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Asset Allocations of 401(k) Savers Changed Significantly Over Two Decades

While most 401(k) retirement plan savers continue to invest heavily in equities, the asset allocations of plan participants in their twenties at the end of 2015 differed significantly from those of plan participants in their twenties in the mid-1990s, shifting away from equity funds and company stock and toward balanced funds, a study conducted by the Employee Benefit Research Institute (EBRI) and the Investment Company Institute (ICI) found.

Published on August 3, "401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2015," is the latest update of a 1999 joint study that analyzed 1996 data from the EBRI/ICI database. At year-end 2015, the EBRI/ICI database included statistical information on 26.1 million 401(k) plan participants in 101,625 employer-sponsored 401(k) plans with $1.9 trillion in assets. In the new study, the authors were able to make a cross-generational comparison of 401(k) investors in their twenties in 1996 and 2015 by drawing on 20 years of data analyzed in the EBRI/ICI series of annual studies on 401(k) participants' activities.

The research showed that throughout the study period, the share of assets younger 401(k) participants invested in equities was high: plan participants in their twenties held 80% of their aggregate assets in equities at year-end 2015, or only slightly more than the 77% of assets held in equities by their 1996 counterparts. But the analysis also found that the vehicles younger savers used to invest in equities changed between 1996 and 2015: whereas savers in their twenties allocated 55% of their aggregate assets to equity funds in 1996, this share had fallen to 28% by year-end 2015. Meanwhile, the share of assets that these younger 401(k) participants allocated to company stock decreased from 17% in 1996 to 5% at year-end 2015.

The findings further indicated that compared to their 1996 counterparts, younger 401(k) participants in 2015 were much more heavily invested in balanced funds, including target-date funds. According to the analysis, participants in their twenties in 1996 allocated only 8% of their 401(k) plan assets to balanced funds (target-date funds were not reported separately in the database before 2006); whereas their counterparts in 2015 invested 54% of their assets in balanced funds, with nearly half (47%) of these assets invested in target-date funds.

The authors emphasized that trends among investors in their twenties are mirrored across all age groups in the database: among all investors,

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in this issue:

The Retirement Community Alternative

Whether you are on the verge of retirement or it is years away, many of your current financial decisions are shaped by the questions of *where* you will live in the future and *how* your financial and social needs will be met. In addition to decisions about your own future, you may have aging parents who need help working through the complexities of choosing their own retirement housing.

Changing Needs

Your housing needs can be affected by any number of life changes, including seeing your children move out of the family home, experiencing changes to your health, or facing the loss of a spouse. Each of these life changes can raise questions regarding the physical layout of your home, the maintenance required to take care of it, and the location of necessary resources, as well as the need for continued social interaction.

If you have lived in the same neighborhood for many years, the thought of moving can be both difficult and emotional. In addition to a lifetime of memories, your family home offers the comfort of familiarity and an important sense of community. It also may be completely paid off by the time you retire. However, its size and maintenance requirements may become increasingly difficult to manage. The family home could also become isolating, especially after lifelong friends have moved away, or if located in an area with little or no access to social support systems.

Alternatives

Retirement communities are enjoying increased popularity as

an alternative means to meet the housing needs of older adults. Many retirement communities offer an array of services, with costs directly related to the level of direct care provided. A complete community may have independent living options with condominiums and apartments; supervised assisted living for those who need help with basic daily activities, but not full-time skilled nursing care; and a nursing home wing for those individuals requiring more intensive medical care, all conveniently situated on one campus.

There are a number of advantages to such living arrangements. The security of knowing that medical care and support services are readily available and a resident can shift from independent living to a nursing home level of care without having to make difficult moving decisions is the main attraction of retirement communities. Financial concerns may also be alleviated in a total life care community, particularly if providing for later health care has been done *before* the need arises. In addition, most retirement communities offer planned activities and transportation to meet a variety of recreational and social needs. Many active older adults enjoy the socialization among peers that a retirement community provides.

Periods of Adjustment

Although these communities are designed to meet the needs of older adults, isolation from family and prior friends may involve an adjustment period for some people. For example, structured group activities to interact with others may impose on some people's sense of privacy, while others may dislike the idea of being confined to living solely among people their own age.

One of the most important questions to ask when visiting a community is *who* decides when the resident needs a higher level of care. This issue alone can affect an individual's sense of self-esteem and independence, as well as the cost of care. When couples move into a retirement community, it is important to consider how the necessity for an increased level of care for one spouse may affect the independence of the other spouse.

The decision to enter a retirement community involves a lot of thoughtful planning. Knowing *in advance* some of the factors involved may help facilitate the decision-making process for you and your loved ones. ■

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allocations to equity funds declined from 53% in 1996 to 43% in 2015, and allocations to balanced funds increased from 7% of assets in 1996 to 25% in 2015.

The analysis also showed that target-date funds have been growing in popularity among 401(k) investors of all ages, and particularly among recently hired participants. The study found that among all participants, investments in target-date funds rose from 5% of assets at year-end 2006 to 20% of assets at year-end 2016, and that nearly half of the 401(k) participants tracked in the database held these funds.

