Buena Vista Investment Management, LLC

Creative Investment Solutions

Investing your 401(k)-Looking Beyond the Obvious

By John Moffat, Partner Buena Vista Investment Management

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Today, Americans are bombarded with stories about the fiscal problems of our government and the potential changes on the horizon to Social Security. This means that Americans may very well be responsible for saving a greater portion of their overall retirement dollars. The potential changes to Social Security will make investing in your 401(k) even more important. In this article we will provide some insight into one of the most important building blocks of a quality 401(k) portfolio; common stock diversification.

Most 401(k) participants are given a menu of investment options, some reading material and are then told to go invest their retirement dollars. I think it is safe to say that most 401(k) participants have little or no formal training in investments but still must shoulder the responsibility of understanding complex global financial markets and building their own retirement portfolio.

In my opinion, 401(k) participants must first begin by going beyond the obvious. The obvious to most 401(k) participants lies in the historic investment return for the investment funds available to them. Lacking any formal training in investments, most 401(k) participants only look at historic investment returns. They choose the highest returning fund or funds and assume that these investments will generate the same kinds of return going forward. But the reality is that this may not always be the case.

It is easy to pick equity investments for your retirement plan based on the highest historic investment return but it is also important to understand that past performance is not an indication of future return. So rather than starting with investment return I would recommend that 401(k) participants start with a diversified approach to their portfolio.

In my opinion, diversification is a key component to building the stock portion of an investment portfolio and improving long-term investment performance. First, participants should understand that there are four major mutual fund categories that should be included in a portfolio; small capitalization funds, mid-capitalization funds, large capitalization funds and international funds. Capitalization refers to the size of the company held in the mutual fund. For example, Wisconsin Rapids based Renaissance Learning would be classified as a small capitalization company and Wal-Mart would be considered a large capitalization company.

We would recommend an equal weighting of all four categories. It is a simple and effective way to build a highly diversified portfolio. In this approach, the 401(k) participant would have 25% of his or her funds in international investments and 75% in US funds, allocated equally between small, midsize and large company funds. Equal weighting means the 401(k) participant does not choose which funds are going to outperform. Early in an economic cycle small capitalization funds may do better than large capitalization funds, while later in the cycle international funds may do better.

This simplistic diversification approach can be the first step to achieving better long-term investment performance in your 401(k) plan.