

IRA might help fill gaps left by employer-sponsored plans

Employer-sponsored retirement plans like 401(k)s, 403(b)s and their many siblings serve a necessary purpose to encourage savings. But they often have flaws and missing pieces that make it wise to pair their use with that of an IRA – Roth or traditional.

Here's a starter list of vacancies that an IRA may help fill.

Broad diversification: Most employer retirement plans, whether they have seven fund choices or 70, stick to primary asset classes.



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In most cases, you need to use an IRA or taxable account to gain exposure to asset classes like Treasury Inflation Protected Securities, commodities, foreign bonds, emerging markets and Real Estate Investment Trusts. Including some of these choices in your portfolio can help reduce risk and increase global diversification.

Inexpensive index funds: Many employer retirement plans do include passive index fund options. Theoretically, these should be used to gain broad market coverage at the lowest possible cost. Often, though, index funds used in these accounts come with expense ratios that far exceed options that could be purchased in the retail marketplace.

For example, State Farm offers an S&P 500 Index fund, with a retirement plan share class that has an expense ratio of 1.10 percent. That means that for every \$10,000 invested, \$110 goes to pay management fees. Alternatively, you could use an IRA to purchase the

exact same market coverage through a product such as the iShares S&P 500 Index exchange-traded fund for an expense ratio of 0.09 percent (\$9 per \$10,000 invested). Don't pay 12 times as much for the same product if you don't have to. Instead, use an IRA to gain exposure to that part of the market and use other 401(k) options where you get more for what you pay.

Money managers who can go anywhere: Typically, investment choices in retirement plans are selected by the plan sponsor to offer exposure to specific segments of the market. The managers of these funds must choose stocks or bonds only from pre-defined portions of the market regardless of its relative attractiveness. In some cases, this works well as specialist managers focus only on what they know best. However, some of the mutual funds I prefer do not have strict constraints. Their money managers are free to invest where they see the most attractive opportunities. There's room for both approaches in any portfolio.

Socially Responsible Investing (SRI): Few retirement plans have choices for people who are serious about aligning their investment strategy with their values. SRI options have expanded considerably over the past decade. These funds may have drawbacks and are usually more expensive but if you want to make a statement about the type of companies you invest in, you can do it in an IRA.

Cost transparency: The Pension Protection Act of 2006 and subsequent legislative talk have made overtures at cost clarity in employer plans but they are still muddied with questionable disclosure. If you can't easily determine the expense ratios or the other

management fees of fund choices in your 401(k), you should demand disclosure from the plan sponsor or human resources rep responsible for the plan. This is especially problematic in 403(b) plans that are prominent for educators and non-profit employees. These plans use investment vehicles that are variable annuity subaccounts and not mutual funds. This makes them harder to research and determine exactly what the costs are.

In considering how to balance use of a 401(k) and an IRA, you'll need to determine how much of your income to defer to your employer plan. Generally, you should participate in your employer plan at least to the level at which you obtain the maximum employer match – if there is still one. After that point, you can decide about use of an IRA if you are eligible. Then you can go back to maximizing 401(k) contributions, especially if you are over 50 and can utilize catch-up rules to save even more. There are many variables that impact this decision. It's wise to understand all your options.

Of course, if you've moved on to a new job or retired, you do not need to leave your dollars in the employer retirement plan. You can take control of your investment choices and their costs with a rollover to an IRA.

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