A Brief Guide for 401(k) Plan Participants

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If you are a 401(k) plan participant today you are in the first generation to face saving for retirement on your own. You are a trailblazer learning how to support yourself in retirement. It is complicated, but to paraphrase comedian Steve Martin, the answer is simple: "First get a lot of money. Then keep it." The following provides some guidance on saving enough and not losing it.

Save Enough

As explained in this video, you can save enough by using either of these rules:

- Start saving early and save 15% of pay, including employer matches
- Use the "Rule of 22." Figure out what you'd like to spend each year in retirement and multiply that by 22. For example, if you want to spend $100,000 per year when you retire, you'll need $2.2 million (22 X $100,000).

In order to keep your savings you'll need to spend them wisely and invest them wisely.

Spend Wisely

The 4% Withdrawal Rule stems from a 1994 study by financial planner William Bengen. After testing a variety of withdrawal rates using historical rates of return, Bengen found that 4% was the highest rate that held up over a period of at least 30 years. The 4% withdrawal rule spends 4% of savings in the first year, & then that dollar amount increases by inflation in each subsequent year.

The 4% Rule is currently not the slam dunk it used to be. A recent study estimates the success probability of a 4% Rule to be more than 90% using historical capital market assumptions, but this probability drops to about 75% in today's market environment.

In other words, the 4% Rule should serve you well, but it will work even better when the current market manipulation ends and interest rates return to normal.

Invest Wisely

As explained in this video, you need to be very protective of your savings in the Risk Zone that spans the 5-10 years before and after retirement because that's when your savings will be at their peak. Importantly, this means you do not want to default your investment choice to your employer during this time period unless you will be defaulted into a safe investment.

The most popular default investment is a target date fund (TDF). These funds lost 30% in 2008 and they have become riskier since. They will lose money again and the next time will be much worse than 2008. It's possible that your employer has chosen a TDF that actually protects, but there are only a few of these. They receive high Prudence Scores.

In other words, you need and deserve to know what you will be invested in if you default. If it's not very safe in the Risk Zone, you should not default.

Conclusion

We hope these guidelines bring you to a comfortable retirement. You work hard and deserve what you earn.