In addition, the study found that recently hired participants have become especially likely to hold target-date funds, and to have allocated a large portion of their balances to these funds: the findings showed that at year-end 2015, 60% of recently hired participants held target-date funds, and that these funds accounted for more than one-third of their assets.

The results of the analysis also revealed that among all of the 401(k) participants studied, investment in company stock remained at historically low levels in 2015: less than 7% of 401(k) assets were invested in company stock at year-end 2015, roughly the same share as in 2012, 2013, and 2014; but down sharply from 1999, when 63% of participants were invested in company stock, and company stock accounted for 19% of assets. The study also found that recently hired 401(k) participants have been investing in company stock at especially low rates: at year-end 2015, around one-quarter of recently hired 401(k) plan participants in plans offering company stock held company stock, compared with around 43% of all 401(k) participants. ■

Why Should You Start Saving for Retirement Now?

You are busy dealing with life's day-to-day issues. To you, retirement may seem like a long way off. But preparing now for your financial future is essential because what you do *today* can help ensure a secure retirement *tomorrow*.

Although time may be on your side, there are four factors you will need to consider when planning for your retirement.

1) Inflation. You may be aware that, over time, inflation can erode your savings. But, many people don't realize the potentially serious effects of inflation. At 3% inflation, $100 today will be worth only $67.30 in 20 years—a loss of one-third of its value. At 35 years, this amount would be further reduced to just $34.44. Thus, it is important to seek retirement savings vehicles that have the best chance of outpacing inflation.

2) Taxes. Your present income level, tax bracket, and the types of tax-deferred retirement savings plans that are available can all play an integral part in how much money you can save for retirement. By maximizing your pre-tax contributions to employer-sponsored plans and **Individual Retirement Accounts (IRAs)**, you can take advantage of the tax-deferred benefits of such plans.

3) Compound Interest. Becoming a disciplined saver is one of the key components of retirement plan success. By making regular contributions to your employer-sponsored retirement plan and your IRA, you can maximize the power of **compound interest** (the interest earned not only on the initial principal, but also on the accumulated interest from prior periods). With consistent contributions, your retirement savings have a greater chance of accumulating to meet your long-term goals.

4) Personal Savings. Considering the effects of inflation, it is possible that your retirement plan income may fall short of your needs, especially during a long retirement. Furthermore, Social Security generally provides only a base level of retirement income. Thus, to avoid a potential shortfall, start planning to supplement your retirement income with personal savings.

While understanding these principles is no guarantee of future success, they can get you started down the right path. The sooner you recognize the effects that economic forces can have on your retirement income, the more likely you may be to adopt strategies that can help you achieve your long-term objectives. Being proactive today can help increase your retirement savings for tomorrow. ■

Taxes and Your Retirement Destination

How would you like to spend your "golden" years? Do you want to live in an affordable condo on a golf course with extra room for visiting grandchildren? Would you like to remain in your community surrounded by friends and family? Or would you prefer a fresh start in a new locale that offers different cultural activities and recreational opportunities? Is easy access to certain medical providers and facilities a priority?

Besides considering these lifestyle choices, you may also want to research the effects of state tax structures on your projected retirement income as you decide where to live in retirement.

Let's take a look at some key tax issues:

Earned and unearned income taxes. Do you plan to continue working during retirement? If so, it is important to know that some states treat senior citizens like everyone else on their income tax rolls; some give seniors special tax breaks on earned income, and others do not tax earned income for any residents. Tax rates on unearned income may also vary from state to state. If you move, you may be required to file income tax returns in *two* states due to individual state residency requirements. Also, be sure to research any local income taxes that would apply to your circumstances.

Pension income taxes. In many cases, seniors receive important income from military, government, and private pension plans. Some states exempt all pension income from taxation, while others exempt certain types and/or amounts of pension income. Be sure you understand the applicable tax rules.

Social Security benefit taxes. Some states do not tax Social Security benefits at all, while others follow Federal tax formulas for determining the tax on such benefits. Still others have developed their own formulas to determine the income tax on Social Security benefits. Again, research the rules that will apply to your circumstances.

Property taxes. This is another area where some states and localities may offer advantages to seniors. Familiarize yourself with the relevant personal property tax laws, especially for cars and boats.

Sales taxes. Many states—and sometimes localities within each state—tax clothing, gas, household goods, and sometimes even food and prescription drugs. When you consider your retirement budget, remember to add state and local sales taxes, if applicable.

Estate taxes. While they do not *directly* affect your cost of living as a senior, do not overlook estate taxes

when determining the feasibility of settling in one state over another. In some states, your spouse may be taxed on a portion of his or her inheritance that, in another state, would pass to him or her free of state estate tax. Be sure to monitor changes in state estate tax codes as states seek ways to attract seniors.

Starting in 2018, legislation limits its deductions for all non-business state and local tax deductions, to an exemption of up to $10,000 for most filers.

While no *single* tax consideration will determine the most favorable environment for your retirement years, an analysis of your *overall* financial situation and options can help you choose a retirement destination that best suits your needs and interests, allowing you to enjoy your "golden" years.

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