



“Participants who didn’t seek help often made mistakes in risk with their portfolios — either too much or too little.”

—Christopher L. Jones, CIO Financial Engines, Pensions and Investments
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Professional Advisors Prove Their Worth in 401(k) Plans

In the wake of the recent financial crisis, 401(k) plan participants are scrutinizing their account value and performance. More than ever, they are putting a pencil to calculate and quantify their ability to retire. Meanwhile, a recent study shows that plan participants could substantially improve their odds of investing success and their assets by making one key move: following professional advice.

A January 2010 Hewitt/Financial Engines study shows that investors who received investing education from a professional source improved their returns by nearly 2% after fees were paid. (Source: Help in Defined Contribution Plans: Is it Working and for Whom? , January 25, 2010, by Hewitt Associates and Financial Engines ¹)

The study which analyzed the returns of some 400,000 participants’ accounts determined that investment help such as target date funds, online advice, and the offering of managed accounts enabled participants to make smart investment decisions with minimal effort or expertise. The study concluded that by simply taking advantage of such opportunities, a participant can add thousands of dollars in additional retirement savings over time.

The findings of this study affirm those of a Charles Schwab study which arrived at a similar conclusion — professional advice is well worth the incrementally higher expense and pays for itself in spades for plan participants.

¹ http://www.hewittassociates.com/_MetaBasicCMAAssetCache_/Assets/Articles/2010/DCHelpReport_Jan2010.pdf

The 2007 Schwab study showed that 401(k) participants who received professional assistance or advice in allocating their 401(k) assets earned a significantly higher rate of return than those who did not receive assistance. Individuals who availed themselves of financial advice or plan-sponsored asset allocation models received substantially greater returns than those who chose to go it alone. The returns differential in the Schwab study was even more compelling, with an additional almost 3% to 5% increase in returns in exchange for professional advice. (Source: Schwab press release dated Nov. 28, 2007, titled “New Schwab Data indicates Use of Advice and Professionally-Managed Portfolios Results in Higher Rate of Return for 401(k) Participants”²)

“It’s not surprising that people using advice are more likely to earn higher returns, but it is remarkable to see how much better they are doing,” said Jim McCool, Executive Vice President of Schwab Corporate & Retirement Services.

Asset Allocation is Key

While the affirmation of the value of professional financial advice is encouraging, the studies’ findings are not the least bit surprising to investing experts who understand the pivotal role played by asset allocation. Renowned investing expert Roger Ibbotson determined that more than 100% of variability of a fund’s investment return is due to asset allocation. Participants who have the opportunity to receive professional advice regarding appropriate asset allocation are bound to significantly improve their odds of investing success.

Proper asset allocation should be done based on 30 years or more of historical risk and return data, not a few years of data or speculation about the future. Given this, an advisor who provides ample data about style pure indexes would offer individuals the highest probability of achieving their expected return, thus facilitating the very purpose of retirement investing — income replacement. This knowledge obliterates the utility of a fund line-up that consists of actively managed funds.

Performance Chasers Underperform

“Absence of Value: An Analysis of Investment Allocation Decisions by Institutional Plan Sponsors” analyzed a whopping 80,000 annual returns of institutional funds for the 22-year time period from 1984-2007 to conclude that “much like individual investors who seem to switch mutual funds at the wrong time, institutional investors do not appear to create value from their investment decisions. In fact,

² http://www.businesswire.com/portal/site/schwab/index.jsp?epi-content=GENERIC&newsId=20071128005300&dmHsc=v2*A116765640000*B1204625103000*C1199192399000*DgroupByDate*J2*N1002458&newsLang=en&beanID=1186282858&viewID=news_view

the study estimates that over \$170 billion was lost over the time period examined,” and that is before transaction costs and consultant fees are considered. The study concluded that plan sponsors could have saved hundreds of billions of dollars in assets if they had avoided manager selection based on recent performance and held course.

This study and dozens (if not hundreds) just like it arrive at similar conclusions to reveal the best method for successful investment portfolio implementation is a risk-appropriate, low-cost and globally diversified index portfolio. The professional advisor who recommends such a strategy and provides online education to enable plan participants to identify the index portfolio that best matches their risk capacity is what industry experts would term “the total package” when it comes to investment advice.

The best way to achieve the total package, however, might very well be to not opt for a package deal, or “bundled plans.” One-stop shopping is very appealing, but it can also be very pricey.

Fees play such an important role in 401(k) plans, in fact, that plan sponsors are duty-bound to monitor and benchmark investment selections for fees, performance and appropriateness for plan participants. Plan sponsors can opt to delegate this onerous duty to a third party who is responsible for ensuring that investment choices are, in fact, in the best interest of the plan participants. It turns out that such a task is easier said than done.

The Fiduciary Shell Game

In a universe rife with “pay to play” inducements, it is pretty tough to find an individual to sign on the dotted line to accept responsibility for the investment selections of a plan — to become a real fiduciary who will commit in writing that their actions will always be in the very best interest of plan participants. Many companies prefer to provide the impression of being a trusted fiduciary, while the fine print says otherwise.

Insurance giant John Hancock bills itself as a leader in providing “fiduciary responsibility support,” even going so far as to provide plan sponsors of retirement plans with its “fiduciary standards warranty.” When pressed on the issue of fiduciary, however, John Hancock admitted they are not a fiduciary, nor do they have any desire to be one. Hancock’s decision to skirt a fiduciary obligation may largely be attributed to a desire to include and recommend funds that carry 12b-1 and other hidden fees. Accepting a fiduciary obligation presents a direct conflict of interest for advisors who choose to be paid by multiple parties—a fiduciary cannot serve two masters.

Index Funds Advisors is a 3(38) fiduciary when it comes to 401(k) plans. This means we are 100% responsible and liable for our investment decisions which include the selection, monitoring and replacement of plan investments options. We do so because we are fully committed to making independent investment choices that are in the best interest of plan participants. This commitment is precisely what is required to ensure that each plan participant has the highest probability of success in their retirement plan.

Is your portfolio properly diversified to match your risk capacity? Find out with a visit to ifa.com. Take the Risk Capacity Survey. You will be matched with an Index Portfolio that's right for you. Or, if you would like to speak with one of IFA's Investment Advisor Representatives to learn how you can improve your diversification for risk-optimized returns, call 888-643-3133



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