CHAPTER 2.5

MYTH 5: "YOUR RETIREMENT IS JUST A 401(K) AWAY"

Baby boomers have been the primary mice used
in the great 401(k) retirement experiment.
—DOUG WARREN, author of *The Synergy Effect*

Many ideas or inventions start off with great intentions. Nuclear fusion opened the door to free energy for mankind and now can be used to provide electricity to an entire city. By contrast, if stuffed into a warhead, it can level an entire city.

It is often with a dash of man's greed and ingenuity that we can turn something great into something that can cause more damage than good. Such is the 401(k). A great little piece of tax code that, if used right, can power our retirement for years to come. But if used as it is in most of today's plans, it can damage our chances for financial freedom.

And since the 401(k) is the only retirement account most people will ever have, this chapter could be the most important one in this book. In the pages ahead, we will show how to use the 401(k) system and not let the system use you. You will discover how to implement much of what we have learned thus far so that your 401(k) becomes a great retirement plan for *you* (not a retirement plan for the broker or the mutual fund managers). But first a bit of backstory is important.

HOW DID WE GET HERE?

The 401(k), given to us in 1984, gave us the opportunity to participate in the stock market. To own a piece of American capitalism. And we could save on our taxes by making tax-deductible contributions from our paychecks.

But the 401(k) was never meant to be the sole retirement plan for

Americans. I reached out to John Shoven, professor of economics at Stanford. He made it perfectly clear when we spoke by phone: "Tony, you can't save just three percent of your income for thirty years and expect to live another thirty years in retirement with the same income you had when you were working!"

And let's not forget that this social experiment is only a few decades old. We are only now starting to see a generation where the majority will attempt to retire having used only a 401(k) during their lifetime.

When we look back at history, what started out as a loophole for highly paid executives to sock away more cash became a boon for companies that decided to eliminate the cost and obligation of traditional pensions and shift *all* the risk and expense to the employee. That's not to say that pensions didn't have their own problems: for instance, you couldn't move them from job to job.

Interestingly, employees didn't mind taking on this new responsibility because at the time, stocks were soaring. Who wants boring guaranteed pensions when stocks could make us rich?

Money then flowed into the market like never before. All that new money being deposited means lots of *buying*, which is what fueled the bull markets of the '80s and '90s. With trillions up for grabs, mutual fund companies began an unprecedented war to manage your money. The stock market was no longer just a place where companies turned to the public to exchange cash for ownership. It was no longer a place for only high-net-worth investors and sophisticated institutions. It became every man's savings vehicle.

WELCOME, CAPTAIN

When the 401(k) came to be, it represented freedom. Freedom that often gave us the illusion of control. And with markets on the rise, we sometimes mistake luck for being a "good investor."

Dr. Alicia Munnell, the director of the Center for Retirement Research at Boston College, is one of the top retirement experts in the country. We spoke for nearly two hours regarding the retirement crises facing the vast majority of Americans. In her view, "We went from a system of defined benefits—where people had a pension; they had an income for life—to the idea of the 401(k), which was obviously cheaper for employers. And on the surface, it seemed like it was beneficial to individuals because they had more control of their own investment decisions." But even Alicia, a former employee of the Federal Reserve and member of the president's Council of Economic Advisers, made some serious missteps when it came to her own retirement. "So, I have a defined benefit plan [guaranteed lifetime income] from the Federal Reserve Bank of Boston. When I was at the Treasury, one of my colleagues said, 'Oh! Take it early. You can invest that money much better than the Federal Reserve can.' That money is long gone."

Being solely responsible for your investment decisions is a scary thought for most (especially before reading this book). As captain of your financial ship, you must navigate all the available investment choices, generate returns sufficient enough to support your retirement, be a part-time investment expert, and do it all while holding down a full-time job or business and raising a family.

Teresa Ghilarducci of the New School for Social Research authored a brilliant article in the *New York Times* titled "Our Ridiculous Approach to Retirement." In it she managed to pack all the challenges we face into a single paragraph:

> Not yet convinced that failure is baked into the voluntary, self-directed, commercially run retirement plans system? Consider what would have to happen for it to work for you. First, figure out when you and your spouse will be laid off or be too sick to work. Second, figure out when you will die. Third, understand that you need to save 7% of every dollar you earn. (Didn't start doing that when you were 25, and you are 55 now? Just save 30% of every dollar.) Fourth, earn at least 3% above inflation on your investments, every year. (Easy. Just find the best funds for the lowest price and have them optimally allocated.) Fifth, do not withdraw any funds when you lose your job, have a health problem, get divorced, buy a house, or send a kid to college. Sixth, time your retirement account withdrawals so the last cent is spent the day you die.

Yes, the system needs to be fixed, and yes, it will take time and some major progress on both Capitol Hill and Wall Street. But the good news is that for those of you who are informed, you will be able to navigate it. You can use the system as an insider would, and let it work to your advantage.

COME AGAIN?

So let's do a little recap. We now know that actively managed stock-picking mutual funds don't beat the market. And this is exactly what you find in the vast majority of 401(k) plans (but not all). We also know that these expensive funds charge hefty fees, which can erode 50% to 70% of our potential retirement nest egg. Depending on your age today, think of how much you have already left on the table to this point? Is it $10,000? $25,000? $100,000? Scary, huh?

