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401K plans rise from the abyss

Despite the gains, money managers advise investors to proceed with care

By **Shonda Novak**
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 STAFF
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Like many Americans, Austinite Jason Morio was pleasantly surprised when he opened quarterly statements from his three 401(k) retirement plans recently.

One account was up 10 percent -- the first gain in several quarters in an account that had dwindled to less than \$16,000 from about \$20,000 three years ago.

"It just kept going down, down, down," said Morio, 28, technical marketing manager for Trous Technologies Inc., an Austin software company.

Now up to about \$18,000, the account isn't growing by "leaps and bounds, but at least it's not going south anymore," Morio said.

Morio is encouraged by the recent gains, including a \$2,000 return in another 401(k) plan that had lost about \$400 a quarter during the past two years.

Battered by the downturn in the economy and stock markets during the past three years, Wall Street has rallied in recent months, pushing returns on many investors' 401(k) plans into the black.

And although no one's ready to proclaim a comeback of the 401(k), recent trends have given disheartened investors renewed hope, even as money managers are advising them to proceed with caution.

"Just because one quarter shows something in the black doesn't mean I'm going to celebrate and change my profile to high-risk international bonds," said Morio, who stemmed some of the red ink in his 401(k) portfolios about a year ago by shifting technology-heavy stock investments and more aggressive mutual funds into a conservative mix of bonds and money market funds. "But if I start to see quarter-over-quarter I'm not losing anything, then yes, I'd say it's starting to come back."

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The three-year bear market has caused many workers to cut or even stop contributions to their retirement accounts. Many workers found it scary to even open their quarterly statements.

Employee participation in retirement savings accounts dropped last year for the first time since 1991, according to a survey by Buck Consultants, an employee benefits firm. Last year, 73 percent of employees contributed to their 401(k) plans, down from 79 percent in 1995.

The stock market drop was largely to blame for the decline, although more companies cutting back on matching contribution plans in the past year also was a factor, said Rich Koski, a principal and 401(k) expert at Buck Consultants.

Signs of improvement

Now, there's cause for guarded optimism.

The stock market began its downward spiral in 2000, with the Dow Jones industrial average plunging from a record high of 11,723 to a five-year low of 7,286 during the next three years. Investors lost trillions of dollars, and workers watched the value of their savings and investment plans nosedive.

But March 11 ushered in a rally in the stock market. The upturn came on the heels of better-than-expected first-quarter corporate earnings, an end to the worst of the fighting in Iraq and some improving economic data.

The S&P 500, a leading barometer of the stock market's performance, the Dow Jones industrial average and the Nasdaq were up by double digits in the second quarter, their best performance in recent years.

In turn, the market upticks have buoyed savings and investment plans across the board, analysts say.

"Obviously, the market's up, and that's helping people out," said Shane Sullivan, a vice president and investments trust specialist with A.G. Edwards & Sons Inc. in Austin.

So far this year, the S&P is up about 13 percent. And it's up more than 20 percent in the past 12 months, said Mark MacQueen, co-founder and executive vice president of Austin-based Sage Advisory Services Inc., a national investment adviser that manages about \$3 billion for institutional and wealthy investors.

"Absolutely, things are looking a little better," MacQueen said. "In 2003, for the first time in four years, we'll have positive returns in the stock market, and this should make everyone feel better."

MacQueen said there are reasons for continued optimism, from rising interest rates to the deaths of Saddam Hussein's sons in Iraq. Additionally, a weaker U.S. dollar will help American products be more competitive abroad, and in turn help the economy improve.

In Central Texas, some investors also are feeling more upbeat, money managers say. But as a tech center, Austin has been harder hit by layoffs than many cities. And the new economic reality has ushered in a new wariness -- and more realistic expectations about how quickly retirement accounts will grow.

Different views

Although pleased with their recent 401(k) statements, many Austin investors "have changed their perspective," Sullivan said.

"Investors in 2003 are more interested in a plan that provides consistent returns vs. the investor of 1999, who was looking for the plan with the highest return," Sullivan said.

Lawrence Sternberg, a technical project manager at Motive Communications Inc., an Austin software company, has learned the importance of diversifying his 401(k) investments.

"Initially, I was contributing to growth funds, which are the most volatile," Sternberg said. He's still contributing to those types of funds, but he has added money market accounts to the mix.

Sternberg's 401(k) was up nearly 20 percent in the second quarter -- the first increase in more than a year. He's sunk \$32,000 into the account since opening it in April of 2000. During that time, it has fallen as much as 30 percent. Only recently has it grown above his total contribution, now standing at \$35,000.

Unlike many of his young co-workers who stopped contributing to their 401(k) plans, "ultimately, I know I'm doing the right thing by putting that money away," Sternberg said.

"On some levels, I wish I hadn't contributed so I could have had fun with that money and gone on a great vacation. But on another level, I know the market is eventually going to come back. It's just a question of when."

Despite the improved stock market outlook, MacQueen cautioned against over-exuberance.

"The market is subject to many outside influences, especially world crises," MacQueen said. "There's always something that can make the market change, which nobody can predict."

MacQueen and other money managers say 401(k) investors should stay the course, stick to long-term disciplined investing and "not look for quick riches." He thinks investors should be content with 6 percent to 10 percent returns "versus 30 percent, when the Nasdaq exploded."

Be sure to diversify

Brokers also are preaching diversification, advising investors to have money in stocks and bonds and in a variety of companies of various sizes in different industries.

Louis Kokernak, a financial planner and investment adviser at Haven Financial Advisors in Austin, said his clients' retirement plans were up on average about 12 percent in the second quarter from the prior three months. "As much as anything, I talk down people's expectations because over time, that's not sustainable," Kokernak said. "Neither the economy nor the stock market is going to be up 12 percent every quarter."

He said investors should focus on the long term, expecting "reasonable" returns of 5 percent to 10 percent over 25 years or so.

Recent changes in federal law mean people can put more money into their retirement accounts. The changes upped the maximum annual contribution from \$11,000 to \$12,000 in 2003. And that amount will increase \$1,000 a year until 2006, then \$500 a year until 2011. Like many of their high-tech colleagues, Morio and Sternberg have abandoned hopes of retiring in their 30s.

"I was naive to how quickly the bubble can burst," Sternberg said. "At 25, I hoped to retire by 30. It had been going really strong three to four years, and I was hoping for another few years. I thought it would last long enough for me to get in and get out."

Morio, who has worked at five Austin startups in as many years, said he'll be lucky to retire by his late 40s.

"I don't have the delusions of grandeur we originally had when the dot-com boom started," Morio said. "That fairy tale's over."