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401k Fiduciary Concern: Financial Literacy and the Savings/Investing Dichotomy

June 01

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There's a growing realization among 401k plan sponsors that they old ways of employee education have not produced the desired results. For plan fiduciaries, this means a movement away from emphasizing investing and investments and towards emphasizing saving and savings. Yet, there is no consensus on the savings/investing dichotomy. When asked an "either/or" questions, professionals remain divided on the best answer.

Reading the literature, it does appear there's a popular view that savings trumps investing as the key to financial literacy for those saving for retirement. "Regarding retirement savers only, the most important financial literacy topic is definitely savings because it should be a priority to establish a foundational knowledge on savings topics before thinking about investing," says Edgar Rodriguez, Marketing Manager at iGrad/Enrich Financial Literacy in San Diego, California. "According to an S&P Global Fin Lilt Survey, only 33% of adults are financially literate."

On the face of it, the case for the priority of saving can be quite logical and compelling. Jaycob Arbogast, Financial Planner at Arbogast Advisers LLC in Chico California, says "For the average person saving for retirement, the actual act of saving is far more important than the investment returns in the portfolio. There's only so much you can do with investing if you don't have a strong savings plan in place, and that savings plan can work magic even with low investment returns."

Savings takes on its greatest importance during an employee's early career as the power of compounding makes even modest investment returns yield tremendous results during the decades spanning one's career. Besides, it's easier to build healthy habits when you're new to the workforce. "Topics on savings are most important for people in the accumulation phase," says Andy Yadro, Financial Advisor at Googins Advisors in Madison, Wisconsin. "If you don't learn how to save you will never have money to invest. You could be the best investor in the world and still never retire if you aren't a disciplined saver."

Speaking of time, with lifespans growing longer, there's a greater need to save more and more time for compounding to produce greater returns. Bob Johnson, President & CEO of The American College of Financial Services in Bryn Mawr, Pennsylvania, says, "I would have to begrudgingly say savings, because if you don't have savings you can't do investing. But, I believe they are really two sides of the same coin. Arguably, the biggest problem this country faces is the retirement income crisis. And, that crisis is going to get worse with increases in longevity and fewer Americans having any kind of defined benefit pension plan. With the movement from defined benefit to defined contribution plans the majority of Americans are woefully unprepared for retirement. And, when retirement comes, they have only two options – work longer or suffer a lower standard of living in retirement. Exacerbating the problem is that many can't work longer due to health reasons – their own or caring for a loved one."

Throw in some math and the argument for savings makes a great deal of sense. "Topics on savings are far and away more important than topics on investing," says Ben Offit, Partner, Clear Path Advisory, Baltimore, Maryland. "This is because you get far better return saving $1,000 with a 0% return than you get saving $0 with a 1,000% return. Having the habits and discipline to save the money in the first place is the hard thing – knowing how or where to invest is much easier."

With these basic concepts in hand, it's clear to many that education – including during secondary school and at the collegiate level – provides the critical avenue to improve this facet of financial literacy. It can address the main concern facing 401k plan sponsors and retirement policy makers alike – the lack of retirement saving. "Americans have one of the lowest savings rates for developed countries," says Adam Bergman, President & Founder of the IRA Financial Group in New York City." Americans are the ultimate consumers, and that definitely plays a role. However, I believe that education—or its lack thereof—is a big factor. Most people don't understand the basic concepts of retirement planning and how crucial it is, largely because it's not widely taught in our high schools or even our colleges and universities. The goal is to educate Americans, especially generation Xers and millennials, that starting young is the key to retiring rich and the Roth account is the best way to accomplish this. For example, if millennials began funding individual retirement accounts with $3,000 per year at age twenty and continued through age sixty-five, they would wind up with $2.5 million at retirement (assuming they earn the long-run annual compound growth rate in stocks, which was 9.88 percent from 1926 to 2011). Not a bad result for investing only $3,000 a year or about $8 a day. Imagine then if they learned that in school. But young people are not alone in lacking full awareness of the benefits of the Roth IRA or 401k plan, and they are not to blame. I graduated from law school and have a master's in taxation and not once was I ever taught about retirement accounts or their benefits. I must have taken hundreds of university and law courses, but no one ever explained to me the value of retirement savings or the power of the Roth IRA. How can we expect Americans, especially young Americans who are just starting out in their careers, to take advantage of retirement savings if they are not taught about the benefits? I have talked to tens of thousands of retirement-account holders and am always amazed how many people say, 'I wish I had started saving for retirement earlier' or 'I wish I had understood the benefits of a Roth account fifteen years ago.'" Despite these feelings, there remain alternatives views. Jean-Paul Chenette, of LPL Financial in Thousand Oaks, California believes investing is more important than saving. He says "many people view investing as a way to get more money more quickly, often fueled by greed. The market smokes out people's emotions better than simply saving, because the market reveals the two great emotions that drive the market – fear and greed. Fear can drive the market down, while greed can drive it up."

