Wealth Strategies

Your Retirement Paycheck

rfadvisors.com

Wealth Strategies: Your Retirement Paycheck

Do You Truly Understand Your 401(k)?

The days of corporate-funded pension plans are long gone. Essentially, we are now left to our own devices when it comes to saving for retirement, and we must create our own paycheck, per se, most often through employer-sponsored retirement plans.

You've now been given the reins to take control of your future financial life, so what exactly do you need to know? What's important in order to understand and navigate through these types of plans?

Here Are a Few Key Questions:

- Does your company match your 401(k) contributions, and, if so, how much do they match? More importantly, what does "match" mean?
- What are your investment options within the plan?
- Are there costs or fees associated with the plan, and, if so, what is the overall cost to you?
- How much should you contribute to your 401(k), and how should you allocate those funds in order to support yourself in retirement?
- Is there anybody to help guide you through these nuances?

While it's very important to answer the questions above, it's equally as important to understand the history behind these employer-sponsored retirement plans in order to best utilize them.

For decades, it was almost silently understood that employees would be cared for, financially, in retirement by their employers through employer-sponsored defined benefit (pension) plans. However, over time, as companies were sold, declared bankruptcy, or no longer had adequate funds, it became more and more evident that these plans would no longer be able to do so. In 1974, the Employee Retirement Income Security Act (ERISA) was passed and began regulating pension plans, mostly to ensure the payment of guaranteed pension premiums. The Revenue Act of 1978 later established a new type of retirement vehicle: qualified deferred compensation plans, widely known today as 401(k) plans. Employees themselves became largely responsible for funding these plans in order to save for retirement.

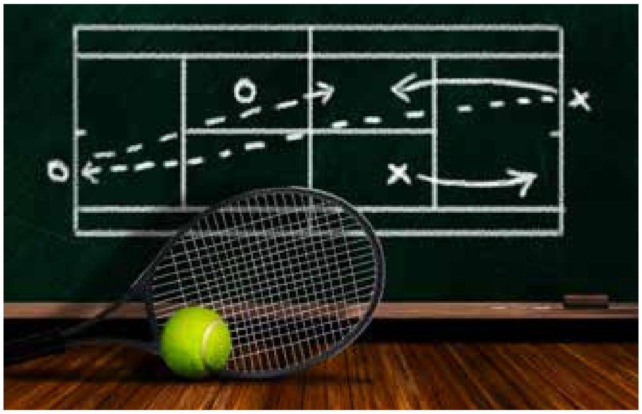
From 1978 until the early 2000s, it can be said that the 401(k) industry was somewhat of a Wild West—free of much-needed regulations, legislation, and rules. The Pension Protection Act of 2006 (PPA) was passed as a means of bringing more regulation to the fraught industry by establishing funding rules for defined benefit plans, providing auto-enrollment of employees, removing fiduciary liability when offering a qualified default investment alternative (QDIA), providing more control over investment options, and establishing many additional benefits for employees who participate in the plans.

> ***You've now been given the reins to take control of your future financial life…***

While the PPA has brought much-needed regulation to the industry, it's still very important to understand what is available within your plan in order to best save for your future.

Game, Set, Match

Think of a match as a bonus—or free money—from your company. Many employers offer a company match as part of their overall benefits package. Match contributions can vary and may be made as a percentage of your salary or a set dollar limit. It's common to find a matching contribution of 50% of employee contributions for the first 6% of salary that an employee contributes (essentially a 3% overall matching contribution). This match should be counted toward a recommended retirement savings target of 10%–15% of income.



In order to find out if your company offers a match, you will need to ask your human resources representative or whoever within your organization helps to administer and monitor the 401(k) plan.

Choices, Choices, Choices

Investment options within an employer-sponsored retirement plan vary widely by provider. While the most common type of investment choice within a 401(k) is between mutual funds, it's also possible to invest in company stock, individual stocks and bonds, and exchange-traded funds, to name a few.

A mutual fund is a pool of funds collected from many investors for the purpose of investing in stocks, bonds, and larger assets. Mutual funds are operated by money managers who invest capital with the goal of producing a return for the end investor. Mutual funds must adhere to their predetermined investment objectives as stated in the fund prospectus. Mutual funds provide an opportunity for smaller investors to participate in the stock market by purchasing smaller shares of stocks and bonds that would generally be unavailable or limited based on the small amount of capital.

Large, publicly traded companies may offer the opportunity for employees to purchase shares of company stock. While this can be a great opportunity for employees, it's always important to ensure that you don't overexpose yourself to risk by not properly diversifying retirement plan assets.

