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Does Your 401(K) Offer a Self-Directed Option?

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401(K) plans should not be a "set it and forget it" investment strategy, but rather, actively reviewed and evaluated as part of your entire portfolio.

401(k) plans can be challenging for the average investor to manage, especially plans offered by smaller organizations. High administrative fees and limited investment options can present substantial issues with these retirement plans as the costs tend to be disproportionately higher when there are fewer participants. This can lead to reduced investment growth and less flexibility in managing retirement savings effectively.

Benefits of Self-Directed Brokerage Accounts with 401(k) plans (SDBA):

Some employer plans allow for having a Self-Directed Brokerage Account (SDBA). This option offers a wider range of investments beyond what traditional plans provide, including individual stocks, bonds, ETFs, and various mutual funds. This flexibility allows for greater customization and possibly lower fees.

Role of your Wealth Counselor:

By working with your Osborne Partners Wealth Counselor, you can enhance your retirement strategy. Your Wealth Counselor can assess your entire financial landscape, including risk tolerance, current personal needs, and long-term personal and professional goals. Many individuals view their 401(k) plan in isolation, not fully considering how it may fit into their broader financial picture. Your Wealth Counselor helps bridge this gap by offering insights on integrating your 401(k) with other retirement income sources and developing strategies for maximizing Social Security benefits. By taking a comprehensive approach, your Wealth Counselor can see to it that all aspects of your financial future are aligned and optimized.

Default Options in 401(k) Plans:

Many 401(k) plans have default options, which are frequently target-date funds. In fact, there is around $4 trillion invested in these funds, which are a type of mutual fund designed to simplify saving for retirement. Target-date funds typically hold a mix of asset classes (stocks, bonds, etc.), providing built-in diversification. This hands-off approach to investing automatically adjusts its asset allocation over time based on a specified target date, which is usually set around the year you plan to retire. The funds are designed to rebalance to your age and do not take into consideration current market conditions. It benefits those who do not follow investment markets and who do not want to proactively rebalance their accounts. In other words, it is designed for those who do not want to take an active approach to investing. As a result, investors in target date funds are unlikely to optimize their returns and invest according to their personal risk tolerance and financial goals. In addition, some target date funds have higher fees compared to other investment options, which can affect investment returns over time.

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At Osborne Partners, we fundamentally believe that every investor's strategy should be tailored to their unique situation. Sponsors of target date funds, on the other hand, believe everyone invested in their funds are the same and that their strategy should be based on their age instead of the range of investable opportunities at any given point in time. This often results in unintended consequences.

For example, researchers at the University of Illinois Champaign-Urbana and MIT did a recent study* analyzing and quantifying the opportunity cost of investing in target date funds. They found, on average, that investors in target date funds were losing 1.7%-2.8% in portfolio performance per year versus investors focused on actively optimizing their investment strategy based on factors other than their age. They also found that target date funds generally were too conservatively allocated for most people around the age of 50.

In other words, investing is difficult and to be successful takes focused work, effort, and proper education. Optimizing your investment strategy requires staying on top of constantly changing market dynamics and then determining how these dynamics impact your personal financial situation. The key to long-term success, in our view, is to have a seasoned team who can help you navigate the various stages of your investment lifecycle and make changes as market dynamics and opportunities change.

Considerations After Leaving an Employer:

Whether changing employers or full retirement, managing your 401(k) post-employment is crucial. Changes in investment options or default options can impact your financial plan. It is important to stay informed and consider consolidating your accounts to maintain a holistic retirement strategy aligned with your goals. For example, one of the risks of leaving your employer and not managing your 401(k) is that the investment options may have changed, you could miss the opportunity to change your investments before a certain deadline and can be put into a "default" investment such as a Money Market Fund. This will not only affect your overall financial plan but can result in a loss of potential returns. Even though it takes a bit of time and effort to consolidate retirement accounts after you leave your employer, it is worth considering doing so that you are taking a holistic approach to your retirement and ensuring that your portfolio aligns with your goals.

At Osborne Partners, we can manage your portfolio within your employer's retirement plan even if a self-directed brokerage account is not an option. We, as your advisor, can help you make selections from the menu of options in your retirement plan. If you are interested in learning more about how we can help optimize your existing retirement plan(s), please contact your Wealth Counselor.

In conclusion, adopting a comprehensive approach to retirement planning by exploring Self-Directed Brokerage Account (SDBA) options and consulting with your Wealth Counselor can greatly improve the effectiveness of your financial strategy. By staying proactive and well-informed, you can maximize the growth potential of your retirement savings and better position yourself to achieve your financial goals. ■

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*National Bureau of Economic Research, Working Paper 29559