Now, stick those expensive mutual funds inside a name-brand 401(k) plan, usually offered by a payroll or insurance company, and it will charge you a whole host of *additional* costs. (See box on following page.) The sum of all these costs forms an insurmountable headwind. With the vast majority of plans out there, the odds of you winning the 401(k) game are slim to none.

401(k) plans receive the benefit of tax deferral, but most are loaded with up to 17 different fees and costs between the underlying investments and the plan administration.

COMMUNICATION EXPENSES
- Enrollment (materials)
- Ongoing (materials)
- Enrollment (meetings)
- Investment advice

RECORD-KEEPING AND ADMINISTRATIVE EXPENSES
- Base fee
- Per participant fee
- Per-eligible employee fee
- Distributions
- Loans origination
- Loans maintenance
- Semiannual discrimination testing
- 5500 filing package
- Other expenses

INVESTMENT EXPENSES
- Base fee
- Individual (mutual) fund expenses
- Manager/advisor fee
- Other asset fees (revenue sharing, wrap, administration, and so on)

TRUSTEE EXPENSES
- Base fee
- Per-participant fee
- Asset charge

But now the good news! With the right 401(k), one that is lean, mean, and doesn't take your green, you can turn the headwind into a tailwind. You can gain momentum by taking advantage of what the government gave us.

AMERICA'S "*BEST*" 401(K)? OKAY, PROVE IT!

Once I truly grasped what Jack Bogle calls the "tyranny of compounding costs," and realized the destructive power of excessive fees, I immediately called the head of my human resources department to find out the specifics of our own company 401(k) plan. I wanted to know if my employees, who I care about like my own family, were being taken to the cleaners. Sure enough, we were using a high-cost name-brand plan loaded with expensive funds and excessive administration and broker fees. The broker assured me that the plan was top notch, lean on fees, and right on track. Sure it was! Right on track to make his BMW lease payment.

Convinced that there had to be a better plan out there, my team and I began to do some research. After a frustrating process of looking at a bunch of garbage plans, a good friend of mine referred me to a firm called America's Best 401k. That's a bold name. I called the owner, Tom Zgainer, and said, "Prove it!"

In the first five minutes of meeting Tom in person, it's obvious he has immense passion about helping people get free from crappy, fee-loaded 401(k) plans. He calls the 401(k) industry "the largest dark pool of assets where nobody really knows how or whose hands are getting greased." A pretty grim diagnosis of his own industry. "Get this, Tony, the industry has been around for three decades now, and only in 2012 did service providers become required by law to disclose fees on statements. But in spite of the disclosure, **over half of all employees still don't know how much they're paying!**" **In fact, 67% of people enrolled in 401(k)s think there are *no fees*, and, of course, nothing could be further from the truth.**

"How are you different, Tom? How is America's Best truly the 'best,' as you say?" Having been burned once, I felt like Papa Bear looking after his cubs because I knew this decision would directly impact my employees and their kids. They had already been paying excessive fees for years, and I couldn't allow that to happen again. I came to find out that, as the owner of the company, I am also the plan *sponsor*; and I discovered it is my legal duty to make sure they aren't getting taken advantage of. (More in the pages ahead.)

Tom explained, "Tony, America's Best 401(k) only allows extremely low-cost index funds [such as Vanguard and Dimensional Funds], and we don't get paid a dime by mutual funds to sell their products." I had just interviewed Jack

Bogle, and he confirmed that Vanguard does not participate in paying to play, a common practice where mutual funds share in their revenues to get "shelf space" in a 401(k) plan. **By the way, what this means to you is that the so-called choices on your 401(k) plan are not the best available choices. They are the ones that pay the most to be offered up on the menu of available funds.** And guess how they recoup their cost to be on the list? High fees, of course. So not only are you failing to get the best performing funds, but also you are typically paying higher fees for inferior performance.

"Okay, Tom. What about the other plan fees? I want to see full disclosure and transparency on every single possible fee!"

Tom proudly produced an itemized spreadsheet and handed it across the coffee table. "The total cost, including the investment options, investment management services, and record-keeping fees, is only 0.75% annually."

"That's it? No hidden fees or other pop-up-out-of-nowhere fees?"

We cut our total fees from well over 2.5% to just 0.75% (a 70% reduction!). As you recall from earlier in chapter 2, when compounded over time, these fee savings equate to hundreds of thousands of dollars—even millions—that will end up in the hands of my employees and their families. That makes me feel so great! Below is a simple chart showing a sample 401(k), similar to the one my company used to use, versus America's Best 401k, and how those savings compound directly into my employees' accounts.

AMERICA'S BEST 401(K)

	MY OLD PLAN (2.5% TOTAL FEES)	AMERICAS BEST 401K	TOTAL SAVINGS THAT GO BACK TO YOU AND YOUR EMPLOYEES
After Year 1	$15,925,465	$16,006,101	$80,635
After Year 7	$22,265,866	$23,025,978	$760,111
After Year 20	$41,999,917	$45,999,618	$3,999,701

Assumptions: $1 million beginning plan balance, $100,000 in annual contributions, 5% growth rate.

