

The 3 Principles of Successful Investing

INTRODUCTION:

One reason to strongly consider 401k Easy for your company 401k plan is the tremendous array of investments your plan will be privy to. It's no secret that appealing investments inspire initial as well as ongoing 401k participation. They're arguably THE most important determinant to your 401k plan's health and success. (You'll already have nailed down convenience, accessibility, etc., with 401k Easy's user-friendly, 24-hour-a-day-accessible architecture.)

Of course, investments one employee finds appealing may not interest another; they may not even interest the first employee five, ten years from now.

So how do you select investments for your company 401k plan? 401k Easy gives you access to more than 600 mutual fund families representing more than 10,000 different mutual fund portfolios, plus access to self-directed brokerage accounts. Do you offer all the options? Not likely, unless your employees have a tremendous amount of time on their hands to read through 10,000-plus investment prospectuses. So how then do you sufficiently narrow the field without over-restricting it?

This page explains three fundamental principles to effectively choosing 401k plan investments – not only in terms of the investments' appeal to your employees, but also in helping you meet relevant government regulations regarding diversity, etc., in the investments chosen for each 401k plan. The content has been written in terms of mutual funds but can easily be extrapolated to choosing self-directed brokerage accounts. And remember...

- Your goal is to derive an investment lineup that will fit the needs and financial objectives of your company's potential 401k plan participants.
- There is no single "best" lineup of investments.
- Your choices are not set in concrete. 401k Easy lets you add and/or remove investments from your plan if and when the need arises.
- We derive no financial benefit or incentive from recommending any mutual fund or brokerage company. If you [contact us](#) for help with choosing your plan's investments, you can be assured that our input has only your plan's health and appeal in mind.
- We follow our own advice. Our investment recommendations will always focus on quality fund providers offering a wide spectrum of suitable investments, ones that span the range from the ultra-safe, low-risk, conservative investments to the highly volatile, high-risk, high-potential-return investments; such can satisfy a wide range of investors, ones with varying personal needs, investment objectives and investing experience.
- 401k Easy contains an extensive catalogue of easy to understand literature to help your employees make educated investment decisions. We recommend that you, as an employer, refrain from dispensing investment advice. Instead, simply direct your employees to the quality materials contained within 401k Easy.

PRINCIPLE 1: Diversification

The most common – and detrimental – mistake made in choosing plan (and personal)

investments is to base a decision on an investment's performance history, particularly its recent performance history. Investment performance is cyclical: a mutual fund that's blazing hot today may be as cold as ice tomorrow, and vice versa. Past performance is no guarantee of future results. It should be considered as only one indicator of an investment's suitability.

A better approach is to let your objective be your primary guiding light. For choosing your company's 401k plan investments, your objective is to select a spectrum of investments that will prove appealing and satisfying to your employees' diverse investment needs. The spectrum, not fund-by-fund performance, is your quarry.

To achieve a suitable spectrum of investment options, select one, two or three mutual fund families, then choose a cross-section of funds from within each family. Mutual fund companies compete for investment dollars by trying to out-perform each other. Your employees can benefit from this competition with access to even a single reputable fund family; access to a second or third family grants added choice and flexibility. By listing a cross-section of investments within each family group, your employees will be able to find investments that suit their investing temperaments and needs, now and down the road.

At minimum, your plan needs to offer investments geared toward the following:

- **Preservation of Principal**
Money market funds are the default choice for "safe" investments. Remember, though, that they are not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.
- **Income**
For a steady stream of income, your plan will need funds that invest in bonds. Like stocks, bonds experience fluctuating share prices, though generally to a lesser degree.
- **Income and Growth**
Balanced funds, also known as "lifestyle funds," invest in combinations of stocks and bonds. Balanced funds that hold a greater percentage of stocks over bonds are more volatile and potentially more profitable. Those that hold a greater percentage of bonds over stocks, on the other hand, are more stable but less likely to return big investment gains.
- **Growth**
Stock funds (domestic or foreign) offer the greatest potential for long-term gain, but they also come with the highest risk: they're more volatile and have the greatest potential for posting investment losses.

PRINCIPLE 2: Choose Investments That Fit Your Goals and Temperament – and Those of Your Plan's Potential Participants

Stock and bond net asset values (share prices) fluctuate. Some fluctuate more frequently and more diversely than others. While this doesn't bother certain investors – ones, perhaps, with plenty of time before retirement, ones used to the ups and downs of investing, ones with other sources of emergency money – many investors prefer to avoid extreme volatility. As mentioned above, "growth" funds tend to be more volatile than "income and growth" funds, which tend to be more volatile than "income" funds, which tend to be more volatile than money market funds.

