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5 Mistakes You May Be Making in Your 401(k)

By Adam Bold, Contributor |US News & World Report

Some might believe that making contributions to a 401(k) plan during your working years will provide enough money for retirement. Somewhere over the rainbow, there's a pot of money waiting for you. Unfortunately, no one is going to hand over a lump sum that will cover all of your living expenses when you stop working. This is just one of the common mistakes that people make when it comes to their 401(k) plans. Here are some of those blunders, and how to improve your chances of reaching your retirement goals.

1. You don't make any changes in your 401(k). Many workers sign up for a 401(k) plan when they start a job, and then don't pay any attention to their investment selections afterwards. Studies have shown that just 1 in 6 401(k) participants ever changes investments in their plan. Your retirement plan is not a "buy and forget" investment. Be proactive with your 401(k) by checking your investments every quarter, and making sure the funds you own are still meeting your expectations and are still the best of those available. It's a lot like getting your car serviced—every few months, your car needs an oil change, and maybe a tune up.

2. You make too many changes in your plan. Some investors respond to day-to-day headlines and fluctuations in the market and feel like they have to move with them. Making too many changes based on emotions can cause you to take short-term actions that end up causing you to sell low and buy high, the exact opposite of the best strategy for opportunities to get higher returns. Say you're seeing the Dow Jones Industrial Average drop 100 points one day, and you sell your stock funds. The next day, the index gains 150 points, and the funds you sold are rallying, too. If you want to buy them back, you'll have to pay the higher price. Try to sit still and don't let your emotions rule—otherwise your plan will get off track.

3. You don't have the right asset allocation. You won't have to make many changes to your 401(k) if you start with the right mix of different kinds of stocks, bonds, and cash. Some people get stuck when they have to choose mutual funds for their plan. Don't ask your parents, spouse, or friends about which funds you should pick. First, figure out your asset allocation and risk tolerance. Then examine the funds offered in your 401(k) plan and pick the ones that fit. Many mutual fund companies have general asset allocation recommendations (conservative, moderate, aggressive) to guide you, but your selections don't have to follow any set of rules. It may be worth the cost to hire a certified financial adviser to help you choose a diversified mix of funds that meet your specific needs. An adviser will also monitor those

selections each quarter and help you make changes when needed. Depending on market conditions, you might have to rebalance your portfolio a few times a year to make sure your asset allocation stays intact, or adjust your asset allocation if your needs change.

4. You're chasing performance. Many investors crowd around funds that performed the best last year. They buy the fund at the peak price, only to be disappointed that the fund can't keep going up. Don't fall for the best performers of the moment. What you really want to know is which funds are going to do well next year. Given that no one knows for sure which areas of the market are going to be winners, it's best to be diversified among many different kinds of stocks and bonds and stick with your asset allocation. That way, you should be able to earn more when the market goes up and lose less when the market goes down. This is because a diversified portfolio is designed to avoid having all eggs in one basket, so while it can prevent losing more than the market during a market decline, it cannot produce more than the market during an upsurge.

5. You're not saving enough. Many companies will match employees' 401(k) contributions up to 3 percent of their salary, so that's all many people contribute. That may not be enough. Contribute 6 percent or 7 percent of your salary, or even more if you can. If you get a raise, put half of it into your 401(k). Use a retirement calculator, such as the one at Mutualfundstore.com, to help determine how much money you'll have at retirement. Many advisers used to estimate that people would need 60 percent to 70 percent of their income to retire comfortably. However, that might not be enough given that many people plan to be more active and travel in their golden years. Plus, people are living longer, and could face higher medical expenses. That's why you need to start saving and contributing as much money as possible to a 401(k) when you're young, and continue the discipline throughout your working years.

Adam Bold is the founder of The Mutual Fund Store, which provides fee-only investment advice with locations coast-to-coast. He's also host of The Mutual Fund Show, a call-in radio program broadcast across the country. Bold is author of the book The Bold Truth about Investing (April, 2009). Bold is Chief Investment Officer of The Mutual Fund Research Center, an SEC registered investment adviser that provides mutual fund and asset allocation recommendations and research to stores in The Mutual Fund Store system.