America's Best 401(k)

	My Old Plan (0.75% total fees)	America's Best 401K	Total Savings That Go Back to You and Your Employees
After Year 1	$14,530,987	$14,582,411	$51,424
After Year 7	$25,077,485	$25,623,385	$545,899
After Year 20	$58,499,799	$61,756,687	$3,355,987

Over $1.2 million going back to my family and my staff by making a simple switch! And by the way, this calculation is based only on fees and doesn't take into account that we are beating 96% of mutual fund managers because we are using low-cost market-mimicking mutual funds.

MEGAPHONE

My staff and I were so impressed that six months after Tom and his team installed my company's plan (and after I had referred him to a ton of my good friends), I decided to partner with America's Best 401k and help it get the word out. I knew this story *had* to be told in this book. And because the company charges so little, it can't afford to run Super Bowl ads or have its sales reps take you golfing. Tom's grassroots efforts are gaining momentum, and I hope to amplify his voice.

NOW IT'S TIME TO PULL BACK THE CURTAIN

Tom and his team have built a powerful online "Fee Checker" that can pull up your company's plan (from the company's tax return filing), and within seconds, it will show how your company's plan stacks up against others and what you are *really* paying in fees. And like the table above, it will show you what the cost savings means to you over time. It's not uncommon to uncover hundreds of thousands of dollars in potential savings! Visit the Fee Checker on the following website: http://americasbest401k.com/401k-fee-checker.

NEED EXTRA MOTIVATION?

As if high fees destroying your retirement weren't enough of a motivation, business owners should be very concerned and employees should be "armed with the truth." Why? Because the US Department of Labor (DOL) is out in full force to defend employees against high-fee plans. And who is liable? *The business owner!* That's right. Not the mutual fund managers. Not the broker. Not the administrator of the crappy 401(k) plan. It's the business owner who can get in serious hot water.

According to the *CFO Daily News*, in 2013 **"[s]eventy-five percent of the 401(k)s audited by the DOL last year resulted in plan sponsors being fined, penalized or forced to make reimbursements for plan errors. And those fines and penalties weren't cheap. In fact, the average fine last year was $600,000 per plan.** That's a jump of nearly $150K from four years ago."

And the DOL just hired another 1,000 enforcement officers in 2014, so we can all expect 401(k) plan audits to increase. I don't know about you, but this certainly got my attention.

Thanks to class action attorneys, numerous corporations are being sued by their own employees. Caterpillar, General Dynamics, and Bank of America, just to name a few. **Even Fidelity, one of the largest 401(k) providers in the industry, recently settled two class-action lawsuits for $12 million after being sued by its own employees over excessive fees in its plan.** Sure, these are big companies with a lot to lose, but it's really the small business owners who are at greater risk because smaller plans (those with less than $10 million in plan assets) have the highest fees of all.

So What Do You Do as a Business Owner? First, *it's the law* that you have your plan "benchmarked" annually against other plans. The new law began in 2012, so it might be news to you. Once a year, the DOL requires that you compare your plan against other "comparable" plans to make sure your plan has reasonable fees. Nearly every business owner I ask has no clue about this! I sure didn't. Do you think the person who sold you that expensive plan is going to call you about it? Of course not!

America's Best 401k will not only provide you with a free fee analysis but

Warning: DOL Found Three-Fourths of 401(k)s Illegal

Here's a very compelling reason to take a closer look at your 401(k) plan:

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Source: CFO Daily News

also provide this complimentary benchmark. If the DOL walks into your office on a Friday afternoon, don't let it ruin your weekend by standing there like a deer in the headlights. You want to be able to confidently hand over your plan benchmark.

WHO TO HOLD TO THE FIRE?

The DOL is on a rampage and can hold the business owner over the fire. I had no idea that as a business owner, and plan sponsor, I am the legal fiduciary for the 401(k) plan. There are numerous cases where business owners have become *personally* liable for an egregious 401(k) plan. By your using a firm like America's Best 401k, it will "install" a professional fiduciary, which will dramatically alleviate your liability (and yes, this is included in the 0.75% annual fee). And it provides ongoing benchmarking as a *free* service.

What to Do If You Are an Employee. First, visit the Fee Checker on the America's Best 401k website (http://americasbest401k.com/401k-fee-checker) and forward the report to the owner (or upper management). Truth is, the highest income earners in any business tend to have the highest account balances, so they too have a lot to lose. You are doing your entire company a wonderful service by educating management on its own plan. High fees are a drain on everyone's hard-earned cash, and a possible change will affect everyone's chances of financial freedom. Remember, we all need a tailwind, not a headwind.

You can also march down to the HR department and make certain they read this chapter. If fees aren't a motivator, remind them that they are the fiduciary to you and your fellow colleagues. They *legally* owe it to you to make sure they have a plan that is competitive and in your best interests. That should grab their attention!

If your employer does not switch to a low-cost option and to the extent that your employer isn't matching your contributions, it may make sense to opt out.

If you decide to opt out but still plan on staying with the company, a good plan will allow for an *in-service distribution*, allowing you to roll your current 401(k) account into an individual retirement account. Just check with your HR department. An IRA is simply a retirement account held in your name alone, but you will have much more freedom to choose the investments. And from there you can implement some of the solutions we will review in section 3. Also, your personal fiduciary can review this account and explain your best options.

Now that we know how to free ourselves from high-cost plans riddled with underperforming mutual funds, how do we best utilize a low-cost plan and the tax benefits that the government gives us?

