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Safe at Home? Not in a 401(k)

How will 401(k) investors react to the latest blast of volatility in the markets?
They also will put money into their own company's stock, which can be far riskier than leaving it in a typical stock mutual fund.
In August, when the Dow Jones Industrial Average went bucking up or down by at least 400 points on six out of the month's 23 trading days, investors pulled out of every variety of stock fund, according to the Aon Hewitt 401(k) Index, which tracks the daily transfers of some 1.5 million participants in retirement plans nationwide. That movement wasn't a tidal wave; investors moved about 0.5% of their total assets, or $580 million. Half of that went into bonds, but fully 23% landed in company stock.
Likewise, in September, when stock indexes slumped by 6% or more, retirement investors put a startling 35% of the money they pulled out of diversified stock funds into the shares of their own company.

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Time and time again, 401(k) participants violate the most important tenet of portfolio management – diversification. Countless experienced portfolio managers have ruined their reputations when they built too large a position in one stock and later watched the stock significantly underperform the overall market or collapse in value.

American International Group, Citigroup, Dell and Enron are just a handful of former high-flying stocks that collapsed. And when those stocks collapsed, 401(k) participants that concentrated their investments in their companies' stocks unnecessarily damaged their portfolios.

Most 401(k) participants would be best served by using the same guideline most professional portfolio managers use to control risk in their portfolios – limiting exposure in any one stock to 5% of assets.

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