below their earlier peak value.

The Vanguard study found that investors who put their money purely in target-date funds fared better than most, with 70 percent seeing their account balances return to or exceed the levels they were at two years ago.

"Pure target-date fund investors fared better throughout this period than many other investors for two primary reasons," says Jean Young, senior analyst with the Vanguard Center for Retirement Research.

"First, most target-date investors have been contributing to their accounts for a limited period, so ongoing contributions benefited the small account balances more. Second, with diversification inherent in their target-fund portfolios, target-date investors do not have all their savings invested in equities."

Fidelity Investments of Boston also reported considerable improvement in 401(k) retirement accounts, noting that the average 401(k) account balance climbed 28 percent between the end of the first quarter of 2009 and the end of the third quarter.

Jamie Kalamarides, senior vice president of retirement solutions for Prudential Financial in Hartford, Conn., says he's not surprised to see many 401(k) plans recover.

"Most providers are seeing the positive effects of the stock-market increases and the ongoing contributions individuals have been making to their retirement plans," he says. While the numbers are certainly promising, Kalamarides says, they mask the real issue: How do investors avoid the downside risk [once they're] in retirement and [ensure they] don't outlive their assets?

And that question should lead HR executives to revisit what's being offered in their plans and ask themselves, "Do workers save to retirement or through retirement?"

Stewart Lawrence, senior vice president and national retirement leader for Segal Co. in New York, says employers might want to take the Vanguard and Fidelity reports with "a grain of salt."

"If you looked at these numbers by account size, my guess is that the bigger the accounts, the less they will have recovered, because employee and employer contributions would be much less of a factor," Lawrence says.

The fact is the Dow Jones and S&P have yet to recover, he says. "So it should strike one as odd that 401(k)s would have recovered when the majority of [these] plans are in equities?"

Experts note that employers are making some tweaks to their 401(k) plans, such as adding automatic enrollment and autoescalation features. Some believe, however, that the real lesson to be gleaned from the past two years is the importance of staying the course.

People have been pretty consistent in their behavior during the market meltdown, says Matt Smith, senior vice president and defined-contribution practice leader for Aon Consulting in Seattle. "We didn't see a lot of people bail out of their 401(k)s or change their investment mix."

The real story here is that it's important to be prudent during both good and bad times, Smith says.

Whether the assets are in a target-date fund or any fund with a diversified mix of investments, he says, you're likely to have better returns over the long run when you let a professional manage them.

As the market continues to recover, Smith says, employers need to make sure they have sound governance processes in place to review their plans ... and reinforce the importance of diversification in their communications to employees.

With the pickup in the economy, some employers are also evaluating whether or not to reinstate the 401(k) plan employer match in 2010.

According to Fidelity, about one-quarter (27 percent) of the 8 percent of employers that reduced or suspended their match have either reinstated it or are considering doing so in 2010. The trend is especially true for companies with 5,000 or more employers, where 44 percent of those surveyed said that was the case.

David P. Boucher, senior vice president of corporate benefit services for Longfellow Benefits in Boston, however, says many of his clients have been hesitant to restore the employer match because of the lack of visibility in their businesses.

"Not everyone is out of the woods," says Boucher, and while some of his clients are considering bringing back their employer match, he's not aware of any clients that have already done so.

Boucher notes that many of his clients are also wrestling with how aggressive they should be when it comes to getting plan participants to consider equities again."

A huge amount of money went into money-market investments [during the downturn]," Boucher says. "Because [many companies] don't see the light at the end of the tunnel in their own businesses, they're cautious about promoting asset allocation toward stocks [to plan participants]."

Boucher advises plan participants to "dollar-cost average" their way back into the market. "If you put your money in cash or a money market," he says, "you need to develop a systematic time frame for getting back into the market."

For its study, Vanguard looked at 1.7 million participant accounts in defined-contribution accounts. Pure target-date fund investors represented 5 percent of this group. Fidelity's study was based on data from 11 million plan participants.

DISCLAIMER: The principal value of a target-date fund is not guaranteed at any time, including the target date.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not ensure against market risk.

Dollar cost averaging involves continuous investment in securities regardless of fluctuation in price levels of such securities. An investor should consider their ability to continue purchasing through fluctuating price levels. Such a plan does not assure a profit and does not protect against loss in declining markets.