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How To Setup Your 401K To Maximize Your Returns

Dan Eggertsen: Hi. I'd like to welcome everyone to the call today. This is Dan Eggertsen. I'm here with my father Carl Eggertsen. How you doing today, Dad?

Carl Eggertsen: I'm doing good Dan. How are you doing?

Dan Eggertsen: I'm doing great. Are you ready to answer a few questions?

Carl Eggertsen: I'm going to try.

Dan Eggertsen: Okay. Well, we've been getting a bunch of them in lately and there are three of them that we see over and over again, specifically on the topic of 401Ks. The first question that we're getting is, "How much should I contribute to my employer's 401K plan and why?"

Carl Eggertsen: Okay. I think that there are a number of good reasons. You can contribute up to \$16,500 in the 401K and assuming that you have good investment options within the 401K, try as much as possible to contribute as much of that as you possibly can every year. Especially if the case is that they have a lot of good options within the 401K.

Dan Eggertsen: In terms of funds?

Carl Eggertsen: Yeah, in terms of options of what to invest in.

Dan Eggertsen: Yeah.

Carl Eggertsen: You ideally want to see some US stock funds, international stock funds, total bond market funds. You want to kind of steer away from niche investments, too much of that and especially like company stock. A little is fine, but you want to put most of your investments in the greater diversified options. So you want to look to make sure that you've got some really good diversified options for the United States and international and also in bonds. Okay? If the company matches up to, let's say \$5000 of that \$16,500 – I'm just giving an example – you want to contribute at least that much; up to the matching because you are getting free money on your \$5000 investment. So the recommendation would be pretty much regards of what's in the 401K. Contribute at least up to the matching amount that your company offers you.

Dan Eggertsen: Right.

Carl Eggertsen: After that, if the 401K is not the best, then you could invest beyond that \$5000 into like a Roth IRA and you would have whatever options you want to make your portfolio more diversified overall.

Dan Eggertsen: Right.

Carl Eggertsen: Okay? So that's the answer.

[02:54.0]

Dan Eggertsen: All right. Well great and I just have a quick story. Something you said reminded me of this. When I was working for a biotech company in the IT department, the company would give employees stock options in the company and I remember - this just highlights the danger and the risk of putting all your eggs in one basket - if you have a 401K plan and you have an option to just invest in company shares, something like this can happen. There's one guy who sat next to me who took all of the stock options and kept them in there and put all of his 401K matching money into those stock options for the company. This is in 99, 2000, 2001 when things were really good and stocks were going through the roof.

Well, he ended up – and me on the other hand is I would take my options and I would sell them as soon as they vested. I would sell them and I would take the earnings that I made from the sale of the options, I would diversify them in the rest of the 401K. Well, a few years later, the stocks for that company, the shares dropped to almost nothing. That guy lost everything and I still had a diversified portfolio in my 401K because I sold all the company options by the time everything went down. So the bottom line is, invest as much as you can into that 401K.

Carl Eggertsen: Yeah.

Dan Eggertsen: Like you said, if they match at least do up to the matching. At least donate that much and then also you want to diversify things in a smart way and not put everything in company stock.

Carl Eggertsen: Right.

Dan Eggertsen: Just wanted to, you know...

Carl Eggertsen: Yeah. That's a good personal story there.

Dan Eggertsen: Yeah. Give my personal insight on that. Okay. Let's move onto the next question.

Carl Eggertsen: Okay.

Dan Eggertsen: What's the biggest benefit of using my employer's 401K plan or just investing the money myself?

Carl Eggertsen: I see there being four. Okay? Number one, matching contributions; that's unique in retirement accounts. Number two is, you can save up to \$16,500 a year. For example, in IRAs you can contribute \$5000 and if you're over 50 you can contribute \$6000 a year. But \$16,500 a year is quite significant and if you've got a good 401K, that is really – and you have matching on top of that - that is a very powerful saving vehicle because you can put in three times as much as you can put into an IRA every year.

