Five Retirement Investing Mistakes Employees Should Avoid

A targeted retirement plan, coupled with financial wellness guidance, can help employees build an achievable vision for life after work. To succeed, however, employees must avoid five common retirement investing mistakes: (1) starting too late, (2) not saving enough, (3) investing too conservatively, (4) failing to prioritize retirement savings over other financial goals and (5) timing the market. This article describes each mistake, outlines what steps employers can take to help employees avoid them and identifies the business case for why employers should take those steps.

by **Lynn Pettus** | *EY*

For the most part, employees understand they and their employers share responsibility for funding and managing their retirement plans. Helping employees avoid five of the most common retirement investment mistakes can help relieve their financial stress while improving productivity levels and the company's bottom line.

While many workers appreciate the importance of knowing how much they will need to save to fund retirement, many need help understanding that *when* they start saving and *where* they invest their contributions will make the difference in achieving their goals or falling short.

By 2018, one in four working persons in the United States will be 55 or older.[1] Those workers have higher salaries, a greater amount of Federal Insurance Contributions Act (FICA) taxes, as well as increased sick and vacation days, all of which drive higher costs in a company's human capital investment. Short of passing the additional expense on to their customers, companies are faced with deciding between absorbing the additional cost or reducing the level of benefits, which could impact their attractiveness to new talent in the tightening labor market.

Managing today's expenses while building a retirement investment plan is a must-have if employees want to retire on their own terms vs. staying in the workforce longer than they and their employers would like. The more employees understand and use their workplace savings plan for long-term financial health, the more apt they are to make confident, money-related decisions and avoid making retirement investing mistakes.

A targeted retirement plan, coupled with financial wellness guidance, can help employees build an achievable vision for life after work and avoid the five most common retirement investing mistakes.

Mistake 1: Starting Too Late

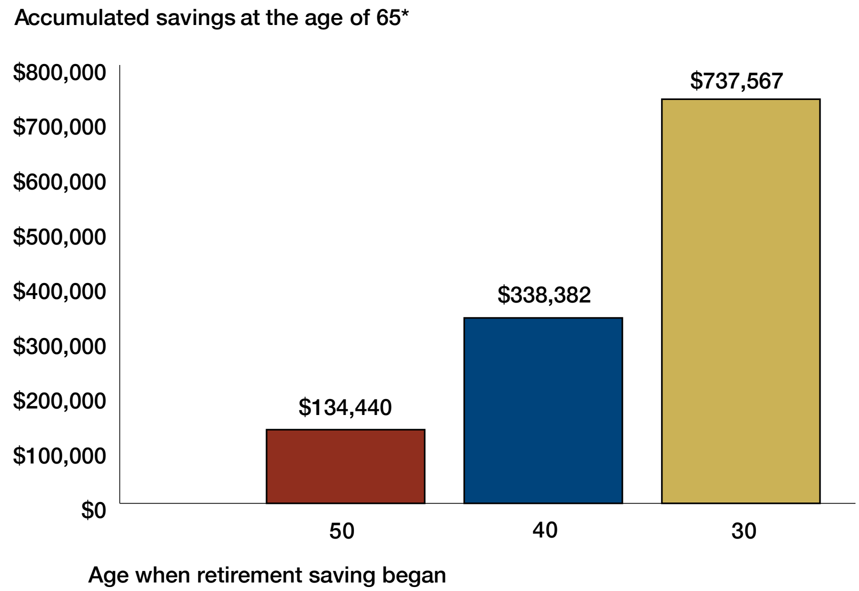
It's no secret that the most powerful component of saving for retirement is a healthy time line. Waiting to begin an employee retirement savings plan constrains the advantages of compounding and accumulated savings growth (Figure 1).

For instance, a 30-year-old employee who begins saving $5,000 each year until the age of 65 can accumulate $737,567 toward retirement, assuming a 7% annual return. But waiting just ten years to begin a regular savings program can result in less than half that amount at the same retirement age. More concerning, an employee who begins saving $5,000 a year at the age of 50 has even fewer contributing years and less time to take advantage of valuable growth from compounding, with just $134,440 of accumulated savings at the age of 65.

Some companies have added autoenrollment for new and existing employees to encourage early, active investing in their workplace savings plans. Adding such enrollment features helps, but it doesn't solve the problem, since employees may opt out to address more pressing near-term financial needs. Even in the face of unexpected financial changes, with the right support, saving for retirement early and addressing immediate needs doesn't have to be an either/or predicament.

