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6 HABITS OF SUCCESSFUL 401(K) SAVERS

By Gregory S. Ostrowski, Managing Partner, CERTIFIED FINANCIAL PLANNER®, Scarborough Capital Management

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Take an active role in managing your retirement plan with these tips.

For the majority of U.S. workers, the 401(k) plan has become the single largest source of retirement savings. If you participate in one, the good news is that you have more control over your retirement money. The bad news is that you have more control over your retirement money.

For people who do not have the time or the financial knowledge, properly managing their 401(k) can be a daunting task. Moreover, if you do not manage it well, the 401(k) can become, at best, a savings account and, at worst, a high-risk gamble with your retirement money.

To avoid the latter, use this guide to better manage your 401(k). Here, you'll find behavioral finance habits of successful savers to help you make the most of your own plan.

1. They determine their investor profile. Investor, know thyself! Everyone is different, and knowing yourself is the first step to allocating your investments appropriately. Before you can determine your asset allocation strategy, however, you must first be able to clearly define your goals.

Remember that 401(k) money is retirement money, and everybody has different dreams about what their retirement will entail – traveling, boating, etc. Also, you may have some preretirement goals that you need to save for. Separating them into different pools of money can allow you to seek varying investment options to help you fund each goal.

Also, how psychologically comfortable are you with those market downturns? Will you really be able to tolerate the inevitable ups and downs that the stock market delivers? Consider these variables when tailoring your plan.

2. They participate. The government, and by extension, your employer, give you the opportunity to take advantage of two very powerful financial concepts: the ability to save money on a tax-advantaged basis and the compounded growth of these dollars.

If your company offers a 401(k) plan, you need to contribute as soon as you can and as much as you can. It's a great first step in taking charge of your financial future.

To help employees increase the size of their nest eggs, as well as encourage reluctant employees to save for retirement, many employers offer matching funds. In the complex world of finance, we call this "free" money. If your employer is willing to give you money, you need to take it.

The only catch is that you need to contribute some of your own money to receive the company match, so it's often advisable to contribute at least as much as you need to get their matching dollars.

3. They don't panic. Listening to the evening news and hearing about the market changes on a daily basis can cause even the most stalwart of investors to get nervous occasionally.

The market will be sure to experience downward dips and swings, which is why knowing how you'll react to those swings is a factor to consider in your overall allocation. Keep your eyes on the long term.

4. They borrow judiciously – or not at all. Early 401(k) plans had no provision for loans, but they were later added as an incentive to encourage greater participation. The reasoning behind it was that if you know you can access the money if you need it, you'll be more apt to save.

Many people believe (often erroneously) that if the interest rate on the 401(k) loan is less than they would pay elsewhere, it's a good deal. That may be, but it does not take into consideration the real cost of the loan – the opportunity cost. The money in your plan cannot grow if it's not there.

Before you take anything out, determine what that money would turn into if you left it in over the life of the loan, compared with what you'd be paying in interest elsewhere. Sometimes what seems like a good deal really isn't.

5. They make decisions when they're in a good frame of mind. While aging can bring on physical ailments, it also makes us more prone to mental disease. As we get older, the chance of us getting dementia and Alzheimer's disease increases.

In a multi-author study, "Behavioral Finance and the Post Retirement Crisis," Harvard University professor David Laibson contributed his piece on "cognitive impairment." In it, he writes, "After age 60, the prevalence of dementia roughly doubles every five years. By the time people reach their 80s, more than half will suffer from either dementia or other significant cognitive deficits." Aside from the difficulty of the situation for everyday living, it can also hamper the ability to make financial decisions.

Even if we don't get one of these diseases, aging slows our ability to process numbers. Laibson also reported that our "numeracy" or "mathematical skills needed to cope with everyday life" is diminished.

What this all means is that if we wait to make important decisions about managing money for our retirement until we actually *get* to retirement, we might be shortchanging ourselves.

If we can make these decisions when these studies show our minds are fresher, we stand a greater chance of making good decisions that we can live with well into our later years.

6. They ask questions. Managing a 401(k) or other retirement savings vehicle can be confusing. That's why it's important to be comfortable with asking questions if something seems confusing or too good to be true.

In that same study, Duke University professor John Payne was interviewed on “evaluability.” The piece begins, “In their decision making, human beings do best when presented with apples-to-apples comparisons.”

He explains that the problem with this begins when the data presented highlights only one aspect, leaving other important factors off the table, thus making it an “apples-to-oranges” comparison.

The example he uses has to do with lifetime income solutions for retirees and monthly payouts. While the monthly payout for one option may be higher, it doesn’t explain how the lower one might be a better overall benefit for the retiree’s spouse.

Until financial services information is universally spelled out in “apples-to-apples” terms, asking questions so you understand the full scope of what you’re signing up for can help you avoid issues down the road.

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