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Solving investor inertia

For many investors, a 401(k) or defined contribution assets are their largest investment. Despite this, their general investing behavior is almost shocking. It's not the market timing or chasing the hot manager that seems to haunt participants. It's their inertia that works against them. A few statistics help to prove the point.

PERSONAL FINANCE

RICHARD TODD

In a study by Ameriks and Zelds, 78 percent of TIAA-CREF participants made no changes in their investment portfolio during a 10-year study. Further, a recent Hewitt study also confirmed the frozen approach, as 81 percent of the 401(k) participants surveyed in 2002 made no investment changes in the year.

This is not only a recent phenomenon, as a 1988 study of TIAA-CREF participants essentially revealed the same thing.

Doing nothing may be more effective than chasing returns, but at a minimum, participants should be actively rebalancing their portfolio back to a strategic target. Strong stock market performance in the late 1990s would have forced investors to take an allocation from stocks and add to bonds. This is called "strategic allocation."

Perhaps it's investment advice that participants desire. But when sophisticated advice tools are made available to participants, they are seldom used.

AIG Valic made Financial Engines, a leading advice provider, available for free to all employees. Only 10 percent, however, took advantage of the service. Further, according to Deloitte and Touche, more than 80 percent of employers say less than 25 percent of participants have taken advantage of investment advice.

Solutions we have seen work consistently are lifecycle funds, model portfolios and target date retirement funds. In other words, a plan participant can make a single decision to invest in one fully diversified portfolio based on time frame and downside risk tolerance.

These are the only variables that the investor controls. Experts make the decisions about design (the percentage in stocks and bonds, domestic versus international, small cap versus large cap), investment products (which underlying mutual funds) and rebalancing (moving back to strategic target). The participant can then remain frozen and benefit from a well-diversified, actively managed portfolio.

There are a number of lifecycle or target date retirement fund products available from fund families, or plan sponsors can work with an investment consultant to design custom portfolios comprised of the funds on the investment menu.

If you are a plan participant and do not have lifecycle options available, ask your investment committee, trustees or benefits department to consider adding them. If you are a retirement plan sponsor, evaluate your participant behavior and explore adding these options. Most retirement plan vendors have the capability. If they don't, it's probably a sign your provider is archaic.

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