November 2014 | Investment Updates

# How Saving Too Much in Your 401(k) Could Cost You

The idea of contributing too much to a company retirement plan may sound strange, but it can happen, especially if an employee contributes high amounts in a short time frame, thereby hitting the annual contribution limit too early and missing out on part of the employer's 401(k) match, rather than spreading contributions out during the year.

For 2014 the annual 401(k) contribution limit for workers under age 50 is $17,500, and for those age 50 and older it's $23,000. (Matching contributions from the employer don't count toward these caps.) Let's say a 40-year-old worker who makes $100,000 a year contributes 25% of her pay to a 401(k) plan every two weeks starting in January, and that the company matches the first 3% dollar-for-dollar. By contributing at such a high rate, the worker would reach the $17,500 cap on annual contributions sometime in September and wouldn't be able to make any more contributions after that.

Up to that point the worker would have had $2,192 added to her 401(k) through her employer match. But by contributing at a lower rate each pay period (17.5% of pay, to be exact) and spreading her contributions out more evenly throughout the full calendar year, the worker would receive a full year's worth of the employer match: $3,000. By contributing too much too soon, the worker has cost herself more than $800 in eligible retirement money from her employer.

It's well worth planning ahead so as not to miss out on matches later in the year. Saving a lot in your 401(k) is a good thing, but when you save it may be nearly as important.

401(k) plans are long-term retirement savings vehicles. Withdrawal of pre-tax contributions and/or earnings will be subject to ordinary income tax and, if taken prior to age 59 1/2, may be subject to a 10% federal tax penalty.

Canandaigua National Bank & Trust

# Three-Step Checklist for Turbulent Markets

When the stock market experiences extreme volatility, an investor's best bet is to focus his/her energy on factors that can be controlled. Unfortunately, many investors panic-sell and lose their money. When the market rebounds, many investors are left wondering if it's the right time to get back in.

Your best bet during turbulent markets is an investment of time. You want to invest in time to see where you stand now, and, if you determine changes are in order, thoroughly research your options. Here is a three-step checklist to manage your investments during turbulent markets.

Step 1: Check adequacy of cash reserves.

The best way to manage your portfolio during volatile markets is to make sure you have adequate cash on hand to cover your near-term needs. This way, your long-term stock investments can ride out the market ups and downs, but you can take comfort in knowing that they won't affect your ability to fund short-term cash needs.

Step 2: Check your long-term positioning.

Once you've done the liquidity check, the next step is to check the asset allocation of your long-term assets. Market sell-offs can be alarming for retirees and people getting close to retirement simply because they typically have more money invested, compared with their younger counterparts. Checking your long-term positioning helps you put things into perspective so that you can make sound investment decisions for your future.

Step 3: Initiate defensive hedges with care.

During turbulent markets, investors may initiate defensive strategies like selling out of stocks and buying into the so-called "safe" investments like gold. Gold and treasuries can serve as a legitimate defensive role in a portfolio; however, these investments may have already enjoyed a sizable run-up. If you're moving into either, do so with caution, and only after you've checked your existing exposure to those asset classes.

Treasuries are guaranteed by the full faith and credit of the U.S. government as to the timely payment of principal and interest. Debt securities are subject to credit/default risk and interest-rate risk (they have varying levels of sensitivity to changes in interest rates). In general, the price of a debt security tends to fall when interest rates rise and rise when interest rates fall. Securities with longer maturities and mortgage securities can be more sensitive to interest rate changes.

Gold/commodity investments will be subject to the risks of investing in physical commodities, including regulatory, economic and political developments, weather events, natural disasters, and market disruptions. Exposure to the commodities markets may subject the investment to greater volatility than investments in more traditional securities, such as stocks and bonds.

# Target-Date Pros and Cons

Whether a target-date fund is the best choice for an investor depends on a few different factors, including the degree to which the investor wants to manage his or her own retirement portfolio. Below are some pros and cons of using target-date funds.

Pros

One-stop shopping: For an easy-to-use, all-in-one retirement savings vehicle, a good target-date fund is tough to beat. It allows investors to focus on one of the most important pieces of the retirement savings puzzle—how much to save—rather than getting bogged down in making investment decisions.

Professionally managed allocations: Fund shops typically put a great deal of thought into the design of their target-date series. That doesn't mean target-date funds are perfect, though, or suitable for all investors. Some used allocations that were overly aggressive when the 2008 market crash hit, resulting in heavy losses for their investors, including those who were close to retirement.

Automated adjustments: Target-date funds adjust their allocations automatically as the investor's retirement date approaches. No other commercially available investment product is designed to do this.

Reasonable fees: Target-date fund fees are generally in line with those of other mutual funds. Also, target-date funds built around index funds tend to be cheaper than those built around actively managed funds.

Cons

Lack of control: For investors who want more control over their investment or allocation choices, target-date funds might not be the best option. By choosing one, an investor is essentially limited to a given fund family's funds and allocation framework. Some investors may not welcome these constraints.

Added complexity if used with other holdings: As an all-in-one vehicle, target-date funds are built to serve as the only retirement holding you need. However, if you'd rather not put all your retirement savings into a target-date fund and/or wish to add satellite holdings, this will mean recalculating the asset allocation of the entire portfolio yourself to make sure it's in line with your needs.

In-retirement shortcomings: Target-date funds may become inadequate once the account holder reaches retirement. For example, those hoping to use assets invested in a target-date fund to generate income to cover living expenses in retirement may be disappointed. In fact, many retirement series put target-date investors into conservatively invested retirement income funds once the retirement date is reached.

