One of the most challenging yet exhilarating obstacles we tackle at Real Investment Advice is chipping away at the financial services dogma that is firmly entrenched through traditional channels of advice and guidance. Once a planning or investment concept take holds, it never gets challenged by upper management (even if those in charge hold planning certifications) at brokerage firms. If a stale rule isn?t broken, why contest it? And if it is busted, why bother to fix it? Candidly, if it places obstacles in the way of organizational sales goals or directs employee effort away from selling, well then forget it. **That?s reality. As harsh as it is.** I know. In September of 2007, I went to those in charge of ?advice? at my former employer with a great concern. This isn?t some fly-by-night operation either. It?s known as a financial services behemoth that spends a fortune to vigorously promote an image of ?client first?, although superiors ignored my pleas to adjust the stock return projections for their planning software. I provided reams of back-up documentation to validate how planning results were not going to be as successful as projected. I was concerned that I was placing clients in jeopardy with overoptimistic outcomes when in reality, there were serious portfolio longevity risk issues. My fiduciary mentality and actions got me in hot water and placed my health and finances at risk. Everything happens for a reason. Daily, I feel fortunate to be part of a team that lives and breathes a great responsibility to report pros and cons of every investment, any account vehicle that you access to build wealth, and question the effectiveness of all planning concepts based on the market cycle you?re living through or retiring in. So, it?s with an objective nature, I plan to stick a needle in the eye of the revered, never-challenged, investment vehicle panacea of the ages ? the 401(k) plan. Yes, the primary source of your wealth building is flawed. It?s far from perfect. **So let?s call it out for what it is.** However, before I do, let?s return to September 1980 when an unknown workplace benefits consultant for a mid-sized company based out of suburban Philadelphia, stumbled upon a sub-section of the U.S. tax code ? 401(k) that was designed primarily to replace or limit the use of executive cash-deferred plans and thought it could benefit employees and their companies. Why not replace a limited corporate tax-sheltered saving plan with a vehicle which would allow a majority of employees to save more than they could in traditional IRAs and at the same time, employers would save Social Security and other payroll taxes by creating and contributing? Win-win. You see, Ted Benna had a noble intent. He had a vision to help American workers EXPAND the limited retirement savings vehicles available to SUPPLEMENT pensions. You see that? **SUPPLEMENT pensions.** Mr. Benna figured the costs of converting old savings plans were marginal, partially offset by payroll tax savings and employees would be provided an another saving and investment alternative. At the time, Mr. Benna?s company became record keepers (for a nominal fee) for organizations converting to 401(k) plans. He was ahead of his time as he suggested his employer, The Johnson Companies, outsource investment responsibilities to a company still in its infancy ? the Vanguard Group. According to Mr. Benna in an interview from 2011, he began to think 401(k)s may not be the right thing and lamented how he created a monster that should be ?blown up.? He felt his original concept had deviated from its intention and had become proficient at enriching the financial services industry and not the savers. **What a surprise.** I?ll also throw in how a majority of corporations ultimately decided to replace pensions with these plans, not utilize them as another choice to build wealth, as the most egregious deviation from Mr. Benna?s vision. So, with that out there, I?ll outline the reasons why I?m not the biggest fan of 401(k)s. Perhaps you?ll better contemplate their limitations. **1). Please don?t classify a 401(k) plan as a benefit. They?re provided in trade for having you as an employee.** Remember ? you provide human capital, sweat equity, in return. That?s worth something. There are plenty of alternative, lower-cost investments and vehicles for retirement savings available today. Even a plain-vanilla brokerage account will do. In other words, a 401(k) shouldn?t be a ?make or break? when it comes to considering an organization for employment. To me, benefits provided by an employer are those subsidies or dollars provided which reduce the pressure of daily living, enhance a lifestyle, or reduce dramatically, the odds of financial devastation. Think health insurance, disability coverage, a robust earned income or salary package. Frankly, you pay me enough and I can save for retirement on my own, thank you very much. And speaking of saving for retirement on your own. **2). All the investment, savings and performance risk in a 401(k) is taken on by you, the employee, NOT the employer**. In the good old days, in the ancient times of pensions (first time I heard the word ?pension? was during a rerun of an episode of The Little Rascals from the mid-1930s), the employer solely bore the risk of saving and investing for a worker?s retirement. In other words, you were provided an income for life in retirement as an employee of the organization for a specific period of time. As the bookkeeping burden and costs expanded to provide pensions and technology made employees less of an asset and more of a liability, the responsibility of saving for retirement was placed one-hundred percent on the shoulders of the employee. In a 401(k), you take on the risk of high fees, limited investment selections and possible devastating stock losses, especially if you?re over-allocated to company stock (a common pitfall). **3). That target date mutual fund may not have a target at all.