UNCONVENTIONAL WISDOM

If you haven't noticed, our government has a spending problem. Like an out-of-control teenager with a Platinum Amex, Uncle Sam has racked up over $17.3 trillion in debt and close to $100 trillion in unfunded (not paid for yet!) liabilities with Social Security and Medicare. So do you think taxes will be higher or lower in the future? Did you know that following the Great Depression, the highest income tax bracket was over 90%?! The truth is, you can tax every wealthy individual and corporation at 100% of its income/profits and still fall way short of the government's promises. Take a look at this video I made for an eye-opening presentation: http://training.tonyrobbins.com/exclusive-video-tony-robbins-deconstructs-the-national-debt.

Conventional logic, as most CPAs will attest, is to maximize your 401(k) (or IRA) contributions for tax purposes because each dollar is deductible. Which simply means you don't have to pay tax on that dollar today but will defer the tax to a later day. But here is the problem: *nobody knows what tax rates are going to be in the future, and therefore you have no idea how much of your money will be left over to actually spend.*

I met recently with one of my senior executives on this topic, and I asked him how much he had in his 401(k). He said he was approaching $1 million and felt comfortable that he could live off of this amount if needed. I asked him in a different way:

"How much of the million dollars in your 401(k) is *yours*?"

"All of it, of course," he replied.

"*Half*, my friend! Half! Between state and federal income taxes, you will be spending only half that amount."

The truth sank in. He sat back realizing that $500,000 is *not* his. It's Uncle Sam's. He was simply investing the government's money alongside his own.

But then I asked, "How much is yours if the tax bracket goes up to sixty percent?" A little mental math, and he replied, "Only four hundred thousand dollars, or forty percent, of the million will be mine." Ouch. But that's not possible, is it? If you look at tax rates on the wealthiest Americans over the last 20 years (between 1990 and 2010), they are near the lowest they have ever been. The average for the three decades from the 1930s through the 1950s was 70%! When taxes were raised by Bill Clinton, he raised them on *all* wage earners, not just the wealthy. With the record-breaking levels of debt we have accumulated, many experts say taxes will likely be raised on everyone over the course of time. In short, the percentage of your 401(k) balance that will actually be yours to spend is a *complete unknown.* And if taxes go up from here, the slice of the pie you get to eat gets smaller. And it's a spiraling effect because the less you get to keep and spend, the more you have to withdraw. The more you withdraw, the quicker you run out.

SENATOR WILLIAM ROTH: THE BEST LEGAL TAX HAVEN?

A Roth IRA—and more recently the addition of the **Roth 401(k)**—is often overlooked, but it is one of the best and yet legal "tax havens" in the face of rising future tax rates. And we owe a big tip of the cap to Senator William Roth for their introduction back in 1997. Let's look at how they work.

If you were a farmer, would you rather pay tax on the seed of your crop or on the entire harvest once you have grown it? Most people seem to get this question wrong. We are conditioned to *not* want to pay tax today (and thus defer into the future). They think it's best to pay tax on the harvest. But in reality, if we first pay tax on the seed, that's when the value of what's being taxed is smallest. A big harvest means a big tax! If we pay our taxes now on the seed, then whatever we have come harvest time is ours to keep! A Roth account works this way. We pay our tax today, deposit the after-tax amount, and then never have to pay tax again! Not on the growth and not on the withdrawals. This arrangement protects your pie from the government's insatiable appetite for more tax revenues and, most importantly, allows you to plan with certainty how much you actually have to spend when you take withdrawals.

And here is an incredibly exciting piece of news!

With your 401(k) contributions being Roth-eligible (by checking the box), you can pay tax today and let your growth and withdrawals be free from the IRS's grabby paws. And you can give substantially more because while a **Roth IRA is limited to $5,500 annually, the Roth 401(k) allows for $17,500 per year.** (And you can do both simultaneously).[6]

And for the high-income earner (making more than $122,000 per year), although you can't use a Roth IRA, there are *no income limitations* on the Roth 401(k). Anyone can participate. This is a relatively recent change in our tax code and can provide quite a benefit for higher-income earners.

SAVE MORE TOMORROW

So the secret to the 401(k) is simple: you have to do it. But you have to do it within a cost-efficient plan *and* take advantage of the Roth 401(k) (especially if you believe taxes will go up for you in the future). And if you take advantage of one the greatest breakthroughs in finance: the system we covered earlier called Save More Tomorrow. Most people won't make the commitment to save more today, but they will make the commitment to save more tomorrow. So in essence, you are agreeing in advance that your savings rate will increase each year. For example, let's say today you save 3% of your salary. Then next year you agree to go up 1% (for a total of 4%). And then you keep "auto-escalating" your savings amount until you reach a certain cap. America's Best 401k has this auto-escalation feature built into the system. So not only do you have the lowest possible fees, but you also have an opportunity to set yourself on an accelerated path to financial freedom.

BULL'S-EYE!

Now we have a chance to combine all we have learned! By now you have decided to set aside a percentage of your income, and that may very well be in your 401(k). **You want to make absolutely sure that your 401(k) has the lowest possible fees and low-cost index funds.** You can see how your company plan fares by using the Fee Checker on America's Best 401k

6. There are different rules for a Roth IRA and a Roth 401(k). According to the IRS: "If you were age 50 or older before 2014, and contributions on your behalf were made only to Roth IRAs, your contribution limit for 2013 will generally be the lesser of: $6,500, or your taxable compensation for the year." See "Publication 590 (2013), Individual Retirement Arrangements (IRAs)," "Roth IRAs," www.irs.gov/publications/p590/ch02.html#en_US_2013_publink1000253532.