"Topics regarding investing are more important that topics regarding saving," says Shay Olivarria, a Los Angeles, California financial education speaker for Bigger Than Your Block and the author of *10 Things College Students Need to Know About Money*. "Since people aren't differentiating between savings and investing, some people think that they are investing when they are actually saving. Banks offering 'retirement accounts' and advisors using investing and saving interchangeably also isn't helping."
Ultimately, retirement is about generating income, and this involves its our set of financial literacy terms. Steve Lewit, CEO of Wealth Financial Group in Buffalo Grove Illinois, says "Ultimately the most important aspect for any retiree is the planning of income so that funds will last throughout a lifetime. Longer life spans require greater planning. If a person retires at 66 and lives to 86 that 30 years of life where assets need to produce sufficient income adjusted for inflation. This is the single biggest challenge for retirees with relatively modest assets. Literacy at this level is crucial – understanding withdrawal rates, significant challenges of down markets with regard to those withdrawal rates, and the creation of a diversified product portfolio that uses market based and insurance based products. Literacy of the many different theories of managing money in the market, i.e., active vs. passive investing; alternative investing; tactical investing; and so on, makes decision making about risk and growth more realistic and accurate."

Because income generation can come from many investment sources, there's a need for retirement savers to understand investments, both in terms of their long-term growth characteristics and their short-term income generation traits. "There are many ways to generate income," says Michelle Brownstein, Senior Vice President and CFP, Personal Capital, San Francisco, California. "We often see retirees focused strictly on income generating investments – so they want to hold only bonds and dividend paying stocks. That ignores a key fact that growth stocks, sold for a long term capital gain, are taxed at a more favorable rate than ordinary income from non-qualified dividends. Your income plan in retirement should be made up of a variety of different income streams and sources so you hedge your bets. Also, just because you're retired, doesn't mean you don't need any more growth. It's important for most people to have a piece of their portfolio that is focused on longer term growth. Those pieces will be used to cover the cost of living later in retirement. Retirement is also a time when many investors hire an adviser – if you do so, hire someone who is a fiduciary to you, NOT A BROKER – it's also important to understand how the adviser is being compensated and how they will help structure your portfolio properly for retirement. Finally, don't forget your spouse. If you are planning only for your life expectancy that's only one side of the coin. You need to plan for both people and take into account gender, health, and family history to do so accurately."

Clearly, at the very least, once the savings hurdle is passed, a minimum understanding of investing and investments is required. "Many of those saving for retirement have an asset allocation that makes no sense given their circumstances," says Johnson. For instance, there are Millennials who are allocating 401k money to money market funds when they have a long time horizon and can afford to bear the risk involved in the stock market. They are risk averse because they witnessed their parents lose money in the financial crisis. Having that event happen in their formative years has made Millennials more risk averse than previous generations. This risk aversion will cost them in the long run. Better asset allocation decisions early in life can dramatically improve people's retirement savings years down the road."

But diving into the arena of investments has been known to produce two disturbing results. First is the overwhelming nature of the subject. With so many options, savers often become paralyzed by the need to make decisions. This can lead to the infamous paralysis of analysis. "Retirement plans can be offered through your employer but the investment choices can be overwhelming," says Jennifer L. Weber, Wealth Management Associate of Hansberger & Merlin at Morgan Stanley in Atlanta, Georgia. "If you're overwhelmed by the options or don't understand all your options, you might not invest. This is a problem. You don't need to know everything. You can select a target date allocation fund, an S&P index fund, or a combination of a few funds. It's important to invest so your money can grow and exceed inflation."

The second issue represents the flip-side on the behavioral spectrum. This involves a form of overconfidence that leads to incorrect decisions, usually associated with supposed "rules-of-thumb." "Simple growth strategies do not work when portfolios are not able to withstand market losses while distributions are being made (sequence of returns risk) or are insufficient to allow a portfolio's principle to be maintained while distributions are made," says Len Hayduchok, CEO, Dedicated Financial Services in Hamilton, New Jersey. "In these scenarios, depending on returns, a portfolio may be depleted and an individual will run out of money – which is the worst case financial planning scenario. Simple strategies to reduce risk are often inappropriate because the return potential will also be reduced significantly, which could result in returns which are inadequate to support lifetime income. Simple risk-reduction strategies also do not address for which specific portions of a portfolio should be withdrawn in which time frames."

When it comes to the choice between "saving" or "investing," it's not an "either/or" proposition. When given the choice of the two, Cary Carbonaro, Managing Director of United Capital of New York & New Jersey in Huntington, New York, says, "All." He believes "savings, investing, asset allocation, compounding interest, time value of money,… They are all important to help you make smart decision for your retirement."

