

April 2009

*In This Issue*

## Now Your 401(k) is a 201(k) - What Next?



We've all seen the markets implode over the last year. At first we watched and thought it would only be a matter of time before everything came back. And, by a matter of time, we meant months, not years. Now, it looks like it might be years before the markets come back. In reality, we have no idea how long it's going to take, but we do know each of us are feeling real pain and are wondering if we're ever going to be able to retire.

For many of us our retirement plans (401(k), Roth IRA's and regular IRA's) are one of our major forms of retirement saving. If we're employers we have the responsibility for choosing what type of 401(k) plan and plan sponsor we should choose to protect the plan assets and provide our employees with the best options for reaching retirement in a comfortable manner.

In many instances we might be feeling like we've let our people down. Markets are down and for many of our employees as well as ourselves we are going to have to wait longer before we are able to retire. We might be feeling that there are no options for us as it relates to what we can do with our 401(k) plans.

The reality is there are options and although those options are not widely talked about, you should be aware of some of the things you can do. But first, some information on the general market cycle we're in.

### **Secular market cycles and why they are important to you**

Macro market cycles are a very important thing to understand. There are two types of long term markets. They are secular bull markets and secular bear markets. In a secular bull market, the general trend is that markets trend up over a long period of time.

The last secular bull market we had was approximately 1982 till 1999. You may have remembered that during this time period investments did very, very well. This was the time that if you put money in the market and came back five years later, in most cases you would be very happy with the market returns you received.

Secular bear markets are a whole different story. During these market

We believe that a successful wealth management relationship starts with clarity of purpose.

Before embarking on any plans or strategies with our Client, we first seek to develop a clear understanding of your personal and financial goals.

We then work with you to select and implement strategies that will help you move toward your goals.

cycles the trend of the market is down. Most of the time if you looked at your account balances and you were invested in the stock market you would be unhappy with your balance five years later.

John Mauldin believes that secular markets are formed by the direction that P/E (price earnings) ratios are moving as well as long term inflation. When P/E ratios are historically low and inflation is stable, there is room for stock prices to rise over a long term basis. When P/E ratios are high and inflation is unstable as it is today, there long term move in the markets are likely to be lower. He believes these two factors are two of the major influencers on secular market trends.

Understanding macro movements that the market can take is important in planning your long-term investment philosophy. When we are experiencing a secular bull market, we can invest for the long term. When we are experiencing a secular bear market, it might be prudent to use active management that invests our assets in alternative and non-correlated assets of the general stock market.

#### **Absolute return versus relative return funds**

During the last bull market we would compare the results of money managers we used to different market indexes. For many of us this could be the S&P 500, the Dow Jones Industrial Average or the NASDAQ. During the last secular bull market trends were up and if our funds outperformed the market we were very happy.

Today, our opinion of what makes us happy has in many instances changed. If the markets are down 38% as they were last year and those who manage our money were down 33% we would most likely still be unhappy. The money manager did their job. The money manager beat the market, but we also lost money and most of us are never happy about losing money.

A relative return money manager lives in the buy and hold world. This is where we are taught that over a long market cycle that if we continue to hold good stocks eventually we will have a positive return. The above statement is true if we consider our time frame to be fifty years. Unfortunately, most of us don't have fifty years for the market to come back. At best, we might have twenty years to wait.

Many of us are happy using a relative return manager during a bull market. When we have negative market downturns in a secular bull market, they tend to last for a shorter time frame than in a secular bear market. We can weather the storm more easily with a relative return manager in a bull market and might even have a stronger return over the full market cycle than with an absolute return manager.

The other major category of investment manager is what's called an absolute return manager. This manager doesn't concentrate on beating

any particular index. An absolute return manager concentrates on having a positive return during any market cycle. This type of manager will often use asset classes that are not correlated with the major stock and bond asset classes that relative return managers concentrate on.

Investors are often happier with an absolute return manager during secular bear markets. An absolute return manager concentrates on getting a positive return every year. They give up maximizing returns in strong markets and concentrate on not losing money in weak markets. They are more concerned in controlling risk than they are in maximizing returns. These goals fit in with many investors goals during secular bear markets like the one we're in today.

### **How does this fit in with my 401(k) plan?**

401(k) plans came into being during the last great secular bull market. As a result most of the features that we see in your 401(k) plan are those that were developed during a bull market. Things like having individual accounts where funds can be changed on the internet were developed during the last secular bull market.

Although these features are often deemed important, we're finding that many participants are more interested in having a positive annual return in their 401(k) plans than having bells and whistles that they may or may not use. We might be moving into a market where concentrating on absolute returns versus relative returns is more important. We might want to consider a different way of looking at how our retirement plans are invested.

Absolute return funds have not become the norm in 401(k) platforms, nor are they likely to do so in the near future. This means that if we want to provide our employees with an absolute return option, we usually have to change how our plan assets are invested.

Today, most 401(k) plans allow the participant to choose what investments to use in their retirement plans. There are some plans that don't allow individual choice. These plans are called pooled investment plans. In a pooled investment plan the plan administrator and their investment advisor can choose a wider variety of investment choices.

Among the choices the plan trustee and investment advisor can choose are absolute return managers and absolute return strategies. The trade off for going to a pooled plan is the individual participant will not be able to control where the investments in their own 401(k) account goes. They will leave that decision to the investment managers that are chosen for the plan.

The market cycle we are presently in might be one where it makes sense for trustees and investment advisors to consider moving from individually managed accounts to pooled accounts where professional investment

management and the ability to invest money in both relative and absolute return strategies is considered. The tradeoff of having individual control versus using professional management is often appreciated by plan participants in the market cycle we are presently in.

**This is interesting, but what do I do?**

The first step we suggest is that you get together with your 401(k) investment advisor and have a conversation about absolute versus relative return strategies. Ask them how you could implement a 401(k) strategy in your company that would help preserve the assets you have.

The second step is to meet with your employees and have your investment advisor explain the options of using an individually managed account versus a pooled account. Your investment manager should explain the difference between relative return and absolute return managers. They should then explain how these different types of managers can be accessed. Finally, you want your employees to let you know which investment platform they would rather have for managing their retirement funds.

After your employees understand the options available for your plan you can gather feedback about what their preferences are. You just might be surprised and find that your people would prefer having professional management during these difficult days.

We at Stage 2 Planning would be glad to spend some time with you reviewing your 401(k) plan. If you would like more information, please contact us at your convenience.

Warmest Regards,

Josh Patrick

Josh Patrick © 2009

Stage 2 Planning Partners is a member of PartnersFinancial, a division of NFP Insurance Services, Inc., which is a subsidiary of National Financial Partners Corp., the parent company of NFP Securities, Inc.

Representatives listed on this website are currently registered to conduct securities business in the following states: AZ, CO, CT, FL, IL, IN, MA, MT, NC, NH, NY, PA, RI, VA, VT, WA

NFP Securities is not affiliated with Harris-Murray

The Patrick Group | 20 Kimball Avenue | Suite 201 | South Burlington | VT | 05403