Dan Eggertsen: Right.
[05:27.4]

Carl Eggertsen: Okay? Number three is the tax deferral which is common among retirement accounts. Number four is, it's a very easy, automated way to withdraw from your paycheck before you're ever tempted to go ahead and spend all your paycheck that you get instead of putting it aside; paying yourself first. It's a very disciplined way, you just tell your company, you fill out the appropriate form and tell them you want X amount of dollars deposited into your retirement account there at work and then you get the paycheck, minus that amount that you get into your hand and then you use that as you would need to in covering your expenses at home and other things. So that is a secret, one of the great secrets of sound, successful investing is automated withdrawals before you're ever tempted to not put your money into that retirement account on that particular month and you're tempted to go spend it on that particular month and before you know it, you're doing it most months.

Dan Eggertsen: Right.

Carl Eggertsen: You want that discipline. That's a great way to discipline. Before you ever get your paycheck, that money is already pulled out and put into your retirement account. So that's another powerful advantage of having a 401K at work there.

Dan Eggertsen: All right. Fantastic. Let's tackle the third and final question for today. Now, when can I pull the money out of my 401K and what if it's an emergency? Is there any additional leeway we have?

Carl Eggertsen: Okay. Well I'm prepared to cover that. First, we should probably start with when you must begin to withdraw. You must begin to withdraw from an IRA on April 1 of the calendar year after you attain the age of 70 ½ years old. Okay? Or April 1 of the calendar year after you retire from a company, okay? After retiring or after you leave the company. So those are ways that you can withdraw with no penalties, no problem whatsoever. If you leave the company, you can roll, if you leave the company, take another job, you can roll to an IRA in an independent financial organization. Or if the new job that you're taking at a company has a 401K or other eligible retirement plan, you can roll it into the 401K or other eligible retirement plan there.

Dan Eggertsen: Okay.

Carl Eggertsen: Okay? Now, other types of withdrawals there're pretty severe restrictions with some exceptions on withdrawals while you're remaining employed with the company. So number one, if you're under the age of 59 ½, you're subject to an excise tax, that's what they call it, of 10% of the amount that you take. That's a pretty hefty penalty. That 10% of penalty can also apply even in some hardship cases, hardship expenses but there're exceptions to some of those. Both cases, taking money under the age of 59 ½, [inaudible] money under age 59 ½ or hardship expenses can both be subject to normal taxation as ordinary income. Okay?

Dan Eggertsen: Okay.

[09:13.3]

Carl Eggertsen: Okay. Now there're some exceptions to the 10% penalty include if the employee dies.

Dan Eggertsen: If the employee becomes totally disabled. If they're separated from service in or after they turn age 55. In other words, if they leave the company in or after they turn 55.

Dan Eggertsen: Right.

Carl Eggertsen: Deductible medical expenses; that would be another reason. Another reason I find very interesting, if you withdraw money in equal payments at least once annually over your life expectancy, you can start taking money out.

Dan Eggertsen: Oh. Okay.

Carl Eggertsen: Okay? So those are exceptions. Now hardship withdrawals, they get even more specific on hardship withdrawals. Things like that are considered immediate and heavy need. Okay? Things unexpected that you have no other dollars available from any other source. So all those things have got to come together; they got to be immediate, they've got to be unexpected, extreme need and there's no other dollars that the individual has available to cover such things as medical care, purchasing a personal residence, educational expenses, to prevent eviction from your personal residence, funeral expenses, or repairing damage of your personal residence.

The IRS and the company seem to both have their own rules. The IRS rules, of course are number one but the company can even add some of their own rules in. So some or all of these hardship cases, depending on who you work for, you may still owe income taxes and possible a 10% penalty but it depends on the situation and on the company that you work for and the IRS has some pretty set rules that will allow the people to be covered, be able to withdraw in some of these situations depending on the variety of things. It gets pretty complicated but the bottom line is the IRS and the company want you to keep your money in your pension and keep it growing as much as possible. They don't want people to think that they can go to their retirement account anytime they want some money.

Dan Eggertsen: Right.

Carl Eggertsen: It's not serving the purpose of what it's for.

Dan Eggertsen: Yeah.

Carl Eggertsen: But there is some leeway and there are some things that people can do in certain situations. So that pretty much I think covers that question.

[11:50.6]

Dan Eggertsen: Well great Dad. That's a great answer and thank you very much for your time today. I want to thank everyone else for being on the call. This information is out there to help anyone who needs it. So again Dad, I appreciate your time and you have a great day.

Carl Eggertsen: Thanks Dan.

Dan Eggertsen: All right. Bye.

Carl Eggertsen: Okay.

Dan Eggertsen: Okay.

[12:19.1]