(http://americasbest401k.com/401k-fee-checker). Once again, if you are an employee, you should make the company owner (or management) aware of their legal responsibility to provide the most efficient plan available and that they are at risk of getting into major hot water with the Department of Labor. If you are a business owner, you are legally required to get the plan benchmarked annually, and America's Best will provide a complimentary benchmark; simply take two minutes to fill out this online form: http://americasbest401k.com/request-a-proposal. Here is the great news: the typical small plan will save $20,000 per year in fees alone. Bigger plans will save hundreds of thousands, even millions, over the life of the plan, all of which goes directly back to the employees and the owner's personal retirement plan as well.

SEVEN FREQUENTLY ASKED QUESTIONS

Stick with me here. We're about to start putting ideas into action. These are the seven most common questions that come up in the context of 401(k) plans and IRAs and how to best utilize them. Here we go!

1. SHOULD I PARTICIPATE IN MY 401(k)?

To the extent that your employer matches your contributions, you should certainly take advantage of your 401(k), as the company is essentially covering the taxes for you. **And if you think taxes are going up, checking the box so that your contributions receive Roth tax treatment is the way to go.** (A quick side note: the 401(k) plan itself might be insanely expensive and the investment options poor. If that is the case, you may not want to participate at all! To determine how your company's plan stacks up, go to http://americasbest401k.com/401k-fee-checker and click on Fee Checker to assess your company's plan.)

Just to be clear, if you check the box to make your contributions Roth-eligible, you will still be investing in the same investment options (or list of funds), with the only difference being that you will pay taxes on the income today. But your future nest egg will be completely tax free when you withdraw. Retirement expert Dr. Jeffrey Brown of the University of Illinois gave me his take on his own personal finances. "I'd take advantage of every Roth opportunity I can because . . . I've spent a lot of time looking at the long-term fiscal outlook for the United States, and you know I am a pretty optimistic guy, on the whole. But I have to tell you that **I cannot envision any situation in which our need for tax revenue in the future is not going to be higher than it is today."**

Taking it one step further, Dr. Brown has personal guidance for his younger students: "Absolutely pour as much money as you can into that Roth because you're going to be paying little or no taxes on it, and then someday you could have the greatest income ever."

If you are one of the few that thinks taxes in future will be lower, you could be in for a huge surprise. "Conventional wisdom" says we *should* be in a lower tax bracket when it comes time to retire, as we won't be earning as much. But in reality, our home is often paid off (so we don't have any mortgage deductions), and the kids are long gone (so we don't have any dependents).

Finally, you might be self-employed and think that all this 401(k) talk is irrelevant. Not so! You can start a Solo 401(k), which is a 401(k) for an individual business owner and his or her spouse.

2. WHAT IS A ROTH 401(k), AND HOW CAN I USE IT TO MY ADVANTAGE?

I said it before, but it's worth repeating: most of today's 401(k) plans allow you to simply "check a box," and your contributions will receive the Roth tax treatment. This decision means you pay tax today, but you never pay tax again!

3. SHOULD I SET UP A ROTH IRA?

Yes!! You can set up a Roth IRA account and contribute $5,500 per year ($6,500 if you're 50 or older). You can even do so if you are already maxing out your 401(k) contributions. Opening a Roth IRA is as simple as opening a bank account. TD Ameritrade, Fidelity, and Schwab are three firms that make the process incredibly simple. You can do it online in less than ten minutes.

4. BUT WHAT IF I MAKE TOO MUCH MONEY FOR A ROTH IRA?
Sadly, you cannot contribute to a Roth IRA if your annual income is over $114,000 as an individual or more than $191,000 for a married couple (for 2014). But don't fret, regardless of how much you make, you can still participate in a Roth 401(k). And if you have an IRA, you might want to consider converting your IRA into a Roth IRA, but know that you will have to pay tax today on all the gains.

5. SHOULD I CONVERT MY TRADITIONAL IRA TO A ROTH IRA?
Let's say you have an IRA with $10,000. The government will allow you to pay the tax today (because it needs the money), and you will never have to pay tax again. This process is called a Roth conversion. So if you are in the 40% bracket, you would pay $4,000 today, and your remaining $6,000 will grow without tax, and all withdrawals will be tax free. Some people cringe at the idea of paying tax today because they view it as "their" money. It's *not*! It's the government's. By paying the tax today, you are giving Uncle Sam his money back earlier. And by doing so, you are protecting yourself and your nest egg from taxes being higher in the future. If you don't think taxes will be higher, you shouldn't convert. You have to decide, but all evidence points to the hard fact that Washington will need more tax revenue, and the biggest well to dip into is the trillions in retirement accounts.

