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The Perfect 401(k) Storm

By Margaret K. O'Meara, CFP®, AIFA™

In 1982, when 401(k) plans were officially sanctioned by Congress¹, the S&P 500 index had been struggling to gain traction for more than a decade.² Back then, few could have imagined one of the longest bull markets in U.S. history was about to begin!³ By the time the new millennium arrived on January 1, 2000, the S&P 500 had generated an average annual total return during the '80s and '90s of more than 17.5%,⁴ according to Vanguard!

But, the seeds of potential disaster were being sown for some soon-to-be retirees in the early 2000s as they began to implement the “lessons” they’d learned over the previous two decades. Here are three of those lessons:

- **Stocks may go down temporarily, but they’ll soon go back up.** For plan participants who’d been watching their account balances balloon over the years it was normal to believe that owning stocks wasn’t as potentially risky as they’d been told. And the last five years of the 1990s “proved” this to be “true” as the S&P 500 total return averaged over 20% per year from 1995-1999,⁵ according to data from Yahoo! Finance. Many media pundits were proclaiming a “New Era” of ongoing investment gains had arrived as our global economy was linked via the internet, forever canceling normal business cycles.
- **Use “conservative” withdrawal rates from your 401(k) – like 10% per year.** When it came time to retire and begin taking income from their retirement accounts, some retirees logically assumed they could easily withdraw 10% per year without eating into their principal. After all, stocks had been doing much better than that for many years. But, a hypothetical retiree with \$500,000 in the S&P 500 who began withdrawing 10% annually in 2000 would have no money left by 2007, according to Thomson/Reuters Investment Analysis.
- **Leave your money in your 401(k) when you retire because it’s “free.”** Some retirees believed they would be better served by leaving their funds in their 401(k) when they began taking withdrawals because there were no or low fees. But, that’s not necessarily the case according to the Department of Labor (DOL). A DOL study found that the fees charged for

¹ <http://www.irs.gov/retirement/>

² Thomson Reuters investment analysis

³ Ibid

⁴ Ibid

⁵ Ibid

401(k) plans varied widely, and were often difficult for consumers to understand.⁶ And, in some cases, it may cost no more to engage a professional investment consultant with access to literally thousands of investment choices.⁷

As the decade of the 2000s winds down, another historic investment milestone appears to be in reach – that of the worst decade for stocks in the history of the market. It may eclipse the disaster of the 1930s during the Great Depression, which saw the S&P 500 produce an average annual total return of 0.0%, according to Vanguard.⁸

Unfortunately, for many retired 401(k) participants who bought into the “lessons” learned during the heady days of the ‘80s and ‘90s, time is not on their side. The funds they have lost over the past decade can’t be easily replaced. And some may have lost everything they had spent a lifetime accumulating for their “golden years.” Of course, hiring a professional financial advisor doesn’t guarantee retirement success. But, it usually provides access to many more choices and opportunities for retirees to possibly reach the goals for which they’ve worked so hard.

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⁶ <http://www.dol.gov/ebsa/pdf/401krept.pdf>

⁷ *ibid*

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<https://institutional.vanguard.com/VGApp/iip/site/institutional/researchcommentary/article?File=NewsLostDecade>