Despite these potential drawbacks, for many investors a target-date fund may be a great choice to save for retirement provided it comes from a quality fund shop and operates using quality parts—that is, quality underlying funds.

The target date is the approximate date when investors plan to start withdrawing their money. An investment in a target-date fund is not guaranteed, and you may experience losses, including losses near, at, or after the target date. The principal value of the fund(s) is not guaranteed at any time, including at the target date. There is no guarantee that the fund will provide adequate income at and through retirement. Consider the investment objectives, risks, charges, and expenses of the fund carefully before investing. Target-date funds are sold by prospectus, which can be obtained from your financial professional or the company and which contains complete information, including investment objectives, risks, charges and expenses. Investors should read the prospectus and consider this information carefully before investing or sending money. Some target date funds have objectives or investment strategies that change over time—please read the prospectus of the fund you are considering carefully for further information.

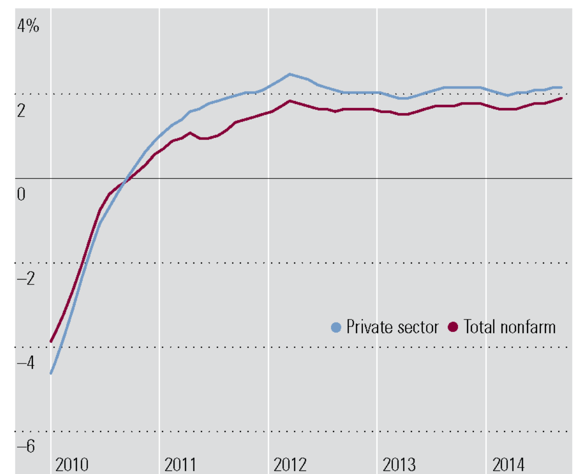
# Employment Continues to Grow at a Slow, Steady Pace

Media and financial news sources often report that the economy added an “x” number of jobs for a particular month. These monthly payroll numbers are polled by the Bureau of Labor Statistics and are published in a report called “Employment Situation” that is typically released on the first Friday of each month. The monthly headline numbers tend to be quite volatile and are often difficult to interpret. In the past two years alone, the number of jobs added varied between as few as 88,000 jobs in June of 2012 to as many as 280,000 in February of 2013. Wide fluctuations in the monthly payroll data occur because the monthly hiring and firing process itself tends to be unpredictable, and seasonal factors that aim to stabilize the data are extremely difficult to measure accurately.

Looking at these figures can usually create more confusion than insight, and that is why Morningstar’s Department of Economic Analysis looks at employment growth through a slightly different lens. When the same volatile monthly jobs data is analyzed not as a monthly net job addition or loss but as a year-over-year 3-month moving average growth rate, a different picture emerges. All of a sudden, it becomes clear that the U.S. jobs market has been incredibly stable despite its monthly ups and downs. As the chart shows, total nonfarm employment has been growing at around 1.7% since early 2011 and has picked up modestly to 1.9% in recent months. Excluding the poorly performing government sector, which constitutes around 16% of total employment, private-sector jobs have been growing at an even higher 2.0–2.1% rate. Combine these results with efficiency and productivity gains and it should come as no surprise that the U.S. economy, on average, grew 2.2% since 2011 based on full-year estimates.

Despite the rock steady growth, the pace of employment recovery has been slow and disappointing to say the least. Considering that the U.S. economy lost over 8.5 million jobs between 2008 and 2010, most economists expected a much faster recovery of the labor market. Instead, it took more than four years to get back the number of jobs lost during the crisis. Seeing those numbers bounce back to their pre-recession level is great news, but it is important to point out that the make-up of the new post-recovery labor force has drastically changed. Unfortunately, the growth in high-paying, long-hours jobs such as construction and manufacturing has been all but robust, and due to efficiency improvements, especially in manufacturing, many of these jobs may never come back. A majority of the labor market recovery has been made in the lower-paying sectors such as retail and leisure and hospitality, which has certainly contributed to slower consumption growth and to the near-anemic pace of the economic recovery in general.

## Employment Growth Since 2010

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Source: Bureau of Labor Statistics. Data through September 2014. Growth calculated on a year-over-year, 3-month average basis.

# Retirement Distribution Pitfalls: Not Accounting for Market Fluctuations

Accumulation is a key facet of reaching your retirement goals. However, we tend to see far less about portfolio drawdown, or decumulation—the logistics of managing a portfolio from which you're simultaneously extracting living expenses during retirement. This can be even more complicated than accumulating assets.

Pitfall: One of the big mistakes of retirement distribution can be not adjusting withdrawals to account for market fluctuations. So-called sequencing risk—the chance that retirees may encounter a harsh bear market early in the life of their withdrawal program—can have a big effect on a portfolio's longevity. Taking fixed distributions from a shrinking pool means that a retirement portfolio could suffer losses from which it would be impossible to recover.

Workaround: Maintaining a well-diversified asset mix may be a retiree's best weapon for protecting his or her portfolio from a bear market. For example, holding assets in high-quality bonds and cash may allow a retiree to meet desired living expenses without having to withdraw from equity holdings during periods of market weakness. That said, the smartest retirement-distribution plans also make adjustments during times of market duress, possibly reducing withdrawals or, at a minimum, forgoing upward inflation adjustments.

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