6. WHAT ABOUT MY OLD 401(k) PLAN(S) WITH PAST EMPLOYERS?
Older plans can either be left with a previous employer or "rolled over" into an IRA. One would leave it with an old employer only if the plan itself was low cost and had favorable investment options. By rolling over the plan into an IRA (it takes about ten minutes online to move the funds from your former plan to a third-party IRA custodian like TD Ameritrade, Schwab, or Fidelity), you will have greater control. You can invest in nearly any investment, not just a limited menu it offers. And with this great control, you will be able to hire a fiduciary advisor and implement some exciting strategies and solutions we will review in section 3. With a fiduciary advisor, you don't pay commissions. You pay for advice. And it's typically 1% or less of your

invested assets, and remember, you might be able to deduct it from your taxes.

Second, by rolling over your old 401(k) into an IRA, you will then have the option to convert an IRA into a Roth IRA.

7. WHAT ELSE CAN I DO IF I AM MAXING OUT MY PLANS AND WOULD LIKE ADDITIONAL OPTIONS TO SAVE?

Small business owners that are making a lot of money and want to reduce their taxes today can benefit greatly from the addition of a *cash-balance plan* on top of their 401(k) plan. Cash-balance (CB) plans are the fastest growing of the defined benefit pension plans and could overtake 401(k) plans within the next few years, according to researchers at Sage Advisory Services, a registered investment advisory firm headquartered in Austin, Texas. In fact, over one third of Fortune 100 companies have adopted a cash-balance plan. So what is it? A cash-balance plan is basically a pension plan. In other words, the amounts deposited are earmarked to provide the business owner with future retirement income. So what's the biggest draw? For a high-income business owner, not only can she max out her 401(k) *and* a profit-sharing plan, but she can also add a cash-balance plan, which creates some very large, fully deductible contributions. On page 156 is a table showing the possible deductions.

Money Power Principle 2. One of the most important Money Power Principles is "You get what you tolerate." Don't tolerate having your money in a plan that is siphoning off fees to the benefit of someone else. And we have to remember that the 401(k) is only as good as what's inside it. Turn the page and discover the next myth. Because the most popular place for people to put their 401(k) money is one of the most misunderstood investments of our time.

2014 IRS ANNUAL CONTRIBUTION LIMITS			
AGE	401(K) CONTRIBUTION + PROFIT-SHARING PLAN	CASH-BALANCE PLAN CONTRIBUTION	TOTAL
65	$56,000	$237,841	$293,841
60	$56,000	$228,807	$284,807
55	$56,000	$175,068	$231,068
50	$56,000	$133,950	$189,950
45	$51,000	$102,490	$153,490
40	$51,000	$78,419	$129,419
35	$51,000	$60,001	$111,001

CHAPTER 2.6

MYTH 6: TARGET-DATE FUNDS: "JUST SET IT AND FORGET IT"

I am increasingly nervous about target-date funds with each passing day.

—JACK BOGLE, founder of investor-owned Vanguard

When you are looking at your 401(k) investment options, do you ever wonder just how they came up with that list? Or why your spouse or best friend who works across town has an entirely different menu of choices?

As the saying goes, always follow the money.

YOU GOTTA PAY TO PLAY

In the world of mutual funds, the common practice of sharing in revenues is known as pay-to-play fees. According to the Watson Towers worldwide consulting firm, approximately 90% of 401(k) plans require pay-to-play fees in exchange for placing a mutual fund as an available option on your plan's menu. These pay-to-play fees virtually guarantee that the client (you and me) gets a limited selection and will end up owning a fund that proves profitable for the distributors (the broker, the firm, and the mutual fund company). Said another way, the "choices" you have in your 401(k) plan are carefully crafted and selected to maximize profits for the vendors, brokers, and managers. If one has to pay to play, they are going to want to maximize their profits to recoup their cost. And target-date funds, sometimes called *lifecycle funds*, may just be the most expensive and widely marketed creation to make their way into your plan's investment options (with the exception being Vanguard's ultra-low-cost versions).

DO TARGET-DATE FUNDS MISS THE MARK?

Despite being the fastest-growing segment of the mutual fund industry, target-date funds (TDFs) may completely miss the mark.

The pitch goes like this: "Just pick the date/year in which you will retire, and we will allocate your portfolio accordingly [the Golden Years 2035 fund, for example]. The closer you get to retirement, the more conservative the portfolio will become." I am sure you have seen these options in your 401(k), and statistics would say that you are likely invested in one.

Here is a bit more about how they *actually* work.

The fund manager decides upon a "glide path," which is the fancy way of describing its schedule for decreasing the stock holdings (more risky) and ramping up the bond holdings (traditionally less risky) in an attempt to be more conservative as your retirement nears. Never mind that each manager can pick his own "glide path," and there is no uniform standard. Sounds more like a "slippery slope" to me. Then again, this is all built on two giant presuppositions:

1. Bonds are safe.
2. Bonds move in the opposite direction of stocks, so that if stocks fall, your bonds will be there to protect you.

As Warren Buffett says, "Bonds should come with a warning label." And since bond prices fall when interest rates go up, we could see bond prices plummet (and bond mutual fund prices, too) if or when interest rates go up. In addition, numerous independent studies show how bonds have strong "correlation" in bad times. Translation: stocks and bonds don't always move in opposite directions. Just look at 2008, when bonds and stocks both fell hard!

The marketing message for target-date funds is seductive. Pick the date, and you don't have to look at it ever again. "Set it and forget it." Just trust us! We've got you covered. But do they?

