
401(k) options worth looking over

Investors should keep track as firms pitch employers more ETFs

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The journey

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Attention, retirement savers: Your 401(k) menu may be changing.

Investment firms are pitching employers on more exchange-traded funds, target-maturity funds, annuities and index funds based on new benchmarks as competitors vie for the \$2.4 trillion 401(k) market.

In just two recent examples, ETF provider WisdomTree Investments formed a new business unit for the 401(k) plan market and Schwab Funds launched a suite of index funds based on new benchmarks that will be targeted in part for corporate retirement plans.

Total ETF assets surged 34 percent in the 12 months ending in February, to \$433 billion, according to the Investment Company Institute. That growth—coupled with complaints about fees charged by traditional mutual funds—is spurring interest in the products for the retirement market.

"Proprietary, actively managed mutual funds are still the dominant paradigm" in most plans, and participants are paying too much in fees because of it, said Matt Gnabasik, founder of Blue Prairie Group LLC, a Chicago retirement plan consultant. "Larger plan sponsors are waking up to this, but in the lower end of the market you still see it."

ETFs are index-tracking baskets of securities that trade like a single stock and, on the whole, have expense ratios typically well below those of mutual funds.

In non-retirement accounts, investors pay trading commissions each time they purchase an ETF. In retirement plans, trades can be aggregated for cost efficiency and added in to the ETF's overall expenses.

"The fee levels will still be much lower with ETFs than with traditional mutual funds," said Bruce Lavine, WisdomTree's president.

Still, only a handful of companies offer ETFs in their 401(k) plans, said Darwin Abrahamson, founder of Invest n Retire LLC, a Portland, Ore., firm that handles ETF-based retirement plans for employers.

That number is expected to grow as more providers enter the market, so you may want to study up on ETFs. Morningstar Inc. is one place to start. The firm's Web site offers news and commentary on products, as well as a search function that lists ETFs by various categories.

In a recent article, Morningstar's fund research director, Russel Kinnel, warned investors and retirement savers not to overdo ETFs as more narrowly focused ones are launched. "All this speculative dross won't end in a pretty way," Kinnel wrote. "While I'd expect most long-term ETF investors will get well diversified, low-cost funds and do just fine, those who enter the casino side of the ETF world will get burned."

In an interview, Kinnel urged 401(k) savers to study any new ETFs added to workplace plans to make sure transaction and record-keeping costs are kept to a minimum.

"And it would be a really bad idea for a [plan to start offering] really crazy ways to bet on currencies, oil and other commodities" through ETFs, Kinnel said.

While the push for ETFs in retirement accounts is meant to address the cost issue, the new Schwab Funds products are aimed at neutralizing a growth bias in index investing that can wreak havoc on retirement accounts in certain market conditions.

Traditional index funds are weighted by the market capitalization of the stocks in the index, or a company's number of shares multiplied by the current price. The three new Schwab funds—which track U.S. large, U.S. smaller and international indexes—weight stocks based on sales, cash flow, book value and dividends.

The strategy is based on research by Robert Arnott of Research Affiliates that showed better investment returns with lower volatility by using the performance benchmarks. Indexes weighted by market capitalization can go on a tear in frothy markets like the late 1990s because they become dominated by the fastest-growing companies.

Especially important for retirement savers, though, is the reverse. When formerly hot markets snap back, the losses can be devastating if an investor is at retirement or already in the early stages.

Critics argue that over the long haul, there may not be a big difference in the two styles of indexing stocks. They're also skeptical that employees will bother to learn the difference.

Here's hoping you'll be among those keeping an eye on new options, and studying which ones make sense.

Have a retirement question? Write to yourmoney@tribune.com, or via mail at Your Money, Chicago Tribune, Room 400, 435 N. Michigan Ave., Chicago, IL 60611. If your letter is selected, we may include you and your question in a future column.

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