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Retirement Report

NEWS AND UPDATES FOR PLAN SPONSORS AND FIDUCIARIES OF DEFINED CONTRIBUTION PLANS

Should You Rock Alternative in Your Lineup?

The term “alternative investments” may conjure images of classic automobiles, fine wine, rare art and valuable jewels. Some may think about the Honus Wagner baseball card that sold for $3.12 million at auction in 2016. Or about the 1962 Ferrari 250 GTO that sold at auction for a whopping $34.65 million in 2014. Or maybe they set their sights even higher and think about the Hope Diamond, with an estimated value of $200-$250 million.

While these treasures are fun to picture, they would not be permissible or practical investments within a retirement plan. So what exactly is an alternative investment in this context? A simple way to comprehend these investments is right in their name—alternative—they are not conventional investment types, e.g. stocks, bonds and cash. Alternative investments include private equity, hedge funds, managed futures, real estate, commodities and derivatives contracts.

Alternative investments, like REITs (real estate investment trusts) and commodities, have their place in a well-managed portfolio within proper asset allocation parameters and with regular oversight. The danger is when participants misuse and/or don’t fully understand this asset class. Alternative investments can be difficult to understand and can be subject to enhanced volatility. Consider the most recent financial crisis. In the aftermath of global equity markets plummeting, some investors sought safe haven in gold which buoyed its price to record levels. As a result, some plan participants observed this phenomenon and were swayed to reallocate some, or even all, of their retirement plan assets there.

Subsequently, along with the meteoric rise in the price of gold, came a decline. Gold peaked at $1,920.70 in August 23, 2011 and fell to $1,048.30 by December 17, 2015.[1] An investor who bought at the high and sold at the low, realized a loss of 45.4 percent over this time period. A $100,000 investment would have fallen to $54,579. Let’s contrast that with a diversified portfolio with its foundation in core asset classes and only a portion allocated to alternatives. Consider a hypothetical portfolio allocated as follows: 40% U.S. Equity, 10% International Equity, 40% Core Fixed Income, 5% Commodities, and 5% Global REITs.[1] Over the same time period, this portfolio achieved a positive return of 46.48 percent. So a $100,000 investment would have grown to $146,480.

A broader stand-alone Commodities fund would have proven just as dangerous. Commodities (as measured by the Bloomberg Commodity Index) produced a negative return every year between 2011 and 2015, for five consecutive years. Annualized five-year returns in Commodities were negative 10.27 percent.[1] This means a $100,000 investment would have fallen to $58,169 during this time period.[1] Again, if an investor instead used a diversified portfolio during this time period they would have achieved annualized returns of 7.62 percent, turning the original investment into $144,366. Again resulting in a much better outcome in the diversified portfolio.

Under both scenarios, participants would have been disappointed had they invested their retirement plan assets exclusively in alternative investments. As seen in the examples above, if these were just portions of a well-diversified portfolio, the effects could have been minimal. Some exposure could have been helpful in 2016, with Commodities finally turning the corner and returning almost 12 percent and Gold up almost 8 percent.[1]

While alternative investments can perform well and occasionally produce great returns, you may want to think twice about using them as stand-alone investment options in a retirement plan. Risk/reward optimization can be maximized within the confines of a well-constructed asset allocation, such as a target date fund. These funds are professionally managed, rebalanced and enjoy constant oversight to appropriate asset allocation across various asset classes.

[1]All return data derived from MPI Stylus and Morningstar Direct. Hypothetical diversified portfolio is comprised of U.S. Equity (S&P500), International Equity (MSCI EAFE), Core Fixed Income (Barclays Aggregate), Commodities (Bloomberg Commodity), and Global REIT (S&P

Global REIT).

Millennial Workers Require Special Plan Sponsor Menu Design

Millennials are the largest demographic cohort in the nation, U.S Census Bureau data shows. And up to 80 percent are already saving in their employer-sponsored retirement plans, according to a 2015 report from Bank of America Merrill Lynch.

The newest generation of workers—which the Pew Research Center defines as those born between 1981 and 1997—has exhibited distinctive attitudes and behaviors that plan sponsors and their advisors must consider when designing menus. Plan administrators, too, must rethink some long-held beliefs about participant behavior.

For starters, millennials tend to be more risk averse and gravitate toward conservative investments that they believe will be less exposed to bouts of volatility. Millennials also tend to be highly educated and research-oriented. Given these inclinations, plan sponsors should consider providing education about the benefits of long-turn investing, since they have just begun their accumulation phase.

The number of millennial plan participants is likely to rise, particularly if the U.S. economy—and the job market—continue their slow but steady recoveries.

Investment Lineups

Employers with growing millennial populations should adjust their lineups to accommodate this generation's more conservative sensibilities. Current research—including a study published by the retirement and trust unit of Wells Fargo—suggests that millennials may be inclined to choose managed options with customizable and adjustable glidepaths. Forward-thinking sponsors would do well to get ahead of the curve by looking widely across all age groups within their plans, making sure all cohorts have access to these types of solutions.

Plans geared toward millennials can offer a menu that includes conservative balanced funds, a mix of core funds and, for an added measure of diversification, funds in non-core asset classes, such as emerging markets and small-cap equities. The mix can also include a risk-managed option to help young investors build up their balances and gain experience with markets until they feel comfortable assuming greater risk levels.