ONE GIGANTIC MISUNDERSTANDING

A survey conducted by Behavioral Research Associates for the investment consulting firm Envestnet found that employees who invested in TDFs had some jaw-dropping misconceptions:

- **57% of those surveyed thought they wouldn't lose money over a ten-year period.** There are no facts to support that perception!
- **30% thought a TDF provided a guaranteed rate of return.** TDFs do not give you any guarantee of anything, much less a rate of return!
- **62% thought they would be able to retire when the year, or "target date," of the fund arrives.** Unfortunately, this false perception is the cruelest of all. The date you set is your retirement year "goal." TDFs are not a plan to get you to your goals, but rather just an asset allocation that *should* become less risky as you get closer to retirement.

Considering that there are trillions of dollars in TDFs, a huge percentage of Americans are in for a shocking surprise.

So what are you really buying with a TDF? You are simply buying into a fund that handles your asset allocation for you. It's as simple as that. Instead of picking from the list of fund options, you buy one fund, and voilà! It's "all handled for you."

SORRY, SHE NO LONGER WORKS HERE

After graduating college, David Babbel decided he wanted to work for the World Bank. It would no doubt be an interesting place to work, but for those fortunate enough to be employed there, they also pay no taxes! Smart man. When he applied they turned him away, saying he needed a postgraduate education in one of six categories to land a job. Not one to risk being denied a position, he decided to go get *all* six. He has a degree in economics, an MBA in international finance, a PhD in finance, a PhD minor in food and resource economics, a PhD certificate in tropical agriculture, and a PhD certificate in Latin American studies. When he returned with his fistful of diplomas, they told him they weren't hiring Americans due to the recent reduction of financial support from Washington to the World Bank. It was a punch in the gut for him. Not knowing where to turn, he responded to a newspaper ad from UC Berkeley. After they hired him as a professor, he later found out that they ran the ad to comply with affirmative action, but had no intention of getting qualified candidates to respond.

Years later he moved on to Wharton to teach multiple subjects related to finance. But he isn't just a bookworm. A paper he had written on how to reduce risk in bond portfolios caught the attention of Goldman Sachs. He took a leave of absence and spent seven years running the risk management and insurance division at Goldman Sachs (while still holding down a part-time professorship at Wharton). Later he finally had a chance to work at the World Bank. He has also consulted for both the United States Treasury and the Federal Reserve. But when the Department of Labor asked him to do a counterstudy on whether target-date funds were the best default retirement option, he had no idea the path that lay ahead. On the other side of the proverbial aisle was the Investment Company Institute (the lobbying arm for the mutual fund industry), which "had paid two million dollars for a study and got exactly what they wanted. A study that said [TDFs] are the best thing since sliced bread." Keep in mind that at this point, TDFs were just a concept. A glimmer in the eye of the industry.

In his study for the Department of Labor, conducted with two other professors, one of whom was trained by two Nobel laureates, Babbel compared TDFs to *stable value funds.* Stable value funds are ultraconservative, "don't have losses and historically have yields [returns] at two percent to three percent greater than money market funds." According to Babbel, the industry-sponsored study, which painted TDFs in the best possible light, was riddled with flaws. To make TDFs look better than stable value funds, they pumped out more fiction than Walt Disney. For example, they made an assumption that stocks and bonds have *no correlation. Wrong.* Bonds and stocks do indeed move in step to a degree and they move even closer during tough times. (Bonds and stocks had 80% correlation in 2008.)

Babbel and his team reviewed the study and picked it apart. They had mathematically dissected the report's fictional findings and were prepared to show its ridiculous assumptions that made TDFs look so superior.

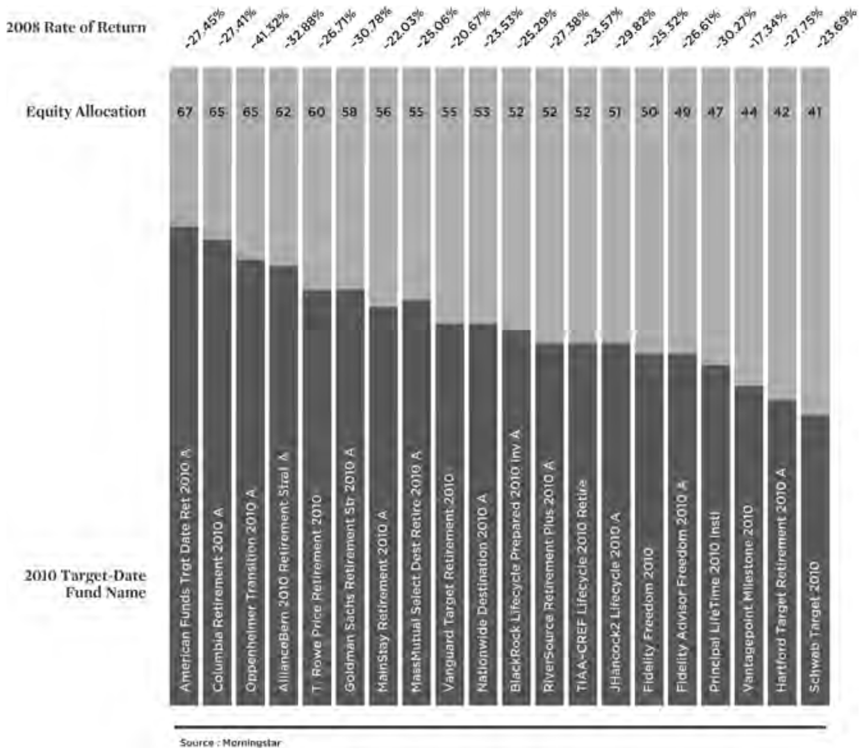
When he showed up on the day to present his conclusion, the economists behind the table, chosen by the Department of Labor to judge both studies, "thought he had some great points that needed further review." But the secretary of labor "had already made her decision and then quit. She didn't even show up at the meeting she had scheduled with him." Dr. Babbel heard that it was prewired. The industry has bought the seal of approval it needed to write its own "fat" check.

