

## ***The Basics of 401(k) Investing: Plan-Provided Investments***

Investing in most 401(k) plans does not require that you select your investments from the thousands of stocks and bonds listed in the business section of your newspaper. Instead your employer has made it simple for you by offering you a limited number of investment funds from which to choose.

### ***Investment Funds***

An investment fund is a pool of money invested to achieve a stated investment objective. By investing in a fund, rather than individual securities, you get professional management, diversification, and lower fees. Investing through a fund also gives you the flexibility and liquidity to switch easily from one investment to another. An investment fund is usually concentrated in a specific type of investment asset. For example, the cash investment in your plan will typically be a money market fund. A stock fund, also called an equity fund, invests primarily in stocks.

A 401(k) bond fund invests mostly in bonds. However, bond funds have a significant disadvantage for 401(k) investors. Unlike an individual bond, a bond fund never matures. This means that you may not get back the amount of your original investment, called your principal, if changes in interest rates reduce the value of bonds in your bond fund. On the other hand, if you invest in a bond fund when interest rates are falling you could earn a capital gain in addition to collecting the interest. Do not invest in a bond fund if you want an investment that will not decline in value.

Real estate investing in a 401(k) is usually provided through an investment fund concentrating in real estate investment trusts (REITs). A REIT is a trust that purchases, owns, and manages real estate. REITs may also manage a portfolio of real estate loans. You do not directly own any property nor are you required to manage property. The trust handles all these details for you as an investor in the fund.

Investment fund choices in your plan can be managed by a variety of sources, including professional investment managers, banks, insurance companies, broker-dealers, and mutual fund companies. Mutual funds are different because they are managed according to specific federal regulations by a company that registers its funds as mutual funds with the Securities and Exchange Commission.

### ***Professionally-Managed Accounts***

If you do not want to direct how your 401(k) money will be invested, a professionally managed account may be the right option for you. Investment options that are professionally managed may also be called lifestyle, lifecycle, life stage, hybrid investment options or balanced funds, but do not be deceived by these misleading names. This is the simplest choice you can make because the professionally managed account will invest your 401(k) money for you. You will not have to spend your time in educational meetings, reading over your employer-sponsored choices, or calculating the best options.

A professionally managed account is not a single investment but a self-contained asset allocation plan that contains a diverse mix of investments. A professionally managed account is not another investment fund. Be cautious about investing some of your 401(k) money in investment funds and some in a professionally managed account. The investment strategies of the two approaches will overlap in unpredictable ways and could significantly reduce your overall investment return.

Be aware that some professionally managed programs will also customize an investment strategy for you that takes into account a variety of factors that include your age, risk tolerance, retirement expectations and investments outside your 401(k) plan. If this is the case, you may have to complete a questionnaire before your money will be invested.

## ***Brokerage Windows***

Some 401(k) plans let you invest in stocks, bonds, or mutual funds of your choosing as well as the funds that are part of your plan's menu. Using this option, you trade through a designated brokerage account (also called a window or open window account), just as you would use a broker outside the plan. Some companies will allow you to invest all of your plan assets this way, others will limit the amount of plan assets you can directly invest with a brokerage firm.

Here are some guidelines to follow when you want to use a brokerage firm to directly purchase the stocks of your choice.

- Determine the fees you will be charged ahead of time. Typically, a brokerage account carries an annual fee, but you will probably also pay transaction costs and commissions on each trade you make.
- Remember to think long term. Transaction costs and commissions mean the brokerage account takes a little bit of your retirement money with every transaction. Whether you are hitting the big time or hitting rock bottom, the brokerage account fees must be paid.
- Be cautious about purchasing a mutual fund through this account. Mutual funds offered directly through your 401(k) may be far cheaper because your employer has negotiated an arrangement with your plan's service provider that reduces or eliminates fees. When you purchase a mutual fund on your own, you get no discounts.
- Know what stocks or kinds of stocks you want before you go to a broker. You can do simple research on individual companies at the library and online. Remember that you are looking for a good long-term investment.

If your company is publicly traded, you will not be able to buy shares of your own company's stock from your 401(k) brokerage account. This is especially true if your 401(k) plan has company stock as an investment option or as a profit sharing contribution. Your company is required to make sure that no employees with special inside information about company activities take advantage of that information by investing in company stock.