

# LACK OF DIVERSITY

## AUGUST 2006

According to the Vanguard Center for Retirement Research and the Wharton School's Pension Research Council, Americans are letting their retirement nest eggs sit without any proper attention. The study finds that investors do not do enough to diversify their savings.

The extensive study looked at more than five million people with employer-sponsored defined contribution plans or IRA accounts that it administers and found that only 10% of investors in the defined contribution plans and 8% of IRA owners did any rebalancing of their portfolios.

Vanguard also found out that IRA holders are about twice as likely to invest in a single asset class or single fund as are those with defined-contribution plans. The typical IRA holder chooses only one fund in comparison with three in defined-contribution plans. The median household income of those studied was \$54,000 for investors in defined plans and \$71,000 for IRA investors.

Workers are neither chasing returns nor day trading. Nor are they rebalancing their portfolios which can lead to some serious problems. *"Such a no involvement attitude can leave portfolios out of balance if market conditions shift,"* states Olivia Mitchell, the executive director of Wharton's Pension Research Council. *"While it is clear that most participants are inattentive to their portfolios, it remains to be seen whether this inactivity is motivated by rational choice, based on the long-term nature of pension assets, or whether it signals inertia, implying that participants would require additional assistance to manage their portfolios,"* according to the paper.

Participants who fail to rebalance their retirement accounts may not understand or appreciate the benefits of doing so. But Utkus and Mitchell say letting the markets dictate one's asset allocation can be especially risky business. *"Inertia investing might also leave the plan out of sync with projected retirement-age targets,"* according to the paper.

For example, during the study time period the Standard & Poor's 500 stock index rose 43%. That means workers who didn't rebalance their 401(k) plans probably had more of their retirement money in stocks than when they first began investing in their 401(k). Having more money in stocks can be good for certain investors, but it's not such a good idea for people close to retirement. That group is *"typically advised to concentrate an ever-increasing part of their portfolio on more stable, lower-risk investments, such as bonds,"* say Utkus and Mitchell.

Some of the solutions that Vanguard offers are *"lifestyle"* funds and auto-balance accounts that they sell to the public. We agree that something needs to be done in regards to the *"attention problem"* that is plaguing retirement accounts, however a *"set it and forget it"* fund is usually costly and often short on performance. The Pension Protection Act of 2006 allows for Registered Investment Advisors the ability to aid Americans with these accounts which can be a much better solution.