Investment returns should also factor into your decision. Compare investment returns to those of direct competitors' – not to those from a different class of funds. You can compare

returns of competing investments using any of several online services, including Standard & Poor (www.ratings.standardpoor.com), Morningstar (www.morningstar.com), Personal Fund's Online Fee Calculator (www.personalfund.com), Mutual Fund Investor's Center (www.mfea.com), SmartMoney Mutual Funds Research (www.smartmoney.com).

Don't be fooled by "cumulative total returns" showing how much an investment has grown or shrunk over several years. A large cumulative return when translated into average annual returns may not be large at all. For instance, a stock fund with a cumulative return of 101% over 12 years equates to an average annual return of only 6% compounded; such may or may not be competitive with competitors' funds or with the benchmark index.

Mutual funds, even no-load funds, are not free, nor, in general, are fees they charge closely regulated. The fees can vary widely from fund to fund (though competition, of course, does keep things in check to a degree). Each fund family sets its fees. The fees are spelled out within the investment prospectuses.

Mutual fund fees to look for include...

- **Expense Ratio**

This is money deducted from a fund's earnings and assets to pay for annual operating expenses, including investment advisory fees, legal and accounting services, postage, printing, etc.

- **12b-1 Fees and Sales Charges**

These pay the fund's marketing and distribution expenses and are incorporated into the expense ratio. Some include a sales charge to compensate sales personnel.

- **Trading Costs**

The cost of trading securities, including charges such as brokerage commissions, are not included in the fund's expense ratio but do reduce the returns investors receive.

Most entities that provide and support 401k plan investments - mutual fund managers, fund distributors, asset custodians, asset trustees, investment brokers and advisors, plan administrators and record-keepers - earn at least a portion of their compensation from asset-based fees deducted from plan assets.

We at Pension Systems Corporation, however, are the exception to the norm: We do not earn any compensation – directly or indirectly – from our clients' 401k plan assets. In cases where rebates are offered on investments, we have the rebates returned to our clients or directly applied to reducing our clients' costs. Our published prices, available online for all to see, are the only net compensation we collect.

We do not accept any rebates or revenue sharing of fees deducted from our clients' plan assets unless those fees can be returned to the clients' plans or used by Pension Systems Corporation to offset plan expenses.

Asset-based fees are an unavoidable fact of life if your company uses mutual funds or self-directed brokerage accounts for its 401k. The cost of these asset-based fees should be factored in when determining the true, overall cost of your 401k – and the cost savings of 401k Easy returning such fees to clients when possible should be factored into our products' affordability.

For more information on asset-based fees we recommend reading [Study of 401\(k\) Plan Fees and Expenses](#) by the US Department of Pension Welfare and Benefits.

PRINCIPLE 3: Use a Long-Term Horizon When Selecting Your Investments Provider

401k investments are long-term investment vehicles. They're not designed (nor intended) for short-term results. Look towards fund companies that will stand up to the test of time.

The public image of the fund families you select for your company 401k plan will affect its popularity among your employees. As with other consumer products, mutual funds (and the companies that produce them) come in various shapes and sizes, with reputations and brand-name recognition to match.

Remember to consider...

- **Is the mutual fund company forthright?**
If the company doesn't frankly discuss the potential drawbacks of an investment along with its attributes, go elsewhere.
- **Does the company follow a disciplined approach to investing?**
Some companies do not ensure that their fund managers stick to the investment strategy described in the prospectus. Even the fund's portfolio name may be misleading; it may not reasonably represent the interlaying of stocks and bonds in the portfolio.
- **Does the company promote the recent fund performances?**
You need to know how a fund has performed over the past three, five, ten years. Its performance during the last 24 months is inconsequential.
- **Does the company put experienced managers in charge?**
How many years of experience does the manager have? What's his/her track record? Some companies allow relatively new managers to gain experience with their smaller funds.

We're Here To Help

The above are guidelines to help you select investments for your 401k plan that will encourage participation and effective retirement saving while ensuring that your company meets the federal mandates regarding 401k plan investment diversity.

We're here to help if you're still unsure of how to proceed with choosing investments for your 401k plan.