Some employer-sponsored retirement plans may offer a self-directed brokerage account (SDBA) in which employees can utilize retirement plan assets to directly purchase stocks and bonds. Stocks represent a stake of ownership in a corporation and provide a claim on part of the corporation's assets and/or earnings. A bond, conversely, is a debt investment in which an investor is essentially loaning money to a corporation or government for a defined period of time at a fixed interest rate. Bonds are typically used to raise capital to finance various projects.

Exchange-traded funds (ETFs) are similar to a stock in that they trade on the stock exchange. However, ETFs track an index, a commodity, or an index fund and experience price changes throughout the day. While widely compared to mutual funds, ETFs differ by being traded openly on the market during the day rather than at the close of the day.

The types of investments available to you will directly guide how you invest within the plan.

Nothing Is Free

As the old adage goes, nothing in life is free. Regardless of which investments you choose within your retirement plan, there are costs and fees associated with them. In addition to the fees associated with the investments themselves, as detailed at the end of this section, 401(k) plans carry costs and fees that must be either paid for by the plan sponsor (employer) or absorbed by the plan participants (employees).

In addition, there are costs associated with the administration and maintenance of the plan. Day-to-day administrative service fees can include the cost to maintain proper records of the plan (recordkeeping fees), administration costs (third-party administrator fees), the cost to hold the assets (custodial/trustee fees), and advisory or consulting fees. Oftentimes, these fees are passed along to plan participants (employees); therefore, it's important to understand how much you're paying.

In addition to all of the fees above, mutual funds and ETFs have what are known in the industry as "expense ratios," meaning that a percentage of the overall purchase price is used to pay the fees associated with the fund, while stocks and bonds usually have transaction fees that are charged each time a position is purchased or sold.

Contributions, Allocations—What's the Difference?

You must now evaluate your own retirement plan and the options available to you in order to create a strategy that best fits your individual financial situation. First, you must determine the amount you will contribute to your plan. A good rule of thumb is to contribute at least as much as necessary in order to maximize your employer's match. To revisit our previous example, if your employer will match 50% of up to 6% (or 3%), you should contribute 6% at a minimum. There are many free retirement plan calculators available online to help you calculate what makes the most sense for you.

Contributing to the plan is only half of the battle. Once you've decided how much you'll contribute, you must then decide where to put that money (your overall allocation). As previously discussed, you'll likely have access to a multitude of investment options, and these options are likely to range from aggressive to conservative in nature, offering different amounts of risk and return. Asset

allocation, simply put, is the balance of risk and reward within your investment portfolio, and it evaluates an individual's goals, investment horizon (time until retirement), and risk tolerance.

Because each person's financial situation varies, there is no black-and-white answer to proper asset allocation. Therefore, it's important to evaluate your own goals, idea of financial security, and future retirement needs in order to decide how to properly allocate your funds.

Now What?

By now, you may be thinking "Wow, there are a lot of things I need to know about my 401(k)." You may also be asking yourself, "Is there anybody out there to help me?" In order to better understand plan specifics, as well as how to maximize the plan based on your situation, begin by speaking with Human Resources to learn whether there's a professional advisor or consultant available to assist. According to the Retirement Advisor Council, about 75% of plan sponsors use the services of an investment advisor for their retirement plan. However, it's important to note that not all of these advisors are allowed to provide direct advice to the plan or its participants regarding investments. It's also important to understand the fee structure and compensation of the advisor to ensure that they aren't providing suggestions based on how they are paid, which would result in a conflict of interest.

If Human Resources is unable to help, or there is no professional advisor connected with your plan able to assist you, other options include consulting a fee-only planner or other investment professional.

If you're a client of Reilly Financial Advisors, 401(k) consulting is just one benefit available to you at no additional cost. Simply reach out to your Senior Wealth Advisor, and he or she will be happy to help you.

Reilly Financial Advisors is a fee-only RIA aimed at helping clients both define and achieve their individual financial goals through four unique service offerings:

- **Wealth Building**
  For those still accumulating their investment portfolios
- **Wealth Management**
  For those who have amassed savings and have specific needs associated with their wealth
- **Wealth Legacy**
  For those who have accumulated a significant amount of wealth and face unique wealth transition needs
- **Corporate Retirement Services**
  Providing tailored solutions for plan sponsors and participants

Reilly Financial Advisors, founded in 1999 and headquartered in San Diego, California, serves clients around the United States and in more than one dozen countries worldwide.

As an independent advisor, Reilly Financial Advisors is able to provide clients with the highest level of fiduciary services, making investment decisions based solely on their best interests.

At Reilly Financial Advisors, it is our goal to be clients' first point of contact for all their financial needs, serving as their trusted financial partner for life.

If you would like to make a complimentary appointment to meet with one of our advisors, you may do so on our website or by calling us at **(800) 682-3237**.