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5 Bad Risks You May Be Taking With Your 401(k)

By Rebecca Lake
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A 401(k) plan is one of the most powerful weapons you can have in your retirement savings arsenal. According to a 2015 report from Deloitte, 75 percent of American workers participate in their employer's 401(k) or a similar defined contribution plan.

While this type of plan can pave the way to a larger investment nest egg, the wrong strategy could shortchange your savings. If you think you've been doing all the right things with your 401(k), you may be surprised to learn that you could be sabotaging your retirement by making any of these risky moves.

Investing heavily in company stock. Investing in your employer's stock may seem like a safe bet if the company's doing well but it could prove to be a serious gamble, says Zack Shepard, vice president of Cincinnati-based Matson Money.

"What an employee is effectively doing is tying their retirement to the same company that pays their salary," Shepard says. "If something happens to the company, you could lose your salary and your retirement in one fell swoop."

Shepard cites Enron as an example of how quickly a company's stock can tumble, taking its employees' 401(k) plans with it. Enron employees held nearly 60 percent of their retirement assets in company stock and collectively, their 401(k)s took a $2 billion hit.

Craig McDaniel, a certified financial planner with The McDaniel Corp. in Columbia, South Carolina, advises investors to proceed with caution when including any stock in their 401(k).

"My general rule of thumb is not to invest more than 20 percent in any one company," McDaniel says.

He says in in many cases, employees are making an emotional – not just financial – investment when adding company stock to their 401(k) holdings. In doing so, they leave themselves open to trouble if the stock's price falls and it takes decades to recover.

"You might get rich by investing in one company, but you won't stay rich," McDaniel says.

Overlooking the cost of your investments. Fees can be a hidden killer where your 401(k) is concerned and you quite literally can't afford to choose investments blindly, says Scott Mann, president of Houston-based Mann Financial Group.

"Just a 1 or 2 percent difference in fees can make the difference between a successful retirement and an underfunded one," Mann says.

Doug Carey, founder and president of WealthTrace in Boulder, Colorado says it's not uncommon for employees to be in the dark about fees.

"I've found when talking to my clients that the majority have no idea what the fees for their 401(k) plans are," Carey says, but after doing the math, it becomes apparent how much of an impact fees can have on retirement.

He offers an example using two hypothetical investors to illustrate the long-term cost. Investor A's 401(k) features an average expense ratio of 0.3 percent, with the administrative fees paid by the employer. Investor B, on the other hand, is paying an average expense ratio of 0.8 percent and an administrative fee of 0.5 percent.

Assuming a $200,000 balance, annual contributions of $15,000 per year and an annual return of 7 percent over 25 years, Investor A would retire with $1.92 million. Investor B, however would have $1.58 million, a difference of $340,000 that's directly attributable to those higher fees.

Skipping out on the match. If your employer offers a matching contribution, the last thing you want to do is allow it to slip through your fingers, advises Catherine Golladay, senior vice president of 401(k) Participant Services at Charles Schwab.

"The No. 1 priority for 401(k) participants is to contribute enough to get the full employer match," she says, and not doing so essentially means leaving money on the table.

"The match is like an automatic return on your investment that you can't get anywhere else," Golladay says.

A 2015 Financial Engines report found one in four workers don't contribute enough to their plan to get the match, leaving an average of $1,336 on the table each year. If your annual contributions fall short of the minimum needed to snag the match, stepping up your elective deferrals belongs on your to-do list.

Leaving your plan on auto-pilot. Automating your plan can be less taxing on your time but being too laissez-faire could cause your 401(k) to skew off-course.

"Taking a set-it-and-forget-it approach to investing your 401(k) can be a recipe for disaster," says ReKeithen Miller, a certified financial planner with Palisades Hudson Financial Group's Atlanta office.

Instead, investors need to be proactive about periodically rebalancing to achieve a target asset allocation. This allows you to reap the benefits of selling high and buying low, while simultaneously controlling risk in your portfolio, Miller says.

Jeff Powell, managing partner at Polaris Greystone Financial Group in San Rafael, California, offers a solution of sorts for investors who prefer to be more hands-off with managing investments.

"If you don't think that you're disciplined enough to rebalance your portfolio each quarter, you may want to consider a target-date fund," Powell says.

Target-date funds allow you to buy one fund that bases your asset allocation on a specific time frame, typically the number of years until you retire. These funds automatically rebalance on a periodic basis, offering broad diversification while minimizing volatility.

Treating your 401(k) like a piggy bank. Taking a loan or hardship withdrawal from your plan can provide you with cash in a pinch but you must consider the bigger picture where retirement is concerned, says Shepard.

"Once you take a hardship withdrawal or loan, your money immediately stops working for you, increasing the risk of not being able to retire," Shepard says.

To put it in perspective, he uses an example of an employee who begins contributing $5,000 a year to their 401(k) at age 30 and takes a hardship withdrawal of $10,000 at age 40. Assuming a consistent 10 percent annual return, they'll have missed out on $173,355 by age 65.

Golladay says that's not the only risk for investors. She points to some other negative consequences that can result from tapping your 401(k) prematurely.

"First, you repay the loan with after-tax dollars, negating many of the tax benefits of the plan," she says. "If you leave your job before you repay the loan in full, your outstanding balance is treated as a withdrawal, spurring a tax bill and potentially, an additional 10 percent penalty."

Golladay's best advice for 401(k) savers who may be considering a loan or withdrawal as a quick cash fix?

"Don't punish your future self by borrowing against your retirement."