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Are You a Self-Destructive 401(k) Participant?

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We've met the greatest enemy of a sound 401(k) plan, and it is us.

Though we may not choose to admit it, most of us make enough ridiculous mistakes to inspire Fox to create a new reality series, *America's Dumbest Investors*. With that in mind, let's take a look at some of the most self-destructive behaviors individuals engage in with their 401 (k) plans.

If none of these characteristics apply, bully for you. For the rest of us -- myself included -- we should take a long, hard look to see if these patterns sound familiar.

Do-Nothings

The first big impediment to retirement planning is inertia. Studies have shown that 25% of all eligible employees don't even bother to enroll in their 401(k) plans. Except for the folks who decide to opt out because their plans are so inadequate that they are investing in their own individual retirement plans, this is silly behavior.

Twenty-somethings are especially guilty in this area -- which is awful, because the money you invest when you're young grows exponentially. Consider this investment fable, borrowed from Burton Malkiel's Random Walk Guide to Investing. William and James are twin brothers aged 65. Starting 45 years ago, William put $2,000 in his 401(k) plan at the end of each year. After 20 years, he stopped making contributions and let his 401(k) keep growing -- he got 10% returns a year. James started investing in his 401(k) plan when he was 40, right as William quit, and contributed $2,000 a year for 25 years -- five longer than William. James also got 10% returns a year.

What did William and James retire with at 65? James' 401(k) is worth less than $200,000. William, meanwhile, has more than $1.2 million in his 401(k).

Now, this stark comparison doesn't even factor in matching contributions, if your employer makes them. By not enrolling, employees lose $5 billion a year, according to Access Research. Imagine how much they lose when you factor in compound annual growth over three or four decades.

One other point on the do-nothings: You have to rebalance once a year to keep your asset allocation, and reallocate your assets from time to time to adjust for your age and risk level as it changes. A 1988 study of TIAA-CREF participants found the median number of asset allocation changes and rebalancing by an individual over his or her investing lifetime was zero -- never!

Presumably, readers of *TheStreet.com* don't fall into to this camp. If you're reading about investments and doing research online, chances are you know better than to do nothing.

Before you sprain your arm patting yourself on the back, I'm guessing many of you fall prey to the next behavioral pattern.

The Men (and Women) Who Do Too Much

Almost as bad as doing nothing is doing too much with your portfolio.

Many investors like to think they are smarter than everybody else. They like to trade in and out of funds based on their market-timing bets, and this is made easier by "open platform" 401(k) plans that offer access to hundreds of mutual funds.

I trudge this factoid out frequently, but it bears repeating: Since 1984, investors held funds for an average of two years, according to Dalbar. The average investor earned a mere 2.57% annually during that time, compared with 12.22% for the S&P 500.

That stark shortfall is the result of overactive trading. And men are apparently worse than women on this count: According to Terrance Odean at University of California at Berkeley, women turn over their portfolios at a clip of 53% a year, which is high. But men turn over their portfolios 77% annually.

This behavior overlaps a bit with the next behavior pattern.

Performance-Chasers

Sadly, the one thing investors do fully understand is the something that shouldn't matter nearly as much: recent performance.

Past performance doesn't guarantee future results, as the disclaimer says. It's far more important to build a diversified portfolio of low-cost funds from a mix of asset classes. But people like to follow the money -- buying tech stocks and funds in 1999, buying long-term bonds in early 2003, just before the crash.

It's hard to laugh at yourself for this embarrassing type of investor behavior, so let's laugh at the Swedish. When Sweden privatized a portion of its social security system in 2000, it offered Swedes 450 mutual funds from which to choose. The most popular choice was the Internet fund that had the hottest returns the previous 12 months. It subsequently lost about four-fifths of its value.

American investors, of course, have made similar mistakes. Part of the problem here is having too much choice, many 401(k) and behavioral-finance experts say. There is a movement afoot to curtail the limitless choices -- which tends to promote either picking the hottest offerings or being overwhelmed, making no choice at all.

Focusing on the Wrong Information

Hey, do you know **eBay's** (EBAY:Nasdaq) price-to-earnings multiple? Who are **Cisco's** (CSCO:Nasdaq) biggest competitors in the networking-gear arena? How much is **Microsoft's** (MSFT:Nasdaq) Bill Gates worth?

Know the answer to all three? Wow, cool, that's great cocktail party conversation. Now, do you know how many funds you hold in your various retirement accounts and what your overall stock-bond allocation is? Do you know the names of the consultants and fund firms who are managing your 401(k) plan and roughly how much you pay in fees? How much money will you need to retire, and are you saving enough at present?

Partly because of the financial news media's influence, investors have focused on the wrong information. Retirement savings is pretty boring stuff, not nearly as fun as talking about the latest China.com play or whether **Martha Stewart Omnimedia** (MSO:NYSE) can survive if its leader goes to prison. But investors need to understand the difference between business news and investment advice. The first is fun to watch and has no bearing on your retirement plans; the second is boring and spells the difference between a wonderful early retirement or a penny-pinching late one.

Company Men and Women

We have too much money in our company's stock. This has been a major problem since Studebaker went bust and left its workers' pensions empty, and it was a nightmare for **Enron** employees who lost their jobs and much of their Enron-pegged nest egg. And it's still a problem.

According to Greenwich Associates, participants in defined-contribution plans such as 401(k)s have 25.7% of their portfolios in company stock -- compared with 9.6% in fixed-income funds and a mere 3.5% in international stocks.

This is extremely dangerous because your job and your retirement are tethered to the fate of one company. We all hear the stories about the clerk at **Wal-Mart** (WMT:NYSE) or the **Dell** (DELL:Nasdaq) secretary who's now a millionaire because of their company stock -- these are rare stories of great good fortune that are akin to Publisher's Clearing House winners. Even if your company doesn't blow up like Enron or **WorldCom**, if you have too much of your portfolio in your company stock, you're vulnerable to a downturn in the company's fortunes. Stocks fall 50% over the course of a few years all the time -- it happened to both of my employers' stocks. If you are a few years from retirement when that happens, the results can be devastating.

Experts are in unison on this: Don't put a penny more than necessary in your employer's stock. Ted Benna, founder of the original 401(k) plan, even advocates legislation to fix excessive usage of company stock in retirement plans. "We have laws to force people to wear seatbelts to protect people who choose to not protect themselves, we need a law here, too," Benna said.

Neither a Borrower Nor Liquidator Be

Investors can take loans against their retirement portfolio. They also "cash out" their plans when they switch jobs. Both of these options are ill-advised, especially among younger investors, because you undermine the value of compound annual growth over time to attain goals that are often short term in nature.

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