FIGURE 1

The Importance of Saving Early



*Assumes annual savings of $5,000 and a 7% rate of return.

Mistake 2: Not Saving Enough

The most common autoenrollment default contribution is 3%, and it typically enables the employee to receive at least some portion of the employer matching contribution. While this feature offers a set-it-and-forget-it function, many employees forget or neglect to increase their contribution saving levels over time. As earnings increase, stagnant retirement contribution levels constrain growth and create a retirement saving shortfall. To close the gap, employers are combining autoenrollment solutions with an autoescalation feature that increases employee deferral rates at regular increments (Figure 2).

A steady increase in retirement contributions over time means employees have a better chance their savings will keep pace with inflation, weather market corrections and meet retirement goals.

If automated increases are timed with annual compensation increases, employees may not even notice the additional investments they are making. But an automated solution does not take into account pressing financial priorities, such as job loss, temporary unemployment or unplanned health care expenses, which may redirect retirement savings dollars to more urgent needs.

Mistake 3: Investing Too Conservatively

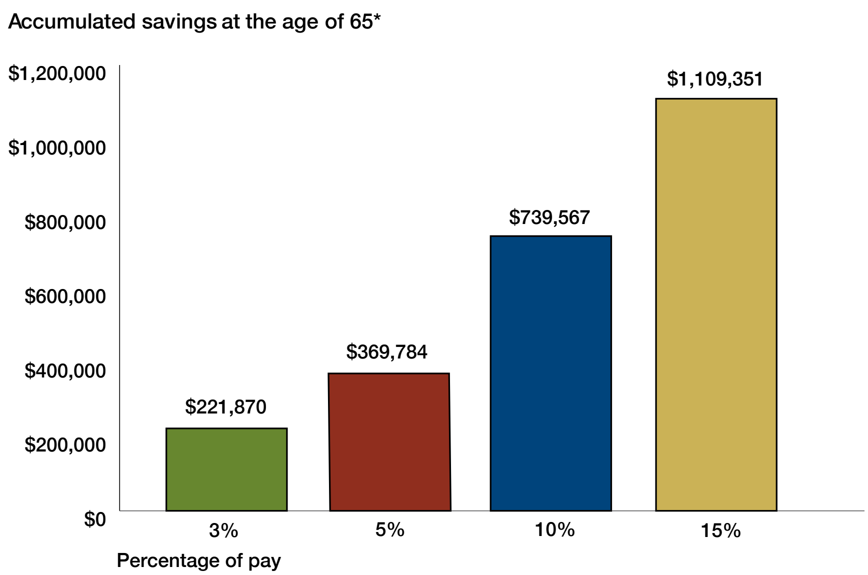
An employee's *asset allocation,* or mix of cash, stocks and bonds, is one indicator of how much money he or she will have in the future. The goal of diversifying investment allocation is to maximize the return of the underlying investments while minimizing the level of risk the employee needs to take to achieve that return. Sound asset allocation also helps protect investments from the risk of inflation, further reinforcing the need to strike the right balance of asset classes (Figure 3).

Investing in low-risk assets such as cash does reduce the amount of investment losses an investor incurs; however, investors run the risk of not keeping up with inflation, which will erode the value of their money.

For instance, take the results of the *EY Financial Wellness Assessment,* in which 22% of respondents, spanning

