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JUNE 14, 2009

We have decided to take a few liberties with our algebra. With apologies to Albert Einstein, we offer you the following equation: $403(b) + 401(k) = 804(b)(k)$. Although this equation is 100% myth and 0% math, the point of our mathematical fantasy is to demonstrate that something is not adding up in the universe of qualified retirement plans.

THE 804(b)(k) CONUNDRUM

Based on recent studies and our own knowledge of investment markets, we are becoming concerned that conventional menu-driven qualified retirement plans contain elements of risk that are not clearly understood. Since many of our *DocOnomics* readers have a sizable percentage of their wealth invested in employer-administered 403(b) and 401(k) plans, we thought we would take the time to elaborate.

At *DocOnomics*, it is our staunch view that the debts and deficits that characterize our Federal, state and local governments have launched us into alternating cycles of deflation and inflation.

In a deflation, we observe job income loss along with mounting levels of loan defaults, foreclosures and bankruptcies. The investor's objective in a deflation is to protect the nominal value of assets. This is when cash and guaranteed returns tend to be in vogue. In a deflation, we have become accustomed to government bailout programs and "soft landing" strategies intended to avoid painful recessions and outright depressions. This generally involves a great deal of money being created out of thin air. Witness the present.

In an inflation, we observe the after-effects of the government's massive bailouts and money creation schemes. An endless supply of money chasing finite supplies of goods and services results in rising prices. Items that are relatively scarce or fixed in supply generally will increase the most. If these items are critical to everyday life (e.g., food, oil), the flow through effects can be quite dynamic and traumatic for those whose incomes cannot keep up with the rising prices. This is otherwise known as loss of purchasing power and can lead to lifestyle disruptions. Think about those on fixed incomes as the primary victims.

Therefore, we must ask whether or not 403(b) and 401(k) plans can adequately protect one's wealth from the ravages of deflation and inflation. Here is how we dissect the situation:

Portfolio Allocation Weakness

We believe that if you have a significant portion of your wealth invested in menu-driven 403(b) and/or 401(k) plans, you can protect yourself against deflation much better than inflation. See the table below:

Deflation Protection

1. Cash equivalents
2. Guaranteed returns with complete protection of principal

These investment options generally are available on 403(b) and 401(k) plan menus.

Inflation Protection

1. Diversified commodities and natural resources, including countries that export these items
2. Foreign currencies (i.e., likely to benefit from an increasingly devalued US Dollar)
3. Infrastructure and clean technology (i.e., sectors likely to benefit from government stimulus)
4. Precious metals

These investment options rarely are available on 403(b) and 401(k) menus and must be accessed via taxable investment accounts or self-directed IRA accounts held at brokerage firms.

Structural Overload

Risk can be defined in many ways. In our experience, investment risk is associated either with lack of diversification or a high level of concentration. At *DocOnomics*, it has occurred to us that our Federal government is becoming increasingly eager if not desperate to find new sources of financing. The foreign lenders to our government, most notably China, are backing away from the table as Washington pushes the stimulus throttles to previously unimaginable speeds.

Since the largest concentration of liquid wealth in the country is to be found in qualified retirement plans, the thought occurs to us that such plans will be viewed by Washington as low-hanging fruit. Imagine being required to invest a significant portion of your 403(b) or 401(k) assets in special issue government bonds paying 2%. We can hear the sales pitch now. "It is imperative that America reduce its dependence on foreign lenders. This is a matter of national security. To accomplish this critical objective, all qualified retirement plans will be mandated to invest a certain percentage of assets with the US Government."

The above is not so much a stretch of our collective imaginations as it is our acknowledgement of what typically occurs in desperate situations. The decades of the 1930s and 1940s quickly come to mind. In 2009, there is little question that our policymakers in Washington are running out of options and will be increasingly inclined to make radical moves. Please be forewarned that holding a very high concentration of your wealth in qualified retirement plans represents a true diversification risk that few ever talk about.

Cost Burdens

Imagine if all the losses sustained in your 403(b) or 401(k) plan over the past 18 months were replicated over a prolonged period of time--and completely hidden from view. You would not be pleased with this situation, yet this is exactly what is happening to millions of individuals that participate in 403(b) and 401(k) plans.

Over time, internal expenses can consume a significant portion of the assets in traditional mutual fund-based retirement plans -- especially those offered by insurance companies. One of our favorite syndicated financial columnists compared a plan with low internal expenses to a plan with high internal expenses. The results were dramatic. Holding all variables constant except for the internal expense rates, the high-cost plan returned 1/3 less than the low-cost plan over a sustained period of time. The 33% differential is a bit like suffering through the recent market declines--but on the installment plan with the proverbial low and affordable monthly payments.

Fortunately for some of you, there may be an available remedy for the ill-effects of portfolio allocation weakness, structural overload and cost burden. This comes in the form of an "in-service distribution" into a self-directed IRA that may not be considered to be low-hanging fruit if and when the government desperados change the rules of the game. Under the current law, only those who are 59 ½ and older are allowed to take in-service distributions while still an active plan participant. Your plan administrator will be able to tell you if your particular plan allows for in-service distributions. If so, you may find that assets can be moved into self-directed IRA accounts that can hold individual securities and/or assets that protect you from an inflationary-induced loss of purchasing power. For a recap of these types of investments, please refer to the table presented earlier.

The migration of retirement assets into self-directed IRA accounts not only could remove these assets from the government's "low-hanging fruit" category but also reduce the associated internal cost burden. This would occur as the traditional administrative fees of 403(b) and 401(k) plans are replaced by some combination of trading commissions on individual securities transactions and advisory fees paid to specialists that are independently retained to manage such accounts according to one's personal objectives.

In summary, it sometimes is best to question the medicine that commonly is passed off as time-tested and safe. This is indeed a time when many conventional investment assumptions and practices need to be cast aside and replaced by intuitive thinking and new approaches. We hope that you will do this and solicit our help along the way.