

# 8 retirement plan mistakes

Friday January 4, 6:00 am ET

Cheryl Allebrand

Think of how important your retirement savings are. You can't afford to make many big mistakes -- especially as the years go by and you accumulate substantial sums of money in your tax-deferred retirement plans.

One common mistake among risk-averse investors is to seek safety at the expense of growth. Putting all your money in a money market fund may keep it safe from volatility, but it won't help you stay ahead of inflation. You'll need to achieve growth in your plan. On the other hand, taking too much risk by choosing volatile investments is just as unwise, especially for people who are already retired or who plan to retire soon.

Smart retirement plan investing requires you to look at your individual situation so that you can properly balance safety with growth potential. And while the costliest mistakes are usually related to plan investments, you can make other mistakes that can create a royal mess.

## Avoid these 8 mistakes:

1. [Managing investments in isolation](#)
2. [Putting the wrong investments in taxable vs. tax-deferred accounts](#)
3. [Not taking advantage of employer matching contributions](#)
4. [Ignoring high fees](#)
5. [Not filing IRS Form 8606 with nondeductible IRAs](#)
6. [Believing you can't touch the principal in retirement](#)
7. [Assuming that using net unrealized appreciation is always the best option](#)
8. [Failing to update beneficiaries on your forms](#)

### 1. Managing your investments in isolation

Many people look at their 401(k) or 403(b) plan, IRAs or other retirement plans as separate entities instead of integrating them as one total portfolio. By not seeing the forest for the trees, they don't correctly position their assets in their plans.

Here's an example. Suppose you decide to allocate 10 percent of your overall investments to real estate investment trusts, or REITs. If you have 25 percent of your 401(k) invested in REIT funds, you might think, "My 401(k) is overloaded with REITs. I'd better sell them now!"

Hold on a second.

Having 25 percent of your 401(k) in REITS would be perfectly fine -- in fact, optimal -- if it gets you to your 10 percent overall target. Let's say you have no REITs in your taxable account or your IRA. If you do the math, you may discover that you have a 10 percent overall allocation to REITs. You're right on target.

### 2. Putting the wrong investments in taxable vs. tax-deferred accounts

This is related to the point above. Generally, investments that produce high, fully taxable dividends should go into your retirement plans. Inside a tax-deferred plan, dividends from investments such as taxable bond funds and REITs won't cause any tax damage.

Conversely, investments that are designed to produce long-term capital gains, such as growth stocks, are generally best held outside of your retirement plan. They're tax-advantaged to begin with and don't need additional tax sheltering.

When you look at the whole picture, you can allocate investments across the appropriate accounts. You'll end up with an identical portfolio, but it will be positioned for maximum tax efficiency.

### **3. Not taking advantage of employer matching contributions**

Most employers that offer a retirement plan will match your contribution up to a certain limit. For instance, your employer may match the first 3 percent of salary you contribute. If you contribute less than 3 percent, you're literally throwing away free money.

### **4. Ignoring high fees**

In some 401(k) plans, participants pay as much as 2 percent to 2.5 percent in expenses. These fees maybe be well hidden, but they still impair your return. Let's say you have \$200,000 in a high-fee 401(k) plan. At a 2 percent expense level, it's costing you \$4,000 a year. At a more reasonable 1 percent, your expenses are \$2,000. Over many years, that difference, compounded and increasing as your assets grow, can cost you many tens of thousands of dollars.

Do the research to see if your plan is fee heavy. If so, move your money to a rollover IRA, if allowed, as soon as possible -- and also make a case with your employer for changing investment plan providers.

### **5. Not filing IRS Form 8606 with nondeductible IRAs**

If you make contributions to a traditional, nondeductible IRA, make sure you file this form with your tax return to establish the necessary verification trail that you'll need when you make withdrawals from that IRA. Otherwise, you may have to pay taxes on withdrawals that should rightly be tax-free since you didn't get a tax deduction when you made your contribution.

Also, keep in mind that you'll have a two-year window of opportunity to convert these assets to a Roth IRA regardless of your income level beginning in 2010. You'd have to pay taxes on your earnings, but then all future withdrawals would be tax free, and you won't need to keep up with all that paperwork.

### **6. Believing you can't touch the principal in retirement**

Suppose you plan to withdraw 5 percent a year from your plan once you're retired. Many people think that the 5 percent withdrawal can only come from interest and dividends, and therefore load up their plan with bonds, forgoing growth investments. They don't achieve an appropriate allocation.

As part of your annual withdrawals, you can also sell individual holdings and use the proceeds. Over the long term, a conservative balanced portfolio with some equity exposure should return about 7 percent to 8 percent a year. So 5 percent withdrawals are probably sustainable, with some portion coming from the sale of securities. You need to periodically rebalance your assets anyway, so these sales can be part of that process.

### **7. Assuming that net unrealized appreciation is always the best option**

This tax break lets you remove company stock from your 401(k) plan. You pay ordinary income tax only on the cost (basis) of the shares when they first went into your 401(k), which may be much lower than the current market value. When you sell the stock, any additional appreciation is taxed at the long-term capital-gains tax rate.

It sounds appealing, but it's usually not a good idea. It's often better to simply roll the stock over into a traditional IRA and then sell it. The benefits of the tax-deferred build-up inside the IRA generally will outweigh the net unrealized appreciation, or NUA, tax break if the assets are left in your IRA long enough.

But this is not a decision that should be entered into lightly. Be sure to do the math with a competent accountant before taking any action.

### **8. Failing to update beneficiaries to reflect your current wishes**

You designate beneficiaries when you open your plan. If you don't review your beneficiaries periodically, you might be leaving your assets to someone who is already deceased or no longer a part of your life. For

instance, if you're divorced, you probably don't want to leave your money to your ex-spouse. But the plan administrator must distribute the funds to the listed beneficiaries. The beneficiary designation holds no matter what your will calls.

Also, make sure that that any special beneficiary instructions (such as defining the conditions of a trust that you wish to designate) are acceptable to and acknowledged by the plan fiduciary