FIGURE 2

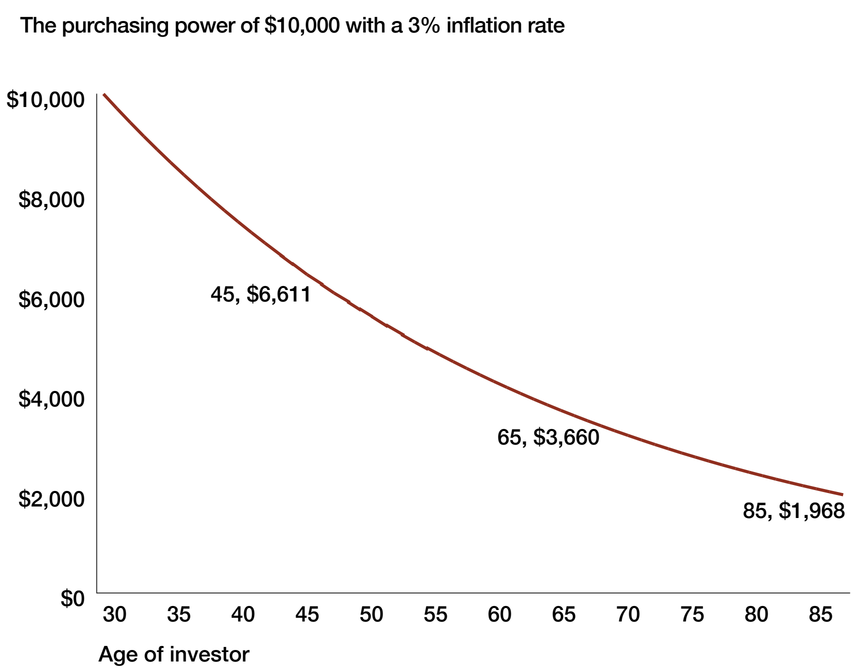
The Importance of Saving More



*Assumes annual savings begin at the age of 30, with $50,000 annual pay and a 7% rate of return.

FIGURE 3

Inflation Risk Compounds the Impact of Investing Too Conservatively



all adult age groups, say they hold more than one-quarter of their workplace retirement savings in cash-type investments. While this statistic may bode well for employees who are near or entering retirement and taking a purposefully conservative approach, it can drastically impact a younger employee's total portfolio over the long haul.

To help employees strike the right balance of cash, stock and bond positions, some employers have turned to target-date funds (TDFs). TDFs are based on algorithms and automatically adjust the mix of investment types based on age and years to retirement. While they take some of the work out of rebalancing a retirement portfolio, TDFs are, by design, a one-size-fits-all solution that may or may not be best for an individual's personal goals and risk tolerance level. Especially when used as a default option, it's incumbent upon the employer to ensure participants are educated about how to appropriately use them within their financial plan.

Mistake 4: Failing to Prioritize Retirement Savings Over Other Financial Goals

Establishing an investment savings plan can be daunting for employees. Add competing financial priorities and decisions on what to save and where, and retirement investing can quickly take a back seat to more immediate needs, such as purchasing a home and making college tuition or loan repayments

Younger generations, in particular, have been forced to prioritize student loan debt over purchasing a home and, many times, over saving for retirement, which can cause the loss of valuable years of accumulated savings.

Retirement planning should always be included in money-related discussions, even when financial priorities shift because of unplanned events. Often, employees need help seeing the big picture.

Mistake 5: Timing the Market

Reacting to market highs and lows can wreak havoc on the inexperienced investor's retirement portfolio. As the market climbs, fear of missing out kicks in and the lure of quick gains can minimize buying power over the long term. Similarly, diverging from a long-term investment strategy in order to panic and sell when the market drops can negate previous years' worth of compounded growth.

An investor who remained in the market from 1997 through 2016 would have seen 7.7% compounded annual growth in his or her investment. However, if the investor missed the 40 best days of market performance during that same time period, he or she would have realized a 2.4% loss.

Beginning a financial education program before the market experiences wide swings prepares employees for the eventuality of market corrections, prevents impulsive reactions and provides a layer of investment risk protection.

Employers Can Help Close the Retirement Savings Gap

Employers have options to help their employees close the retirement savings gap. Adding traditional savings plan features that automatically adjust savings and asset allocation levels according to employee age and years to retirement can help. But adding automatic features gets employees only partway there. The key is educating employees on the need to save, delivering personalized attainable scenarios and then providing guidance on utilizing retirement plan features in building an investment strategy.

Still, motivating employees to become and remain actively engaged in retirement saving and investment—and giving them the tools and information they need to do so—is a tall order.

For employees, sorting through today's priorities in the face of tomorrow's goals becomes easier with support from a financial wellness program. A financial wellness program can include a financial coach who guides individuals through a personalized asset allocation analysis to evaluate investment options, determine investment risk tolerance and conduct regular portfolio reviews to make sure that investments are on track, even if retirement target dates have shifted. A financial coach also can help people achieve a safety net in the form of saving strategies that are in place before a crisis happens. And, if an urgent situation occurs, a financial planner can guide employees through complex, immediate needs to minimize disruption and get back on track.

Adding a financial wellness program that includes targeted education and individual coaching can make sense for employers looking to improve the long-term financial health of their workforce. Over time, employees learn how to track and adjust their retirement portfolios, meet individual retirement savings needs and avoid making the five most common retirement investing mistakes that can defer retirement. BQ

Endnotes

1. "Accommodate Aging Workforce Population," Centers for Disease Control and Prevention, www.cdc.gov/workplacehealthpromotion/model/control-costs/benefits/aging-workforce.html. Accessed April 17, 2017.

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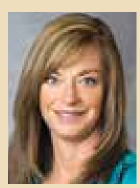

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