

lumen funds

Lumen – the Latin word for light

Registered Investment Advisor

A shortcoming of 401(k) (and other employer-sponsored retirement) plans

Participating in employer-sponsored retirement plans, such as 401(k) and 403(b), is a good way to prepare for retirement, but nearly all of these plans have a major shortcoming – narrow investment choices! You may disagree at this point, because your plan may provide ten or more mutual fund choices. But we are not concerned about the number of mutual funds in the plans. Rather, we are concerned about the number of asset classes these funds hold.

The following table represents the mutual fund choices and the asset classes they hold in a typical employer-sponsored retirement plan:

	Fund Type	Asset Class
1	Growth Fund	Stocks
2	Balanced Fund	Stocks, Bonds
3	Stable Fund	Bonds
4	Money Market	Cash
5	Life Strategy/Asset Allocation Fund	Stocks, Bonds, Cash

As you can see, even though it appears that there are 5 choices, in terms of asset class, there are only 3: stocks, bonds, and cash. Many plans offer more targeted choices within the individual asset class. For example, some plans offer multiple funds in the stock category, such as large-cap/small-cap U.S. stocks, value stocks, growth stocks, international stocks, etc. But no matter how many targeted funds there are, the choices are almost always stocks, bonds, and cash.

There is nothing wrong with stocks, bonds, and cash, but there are other important asset classes such as commodities, real estate, and foreign currencies. Different asset classes have different characteristics; and they behave differently at different times. Sometimes the market favors stocks, sometimes commodities. As an example, from 1980 to 2000, stocks soared; and commodities lagged. Then the market turned. Beginning in 2000, stocks lagged, and commodities soared. Wouldn't it be nice if you can put retirement money in a stocks fund when stocks are rising and then shift to a commodities fund when commodities are rising? Even if you are not interested in actively shifting money from one asset class to another, wouldn't it be nice if you can spread your money into more asset classes? In fact, many studies have found that adding more unrelated asset classes to the mix helps insulate portfolios from vagaries of market cycles without hurting long-term performance. Unfortunately, most company-sponsored plans revolve around stocks, bonds, and cash only. Why?

lumen funds

The answers are as follow:

1. Nearly all companies “outsource” their retirement plans. They hire outside mutual fund companies to recommend funds for the plans. Naturally, these mutual fund companies recommend their own funds. And since most mutual fund companies offer only stocks, bonds, and cash funds, these funds are what the employees get.
2. Even if companies hire third party independent advisors to recommend funds, it is unlikely that the advisors will recommend funds outside of the same three “traditional” asset classes. The reason is that this generation of investment advisors grew up during the 80’s and 90’s, two decades in which stocks and bonds generally soared. As result, these advisors are only comfortable with stocks and bonds; and they are ill-equipped to advise on other asset classes.

The lack of asset class alternatives in employer-sponsored plans is unlikely to change soon. Adding new asset classes to retirement plans requires a cultural change of mindset and a restructure of the investment business. Such changes do not happen over-night. Therefore, if your plans do not provide all the asset classes you desire, you should consider investing outside of your plans for those classes that are not provided.

Legal Notices: Lumen Funds may hold some or all of the investments recommended or not recommended above. All materials presented herein are believed to be reliable but we cannot guarantee their accuracy. Investment recommendations may change without prior notice. Investors should carefully consider their situation and all risks involved and/or consult with their financial advisors prior to making investment decisions.