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Planning Your 401K
Is Your Largest Asset on Target?

Target Retirement Allocations within retirement accounts may be a helpful choice

What is your largest asset? Ask a business owner and he or she will likely respond “my company.” Ask a homeowner and the likely response will be “my home.” While your business or home may indeed be your largest asset now, converting these into an income stream to support retirement needs may be a different matter. For many, the correct answer to the “what is your largest asset” is your retirement account. What are you doing to ensure that this potentially largest asset is being properly managed?

Confused by Investment Choices?

The amount that today’s workers will have as an available nest egg at retirement will be greatly influenced by several factors, including the amount they contribute, the amount of employer matching, and the investment allocation selected.

Apparently, many participants in 401k plans are confused as to what investment option(s) to select and consequently avoid any decision. Recent legislation now permits retirement plan sponsors to automatically enroll employees who do not make investment elections into “target retirement accounts.” These types of investments are age-driven, so that an employee just starting in his/her career, absent from making his/her own election, would be automatically enrolled into an investment geared towards the number of expected working years until retirement. An employee in his ’20s would have a mix of investments more heavily tilted towards stocks than would an employee in her ’50s. The essence of target retirement accounts is that they incrementally reallocate assets into a more conservative investment mix as the investor gets closer to his intended “target.”

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Not all target allocations are constructed equally

While target retirement accounts may help reduce investment confusion by automatically enrolling those unable or unwilling to make a decision, there are some caveats. Many 401k plans offer investment options, including target accounts, from leading companies in the industry. Disparities may exist between investment options that appear to have common goals and objectives. For example, when considering investment options geared for an investor who plans on retiring on or around the year 2020, one leading provider allocated 64% of its portfolio to stocks, while the other more aggressively allocated 70% to stocks. Therefore, not all investment options that appear to have the same goal are created, or constructed, equally.

A target account may not match up to your risk tolerance

A planned year 2020 retirement doesn't necessarily mean you should select a 2020 target investment fund. You may have a desire for a heavier or lighter weighting towards stocks, based upon your risk profile. Many 401k providers and financial advisors alike assist their clients with a tool commonly referred to as a risk tolerance questionnaire. Questions fall into two main categories, the first being factual (your age, planned years until retirement, amount of assets in retirement accounts) and the other gauging feelings (how would you react if your account experienced a loss in the event of a market decline; would you sell, hold or look to buy more, etc). Points are assigned to each response and one's total score is the basis for a recommendation.

Assume that your score reflects a recommended allocation of 80 percent to stocks and you indeed plan to retire in 2020. You should research the options available for an investment mix that is appropriate for your risk tolerance. In this case, a 2025 or 2030 target investment may be more appropriate.

Summary

While target allocations can be quite useful, just be sure to measure your propensity for risk, using a risk tolerance questionnaire first. Then look for a target allocation that most closely aligns with your goals. Your financial advisor may be helpful in more closely examining all available investment options that you are eligible to invest in, and to recommend a strategy that includes or excludes target allocations. Helpful websites also include www.401kHelpCenter.com as well as www.FINRA.org. FINRA stands for the Financial Industry Regulatory Authority, the largest non-governmental regulator for all securities firms doing business in the United States.

Diversification does not guarantee against loss. It is a method used to help manage investment risk.

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