Fast-forward, and by the end of 2013, TDFs were used by 41% of 401(k) participants, to the tune of trillions! Not a bad return for the investment community for a $2 million investment in a study Dr. Babbel and his esteemed economist colleagues called "heavily flawed."

A 2006 federal law paved the way for target-date funds to become the "default" retirement option of choice. Employers can't be held liable for sticking employee money in target-date funds. Today well over half of all employers "auto-enroll" their employees into their 401(k). According to research from Fidelity, over 96% of large employers use these target-date mutual funds as the default investment of choice.

YOU NEVER KNOW WHO'S SWIMMING NAKED UNTIL THE TIDE GOES OUT

Imagine that it is early 2008, and you are closing in on your retirement. You have worked the grind for over 40 years to provide for your family; you are looking forward to more time with the grandkids, more time traveling, and just . . . more time. By all accounts your 401(k) balance is looking healthy. Your "2010 target-date funds" are performing nicely, and you trust that since you are only two years away from retirement, your funds are invested very conservatively. Millions of Americans felt this way before 2008 wiped out their hopes for retirement, or at least the quality of retirement they had expected. The list on page 162 shows the top 20 target-date funds (by size) and their gut-wrenching 2008 performances. Remember that these are 2010 target-date funds, so retirement was now only two years away for their investors. Notice the high percentage that certain funds chose to put into stocks (more risky) even though they were supposed to be in the "final stretch" and thus most conservative. To be fair, even if you are retiring, you must have some exposure to stocks, but at the same time, this type of loss could have devastated or at least delayed your plans for retirement.



LESSER OF TWO EVILS

When I sat down to interview many of the top academic minds in the field of retirement research, I was surprised to learn that they were all in favor of target-date funds.

Wait a second. How could that be!?

I shared with each of them much of what you have just read, and while they didn't disagree that there are issues with TDFs, they pointed to the time before TDFs existed, when people were given the choice to allocate as they wished. This arrangement led to more confusion and, quite frankly, really poor decision making. The data certainly supports their point.

In my interview with Dr. Jeffrey Brown, one of the smartest minds in the country, he explained, "If you go back prior to these things [TDFs], we had a lot of people who were investing in their own employer's stock. Way over-concentrated in their own employer's stock." He reminded me of Enron, where many employees put 100% of their savings in Enron stock, and overnight that money was gone.

When people had 15 different mutual fund options from which to choose, they would divide the money up equally (1/15th in each one), which is not a good strategy. Or they would get nervous if the market dropped (or sell when the market was down) and sit entirely on cash for years on end. Cash isn't always a bad position for a portion of your money, but within a 401(k), when you are paying fees for the plan itself, you are losing money to both fees and inflation when you hold on to cash. In short, I can see Dr. Brown's point.

If the concept of a target-date fund is appealing, Dr. Brown recommends a low-cost target-date fund such as those offered by Vanguard. This could be a good approach for someone with minimal amounts to invest, a very simple situation, and the need for an advisor might be overkill. But if you don't want to use a target-date fund and instead have access to a list of low-cost index funds from which to choose, you might implement one of the asset allocation models you will learn later in this book. **Asset allocation, where to park your money and how to divide it up, is the single most important skill of a successful investor.** And as we will learn from the masters, it's not that complicated! Low-cost TDFs might be great for the average investor, but you are not average if you are reading this book!

If you want to take immediate action to minimize fees and have an advisor assist you in allocating your 401(k) fund choices, you can use the service at Portfolio CheckUp (www.PortfolioCheckUp.com), which, with the click of a button will automatically "peer into" your 401(k) and provide a complimentary asset allocation.

In addition, many people think there aren't many alternatives to TDFs, but in section 5, you'll learn a specific asset allocation from hedge fund guru Ray Dalio that has produced extraordinary returns with minimal downside. When a team of analysts back-tested the portfolio, the worst loss was just 3.93% in the last 75 years. In contrast, according to MarketWatch, "the most conservative target-date retirement funds—those designed to produce income—fell on average 17% in 2008, and the riskiest target-date retirement funds—designed for those retiring in 2055—fell on average a whopping 39.8%, according to a recent report from Ibbotson Associates."

ANOTHER ONE BITES THE DUST

We have exposed and conquered yet another myth together. I hope by now you are seeing that ignorance is not bliss. Ignorance is pain and poverty in the financial world. The knowledge you have acquired in these first chapters will be the fuel you will need to say "Never again! Never again will I be taken advantage of."

Soon we will begin to explore the exciting opportunities, strategies, and vehicles for creating financial freedom, but first we have just a couple more myths to free you from.