Employee Benefit News
HELPING BENEFIT PLAN SPONSORS PUT INFORMATION INTO ACTION

Eight Considerations When Reviewing Your 401k Investment Line-Up

By Robert C. Lawton, AIF, CRPS, President, **Lawton Retirement Plan Consultants, LLC**

At least once each year it is advisable for plan sponsors and/or other plan fiduciaries to take a critical look at their investment fund line-ups. If you work with an investment advisor, he/she can guide this assessment for you. The items that are normally considered in a review include:

1. **Investment Tracks.** It has become common for most 401k plan menus to feature the following investment tracks: Core Funds, Index, Specialty and Target Date. An investment track is a group of investment funds that appeal to a particular type of investor. For example, there are investors who believe index investing is the way to go. They believe that active managers don't beat the market frequently enough to justify their higher cost. Therefore, index funds will be the only investment funds in a plan that will interest this group of investors. Highlighting these funds in your employee education materials for the index investor group will help them identify their index fund track. Talking directly to each of these investor types during your employee education sessions will help them understand which funds are in the tracks that appeal to them.

2. **Covering All Traditional Asset Classes.** Most retirement plan line-ups have a hole or two in their menus. Typically, at least one fund per style (value, blend and growth) is offered in each of the following capitalization sizes: large cap, mid cap and small cap. Doing a little quick math yields a total of 9 funds to cover all of these categories. Your core funds investors will be looking for these funds to properly diversify their account balances.

3. **Commodities Funds.** Most of the clients that I work with offer investment menus that feature at least two commodities funds. These typically include a general commodities fund and a real estate fund. Offering these fund options broadens the spectrum of asset classes represented in your menu and can decrease overall portfolio risk for investors in your plan (if used properly). However, investors should keep in mind that commodity funds may be more volatile than traditional investments and that commodity funds often use leverage to magnify returns (and therefore potential losses). Investors should also be aware that the values of real estate funds can be affected by interest rates, property tax rates and changes in supply and demand.

4. **More Than One International Equity Option.** There appear to be three ways of looking at international equity funds at the moment: Developed/Emerging Markets, Growth/Value and finally World/Foreign. Investors who prefer to view the world through a Developed/Emerging Markets lens typically see developed international markets as Europe, Japan and Hong Kong, while emerging market countries normally include the BRIC nations

(Brazil, Russia, India and China). International Growth/Value investors believe that it is possible to identify international companies by investment style, either growth or value. World/Foreign investors believe in funds that include companies in the United States (a World approach) versus funds that don't (the Foreign approach). Regardless of your view, each approach would appear to yield at least two options. Investors should be aware that international investing is subject to additional risks including currency fluctuation, political risk and lack of liquidity. These risks may be even greater in emerging markets funds.

5. **Fixed Income Options.** Most investment fund menus that I work with feature fixed income options from the following categories: Money Market/Stable Value, Intermediate Bond, High Yield Bond and International Bond. In addition, given some investors feelings about future inflation, it is not uncommon to see an inflation protected bond option or TIPS investment option as well. While these two types of fixed income funds try to offer investors protection against rising inflation, they are subject to interest rate, credit and reinvestment risks.

6. **Index Funds.** Many retirement plans now feature up to three index fund options. Included in this group are large cap, mid cap and small cap options. These tend to be very cost-efficient equity options for your participants.

7. **A Target Date Fund Family.** Target date funds have become one of the most popular fund options in many retirement plans, gathering the most assets and the most participants. I believe that every 401k plan will soon offer a set of target date funds. Your advisor can help you select and monitor an appropriate target date fund family based on risk tolerance since these funds are subject to the risks attendant to the underlying funds in which they invest.

8. **Communication Materials.** How effectively you are communicating your line-up to plan participants directly impacts your participation rate, employee satisfaction and overall understanding of your plan. It's a good idea to check both the written materials that are shared with new enrollees and your web site presentation. It will be helpful for most participants if you clearly outline the investment tracks that are available.

You can see that if you were to offer only one fund in each of the categories listed above that you could easily end up with a line-up that includes between 15 and 20 investment funds (not including target date funds). This is an appropriate number of investment funds to offer, for many larger plans. In fact, a recent survey by Watson Wyatt indicated that 69% of plan sponsors offered their employees up to 19 investment options. However, if your plan is smaller, you may want to consider offering less investment options.

There are good reasons for you to take a look at your investment menu annually. The Department of Labor requires you to offer an investment menu that is appropriate and provides the opportunity for diversification. Remember when looking at your investment menu to consider both fund performance and overall quality and appropriateness.

About the Author

Robert C. Lawton, AIF, CRPS is the founder and President of Lawton Retirement Plan Consultants, LLC. Mr. Lawton is an award-winning 401(k) investment adviser with over 30 years of experience. He has consulted with many Fortune 500 companies, including: Aon Hewitt, Apple, AT&T, First Interstate Bank, Florida Power & Light, General Dynamics, Houghton Mifflin Harcourt, IBM, John Deere, Mazda Motor Corporation, Northwestern Mutual, Northern Trust Company, Trek Bikes, Tribune Company, Underwriters Labs and many others. Mr. Lawton may be contacted at ***(414) 828-4015*** *or* ***bob@lawtonrpc.com****.*

About Lawton Retirement Plan Consultants, LLC

Lawton Retirement Plan Consultants, LLC is a Milwaukee, Wisconsin-based independent, objective Registered Investment Adviser (RIA) providing investment advisory, fiduciary compliance, employee education, provider management and plan design services to 401(k) plan sponsors. The firm currently has contracts in place to provide consulting services on more than $400 million in plan assets. For more information, please contact Robert C. Lawton at ***(414) 828-4015*** *or* ***bob@lawtonrpc.com*** *or visit the firm's website at:* ***http://www.lawtonrpc.com****. Lawton Retirement Plan Consultants, LLC is a Wisconsin Registered Investment Adviser.*

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