About a third of millennials say that they find socially responsible investing "very appealing," and another 59 percent say it's "somewhat appealing," according to a June 2016 survey by Legg Mason and Naissance. Options that include some socially responsible element stand a good chance of aligning with millennials' social and environmental learnings.

Communication and Education

A targeted communications effort can help satisfy millennials' appetite for understanding the different possibilities available for a given financial transaction. These materials should explain the types of investment choices available through the plan. For instance, plan sponsors can teach millennials about Roth 401(k) options, which allow them to contribute to their plans on an after-tax basis, so they don't have to pay taxes when they cash out. That can help save total taxes, since millennials are typically in a lower tax bracket when they make initial contributions than when they are ready to pull assets from these accounts.

As millennials enter the workforce and age through it, plan sponsors and their financial advisors will need to adapt their retirement plans to suit this growing cohort. A well-considered and robust investment lineup, supported by strong communications, can help plan sponsors provide an appealing, competitive retirement plan that retains younger workers and helps them invest their way toward a more secure retirement.

This is an excerpt of Macquarie Investment Management's article Millennial Workers Require Special Plan Sponsor Menu Design.

Partial Plan Terminations

A partial plan termination occurs when 20 percent or more of a company's employees are laid off in one year. Routine turnover during the year is generally not considered a partial plan termination.

To determine whether your turnover rate is routine, consider the following factors:

- What was your turnover rate during other periods and what was the extent to which terminated employees were actually replaced?
- Do the new employees perform the same functions as the previous employees? Do they have the same job classification or title? Do they have comparable compensation?

There is no requirement to notify the IRS of a partial plan termination, but all affected employees must be 100 percent vested in their account balance as of the date of the plan termination. If this hasn't happened, a Voluntary Correction Program would be appropriate.

For more information on partial plan terminations, please contact Lee Pierce at lee@piercefinancial.org or 901-271-3720..

May Any Employee Join the Retirement Committee?

Upon first blush, to the extent an employee from the general populace can and wishes to make a contribution as a committee member, there seems to be no reason why they shouldn't participate on the committee. In practice, most committees consist of executives from finance (preferably the CFO), benefits and human resources. Due to the potential personal liability exposure, if there is interest from other lay people who wish to represent the vote of the participant base, they are best served participating as a non-voting member with no discretionary capabilities. This type of person should be identified and documented as a non-voting member assuming there is no intent to take on fiduciary status and the potential liability attached to all retirement committee members.

Communication Corner: Retirement Plan Puzzle

This month's employee memo offers participants a fun word search puzzle featuring important retirement terms.

Call or email Lee Pierce if you have an interest in distributing the monthly employee memo to your workforce, at lee@piercefinancial.org or 901-271-3720.

The information contained herein has been prepared solely for informational purposes and is not an offer to buy or sell or a solicitation of an offer to buy or sell any security or to participate in any trading strategy. Any decision to invest according to investment advice provided by NFP should be made after conducting such investigations as the investor deems necessary and consulting the investor's own investment, legal, accounting and tax advisors in order to make an independent determination of the suitability and consequences of an investment.

Alternative investments, including hedge funds, oil and gas offerings, real estate, and managed futures, involve a high degree of risk, often engage in leveraging and other speculative investment practices that may increase the risk of investment loss, can be highly illiquid, are not required to provide periodic pricing or valuation information to investors, may involve complex tax structures and delays in distributing important tax information, are not subject to the same regulatory requirements as mutual funds, often charge high fees which may offset any trading profits, and in many cases the underlying investments are not transparent and are known only to the investment manager. The performance of alternative investments, including hedge funds and managed futures, can be volatile. An investor could lose all or a substantial amount of his or her investment. These types of investments may not be suitable for all investors. Please consult with a financial or legal professional before investing in alternative investments.

The hypothetical illustrations do not represent an actual investment. There is no guarantee similar results can be achieved. If fees had been reflected, the return would have been less.

Using diversification and asset allocation as part of your investment strategy neither assures nor guarantees better performance and cannot protect against loss of principal due to changing market conditions.

Bloomberg Commodity Index (BCOM) is calculated on an excess return basis and reflects commodity futures price movements. The index rebalances annually weighted 2/3 by trading volume and 1/3 by world production and weight-caps are applied at the commodity, sector and group level for diversification. Roll period typically occurs from 6th-10th business day based on the roll schedule.

S&P 500 Index is an unmanaged group of securities considered to be representative of the stock market in general. You cannot directly invest in the index.

The MSCI EAFE Index is an equity index which captures large and mid cap representation across Developed Markets countries* around the world, excluding the US and Canada. With 929 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The Barclays Capital U.S. Aggregate Bond Index measures the performance of the U.S. investment grade bond market. The index invests in a wide spectrum of public, investment-grade, taxable, fixed income securities in the United States – including government, corporate, and international dollar-denominated bonds, as well as mortgage-backed and asset-backed securities, all with maturities of more than 1 year.

The target date is the approximate date when investors plan on withdrawing their money. Generally, the asset allocation of each fund will change on an annual basis with the asset allocation becoming more conservative was the fund nears target retirement date. The principal value of the funds is not guaranteed at any time including at and after the target date.

You cannot invest directly in an index.

Past Performance does not guarantee future results.

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