Investing in Your 401(k)

This information is provided courtesy of FINRA and is intended as a general discussion of investing in 401(k) plans.

The variety of investments available in your 401(k) will depend on who your plan provider is and the choices your plan sponsor makes. Getting to know the different types of investments will help you create a portfolio that best suits your long-term financial needs.

Among the most important—and perhaps intimidating—decisions you must make when you participate in a 401(k) plan is how to invest the money you're contributing to your account. The investment portfolio you choose determines the rate at which your account has the potential to grow, and the income that you'll be able to withdraw after you retire.

Investment Options

401(k) Fact
A 401(k) plan sponsor is the plan fiduciary, legally responsible for selecting the plan's investment options and monitoring their suitability. Generally, your employer is your 401(k) plan sponsor.

Most 401(k) plans provide at least three investment choices in your 401(k) plan, but some plans offer dozens. The average plan offers between 8 and 12 alternatives, sometimes only mutual funds and sometimes a combination of mutual funds, guaranteed investment contracts (GICs) or stable value funds, company stock and variable annuities. Some plans offer brokerage accounts, which means you can select investments from the full range of stocks, bonds, mutual funds, and other types of assets, rather than having to choose among the plan's alternatives.

Every 401(k) plan lets you decide how to invest the contributions you make. Some plans also let you decide how to invest your employer's matching contributions, but others let the employer make that choice. That includes the right to provide the match in company stock.

If you have a limited number of choices—say two stock mutual funds, a bond fund, a stable value fund and a money market fund—each is likely to put your money to work quite differently from the others.

The more choices you have, the more difficult it may be to choose the ones best suited to your investment goals and risk tolerance. It's your responsibility to find out how the choices differ from each other and what each of them could contribute to your portfolio.

When you're automatically enrolled in a 401(k) plan, your employer chooses a default investment for your contributions. The default investment will likely be a lifecycle fund, a balanced fund or a managed account, which the federal government has approved as acceptable choices. You have the option of sticking with the default investment, or moving your money into different investments offered by the plan.

Types of 401(k) Investments

The most common type of investment choice offered by a 401(k) plan is the mutual fund. Mutual funds can offer built-in diversification and professional management, and can be designed to meet a wide variety of investment objectives. Be mindful that investing in a mutual fund involves certain risks, including the possibility that you may lose money.

Your 401(k) plan may offer other types of investments. Some of the more common ones include:

- **Company stock.** If you work for a publicly traded company, your 401(k) investment menu may include company stock or a fund that buys only your company's stock. You may find that your employer encourages you to make this choice. For example, you may be able to buy the stock for less than the current market price or contribute a higher percentage of your salary if you're buying the stock. Your employer also may match a higher percentage of your contribution if it goes into the stock. Offering company stock as an investment choice gives you the incentive of partial ownership in order to strengthen commitment to the company. It also provides a way to let you share in the profits if the company prospers. But if you have the bulk of you 401(k) money in company stock, your long-term financial security is at greater risk than if they had built a diversified portfolio. For additional information, see our Investor Alert, Putting Too Much Stock in Your Company—A 401(k) Problem.

- **Individual stocks, bonds and other securities.** Some 401(k) plans allow you to buy a wide assortment of securities through a brokerage account, sometimes called a brokerage window. You give buy and sell orders just as you do with a regular, taxable account. In the case of a 401(k), because the entire account is tax-deferred, if you sell a stock or bond you've purchased through a 401(k) brokerage account for more than you paid, you owe no capital gains tax on the profit—though you will owe income tax when you withdraw from your traditional tax-deferred 401(k) account. A 401(k) brokerage account generally has an annual fee, depending on the brokerage firm the plan uses. There may also be transaction costs and commissions on each trade you make through the account, and you could pay higher fees for mutual funds you buy through the account than on funds that are part of a plan menu.

Building Portfolios

Choosing the right combination of investments is essential to setting your 401(k) portfolio on the right track. But before you begin evaluating your choices, you'll want to consider several factors:

- **Your time horizon.** Generally, the further away you are from an investing goal, the more time you have to compound earnings if the value of your investments rises, and to recover from losses if the value drops. The closer you are to retirement, the more of your portfolio you may want to shift into investments that are designed to preserve your capital and provide regular income.
- **Risk tolerance.** Your risk tolerance will depend on a variety of factors that go beyond your own comfort level with taking risk or desire to achieve a particular return. You'll want to consider your goals, the time horizon for each goal, other financial assets you own, current (and projected) income from your job, the stability of your job and any other sources of income. For more information about risk, see FINRA's
- **Other retirement assets.** If you have other assets, such as individual retirement accounts (IRAs), taxable investments, pensions or deferred annuities, you'll want to consider the bigger picture before deciding how to invest your 401(k). If the bulk of those assets are allocated to more aggressive investments, for example, you might want to invest your 401(k) more conservatively to balance your risk.