"A person currently immersed in planning for retirement cannot have an either/or approach to financial management," John Bird, vice president of product marketing of Envestnet|Yodlee in Redwood City, California. "An individual must have a firm grasp on what their spending habits are in relation to what their savings are to get a proper understanding of their ability to invest and achieve their retirement goals. Without knowing that, if a person intends to invest in a somewhat risky proposition that could delay their retirement goals by X number of years because of the drain on savings for a rainy day perhaps, proper retirement planning becomes a bit of a shell game. A consistent, ongoing 360 degree view of your finances is instrumental in delivering on the goals of the average person."

The savings/investing dichotomy is more of a "yin/yang" thing, where both concepts must co-exist in a balanced way. "In long-term financial planning, saving and investing are equally important – this is the main lesson financial literacy students need to realize," says Mark J. Snyder, Founder & President of Mark J. Snyder Financial Services, Inc. in Medford, New York. "Successful investors understand the importance of saving and good savers often have something in which they'd like to invest, such as a vacation home. Someone may be saving for a child's education. Although it won't pay dividends in the typical sense, that's often a great investment. Each understands that money is a means to an end, not the end itself."

For retirement savers, it's not so much a choice but an understanding. Many agree with Olivarria regarding the confusion between the two terms. "Retirement savers need to understand the difference between saving and investing," says Maria L. Sciuto, VP Client Services at Forté Capital LLC in Poughkeepsie, New York. "Savings implies a short to mid-term goal such as buying a house, starting a business or saving for a vacation. Investing is more long term, typically 10 years or longer. Longer term goals such as college planning and retirement planning come to mind."

It's important for retirement savers to know how both saving and investing can impact their retirement strategies. Chris Schaefer, Senior Investment Advisor, MV Financial, Bethesda, Maryland, says, "Both savings and investing topics are crucial when it comes to retirement. Individuals must first understand the options for saving – such as an employer-sponsored plan or IRA – so they can decide on the route that will work best for their savings goals. They should also find out if their employer offers a match, in which case employees should contribute enough to get the maximum match and grow their savings even faster."

That said, many retirement savers are better served focusing on the basics. In this case, there's no argument that the priority is saving. "If you don't save or have savings, talking about investments would be like teaching someone to swim without water," says Gary M. Shor, VP Financial Life Planning at AEPG Wealth Strategies, located in Warren, New Jersey. "You can try, they may seem to get it, but you need to experience it to really get it."

While financial professionals have they discipline to pay attention to investments, real-world demands can easily interfere with the retirement saver's ability to make appropriate decisions. That's why constantly reminding them of the importance and rewards of savings helps. "The societal construct for 'retirement saving' distorts and devalues true additive behaviors with non-additive, in fact detracting behaviors," says Paxton Taylor, of Raymond James Financial Services, Inc. in Blue Springs, Missouri. "A top violating behavior is negotiating with one's self to save more later in exchange for more consumption now. This is a particularly thorny behavior because it satisfies our modern day need for immediate gratification while at the same time providing no sense of feeling satiated. Unfortunately this lack of feeling content leads to further compromise of tomorrow's consumption for consumption today. One of the amply demonstrated, greatest attributes for successful long-term investing is time. The 'consume now' mentality can disastrously waste the attribute most on the investor's side – time."

The advice to emphasize savings over investing isn't new. In popular literature, it dates back to at least the nineteenth century. The author Mark Twain usually comes up in this sense, but there is another…Damon

Gonzalez, Founder and president of Domestique Capital LLC, located in Plano, Texas, says, "My experience has shown me that for most people their returns aren't the biggest predictor of retirement success. You should first invest in yourself. If you work hard to build a business or career that pays in the six figures, you will have a lot more to work with than somebody who chooses a career that doesn't pay well. I have also known some really high income earners that spend more than they make. As Charles Dickens wrote in *David Copperfield*: 'Annual income twenty pounds, annual expenditure nineteen and six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery.'"

Are you interested in discovering more about issues confronting 401k fiduciaries? If you buy Mr. Carosa's book [401(k) Fiduciary Solutions], you'll have at your fingertips a valuable reference covering the wide spectrum of How-To's (including information on the new wave of plan designs) every 401k plan sponsor and service provider wants and needs to know. Alternatively, would you like to help plan participants create better savings strategies? You can buy Mr. Carosa's latest book [Hey! What's My Number? How to Improve the Odds You Will Retire in Comfort] right now at your favorite on-line or neighborhood book store.
Mr. Carosa is available for keynote speaking engagements, especially in venues located in the Northeast, MidAtantic and Midwestern regions of the United States and in the Toronto region of Canada.