The Great 401(k) Hoax, by William Wolman & Anne Colamosca

About eight years ago (2004) I retired and started American College Funding with my son. American College Funding was a way of helping people make sure that they could get their children through college while spending as little as possible. This became a dual-purpose goal when I could help these same people put the savings away for their financial future. In some cases leveraging the savings to recapture, tax-free, what was to be spent on college. In all cases we would place the savings where it was not at risk to market fluctuations.

I finally had time to read the books that affected my financial future. Many were counter to traditional financial thinking, which got me thinking about how important it would be for everyone to read them so they too could decide for them selves. I didn't have the time to read them when I was working and my financial advisors didn't seem to want to enlighten me on how the financial community was trying to get my money, only to benefit them, not me. Of course, they were a part of that community and they benefited as well, which is why they didn't necessarily want me to know. I decided that I wouldn't be that way. I would make every attempt to educate everyone coming through my office, whether they became clients or not.

One of the books that really struck a chord and started me thinking was a book called '***The Great 401(k) Hoax'.*** A book published in 2002. As you can imagine, the title alone was enough to grab my attention.

The problem is that the 401(k) asks Americans to copy the investment behavior of the rich, even though they obviously do not have the resources to ride out the bad markets of the kind they believe will prevail for the next decade.

The American public has been hoodwinked by political and corporate forces into relying on the 401(k) as the primary long-term investment mechanism. In doing so, the stock market has been put at center stage in providing for a comfortable retirement for the average American. The 401(k) represents an implicit promise to middle class Americans that they can live off the income that they receive from stock ownership, just like the rich do. It is a promise that is impossible to fulfill: thus the great 401(k) hoax.

The authors point to history, which shows that stocks were driven to unsustainable highs three times in the last century, in 1901, 1929 and 1966. Each of these flights into a valuable fantasy was followed by more than a decade in which stock prices stagnated or declined. That does not mean that there were no rallies in these periods, but the fact is, the stock market could not, and did not go to new highs. It looks like a fourth high has been reached at the end of the year 1999, and it is their opinion (and I agree) that we are now in for another decade (or more) where stock prices stay stagnant or decline.

(Note: this happened from 2000 through 2009 when the market, for the first time ever over an entire decade, dropped in value. This book was published in early 2002.)

The path to financial success must begin with a journey to escape the thrall of Wall Street. In the book '*Mobs, Messaihs, and Markets'* by Bill Bonner he has a chapter entitled 'How Not to Be Chumped by Wall Street' that further explains this problem. I have written a summary of that chapter. If you would like to read it let me know and I will get you a copy.

The authors point out that it is hardly a matter of rocket science to conclude that by far the greatest proportion of the 20th century stock market gains were comprised into 40 years. In the other 60 years of the hundred years of the 20th century, stocks languished. In those 60 years, the stock market was hardly a place where the average investor could compound for a comfortable retirement.

Wall Street tells the American family that it can rely on earning an inflation-adjusted rate of return of seven (7) percent on its money with a long-term stock savings plan. Reality, on the contrary, suggests that a return of fewer than two (2) percent is a far more realistic outlook for a person that extends well past the end of the first decade of the 21st century. *(That has turned out to be high as the first decade of the 21st century provided us with a negative return. The late 1990's created a false sense of security that we could get something for nothing.)*

The difference between what Wall Street promises and what history suggests is the difference between comfort and virtual penury. The authors believe the 2% scenario's is the most realistic benchmark for the next 20 years. This suggests that the dream of 7% returns on stock market investing is a hoax on the American public rather than a realistic appraisal of the future. *(7% might be possible if you could eliminate any negative years – a possibility with certain insurance products and annuities, but certainly not in the volatile equities market.)*

Understanding the true origin of the 401(k) plan is important for the American Family. It was the slow growth period in the American economy, the years from the beginning of the OPEC oil embargo in 1973, to the mid 1990's that under minded the old pension system. Not when things were good, but rather when the great corporations were having a tough time making money. Corporate America had a burning desire to get out from under its long-term commitments to its employees. Long-term pension liabilities were showing up as virtual black holes.

How to solve the problem? Simple, if the corporation could meet its obligations by allowing workers to voluntarily contribute part of their earnings toward a 401(k), the dreaded unfunded liabilities would simply not exist. They were given tax incentives to 'match' workers contributions with stock or cash. In effect, the corporation told its workers: 'you are now the owner of your investment fund, but we are not responsible

for whether it will be enough to provide a decent pension. That depends on you.' This is why the 401(k) was, in effect, the major tool used by Wall Street to capture family values.

So what do they suggest? The successful transition must begin with a stern determination to drown out the 'noise' that emanates from Wall Street's house gurus and their disciples. This means financial cable channels, the personal investment magazines, and above all, from the brokerage houses them selves. Some 'noise' is harder to ignore when it emanates from the great universities and research organizations. That is what makes a guide to 'noise' suppression an essential element of investment success. (*Remember that all of the media, whether it be TV, magazines, or newspapers, are funded by Wall Street as advertisers.)*

Providing the best guide to the new investment terrain begins with answering the question: what is the likely rate of return of stock market investments over the coming couple of decades? The best answer (they believe) lies in following the record during the earlier periods of stagnation (after 1901, 1929, 1966, and now 2000). *(The real answer is: no one knows.)*

Average investors must think of bonds, cash, cash value life insurance, annuity's, and potentially real estate as a place to keep their money most of the time. Cash is not only king in very bad markets, but cash is king in stagnant markets *(access is critical – being tied up in a 401(k) is not ideal)*. If stocks are to be considered you should not depart from the rule of low p/e's. What is low? For the entire 100-year period the average p/e ratio on the Dow Jones Industrial average was 15. Anything lower than that is a good cautious number.

It follows, of course, that the core of 401(k)'s should be bonds or cash (or equivalent). The best kind might be Treasury Inflation-Protected Securities (TIPS). Unfortunately 401(k) plans that offer this choice are scarce. If yours does not, you need to find out why and what can be done to include them. Most 401(k)'s almost always stress buying equities (noise – don't listen), especially the new target dated mutual funds (which not one in a thousand people understand). It is naïve to buy the argument that stocks' are a good hedge against inflation. The late 1960's and 1970's were high inflation years, yet the stock market went absolutely nowhere.

The time has come for change. What you can't do is throw your hands up and become passive about investing /saving, that would be a big mistake. I certainly don't claim to have all of the answers, but I do have a passion for making sure that my clients understand what they are up against. Making sure they understand that there is another side (and maybe a solution) to all of the 'noise' put out by Wall Street and its proponents.

You may be limited to what your company offers within your 401(k), but once it is rolled into an IRA that you control, you have many more options. We will be happy to sit down with you and review your financial situation as it relates to what you 'hope' to have happen in the next 10 to 20 years as you prepare for retiring. You need to understand your options and how alternatives might protect you if the markets do indeed remain stagnant over this period. If you don't get returns in the 7% to 8% range in your retirement accounts, what affect will this have on your ability to become financially independent when you need to be? What affect would increased taxes have on the amount of spendable income? What might you do to mitigate this situation?

(Remember Warren Buffet's philosophy: Investing isn't simply about being sure you are right, but about making sure you are protected if you turn out to be wrong.)

Give us a call and we will be happy to provide our input and suggestions. It can't hurt to hear an alternative opinion.

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Some investment suggestions:

- Use index funds
- Make sure management fees are very low
- Save enough to get the company match – don't take the match in company stock if it can be avoided – if not sell it right away and put into cash (think Enron)
- Consider other alternatives if the company doesn't give a match, or if you are contributing more than they match
- Remember, there's no evidence that any money manager can consistently beat the averages
- Stick with blue chip stocks that pay dividends
- Do not even try to pick stocks, because you are likely to fail in the long run unless you get luckier than you have any right to expect
- Everyone thinks bonds are safer than stocks, and they are. But beware; you can still take a shellacking if you have to cash in a bond when inflation drives up interest rates
- Be careful of commissions & fees that can cut your returns