** In 2007, the Department of Labor placed a stamp of approval on target-date fund choices in 401(k) plans so plan providers have been quick to embrace them. A target date fund is a mix of asset classes ? large, small, international company stocks and fixed income that is adjusted over time or allocated conservatively the closer an employee is to the ?target date? identified. For example, the Vanguard Target Retirement 2020 Fund is designed to increase its exposure to bonds the closer it gets to 2020. Let?s be clear ? this is NOT a maturity date, which is part of the confusion of a target-date fund. The target never gets reached. The fund doesn?t go away. It?s always out there. Also, as a rational human, in 2020, the so-called retirement or target year, wouldn?t you intuitively think this fund should be a conservative allocation? Perhaps 30% equities and 70% fixed income? Well, it all depends on a target date fund?s ?glide path,? or method of how the allocation is reshuffled the closer the time to the target date. Every fund group differs in philosophy so you must read the fine print. For example, the Vanguard Fund takes seven years AFTER 2020 to shift from a 60/40 stock & bond allocation to a 30/70 bond & stock mix. In reality, **this is a 2027 fund.** Target date funds are not the best, but suitable choices as most 401(k) participants treat their plans like pensions. In other words, they deposit money into them, ignore allocations and wish for the best. Once money is placed into 401(k) plans it seems to fall into a psychological dark hole and rarely monitored or rebalanced. At least target date funds allocate and rebalance on autopilot (employees don?t need to do anything). **4). Tax-deferred compounding isn?t what it used to be.** In the halcyon days of secular bull markets from 1982-2000 when money snowballed in value, especially sheltered from federal government taxation, tax-deferral was a powerhouse for returns. However, secular or long-term times have changed. The market as represented by the S&P 500 from March 2000 through December 30, 2016 returned 4.2% - accounting for inflation the real return was 2.09% annually (dividends included). To put it in perspective, a thousand dollars placed into the market in March 2000 was worth $1,415 on a real return basis as of the end of December 2016. What a ride for $415 bucks. So, the fact that your allocation was tax-deferred didn?t do you much favors. Sure, it helps, but not the way it did in the past although brokerage house talking heads remain positively giddy over the panacea of ?tax-deferred compounding.? For simplicity sake, let?s say you had $40,000 in your company retirement plan in 2000, set it in an S&P Index fund and forgot it for 16 years. On a nominal return basis, your $40,000 would have been worth roughly $77,258 at the end of 2016. A total gain of $37,528, or $2,329 annually for 16 years. According to the Joint Committee on Taxation, Americans that earn $75,000-100K pay an average tax rate of 18%. If I had my original $40,000 in an after-tax account, naturally I would need to reduce it by 18% because 401(k)s are funded with pre-tax dollars. So, I net $32,800. If I placed that lump sum in an after-tax or brokerage account in a tax-efficient S&P Index investment like $SPY, my investment would have been worth $63,352. A tax-deferred option at this point does look appealing since I accumulated $13,906 more in my 401(k) over my brokerage option. In 2017, I plan to retire and withdraw 4% a year from my accounts as part of my plan to re-create a paycheck. From my tax-deferred selection, I seek to withdraw $3,090 annually, all of it taxed as ordinary income. A majority of clients I engage in planning, pay an effective tax rate between 12-15% in retirement. If I use 15% then that $3,090 nets $2,627. I give up $463 to taxes. If I withdraw 4% from an after-tax account, at least for a period, I have long-term capital gains to deal with. So, 4% of $63,352 is $2,534. Remember, my original investment of $32,800 was post-tax however, I do have over $30,000 in gains that are subject to taxation. On a positive note, a married couple filing jointly with a marginal tax rate of 15%, pays 0% in capital gain taxes therefore the entire $2,534 may not be taxed at all depending on their overall tax situation. It?s also important to understand that capital gains are still income for tax purposes so they may still impact deductions and Social Security taxation. Bottom line: Tax deferral provided me less than an extra 100 bucks a year. So, what?s the point? Where?s the payoff? Obviously this is an overly-simplistic example and in-depth, personal calculation is required based on an individual?s tax situation. The point I am attempting to relay is the lower the earned or projected returns on investments happen to be, the less effective tax-deferred compounding becomes, and the trade-off between income tax and capital gain taxes becomes a significant point of focus. Unlike through the greatest bull market from 1982-2000 when the S&P 500 annualized (with dividends) 15.3% when tax-deferred compounding held powerful significance. Capital gain rates varied from a maximum of 20% in the early 1980s, to max rate of 28% due to the Tax Reform Act of 1986 and a tiered rate structure as part of the Taxpayer Relief Act of 1997. Through this period, tax deferred compounding added greatly to a financial bottom line. Most important to remember is that there?s a point when tax-deferred growth loses its firepower and an intelligent assessment needs to be made so that not every dollar saved gets funneled into tax-deferred accounts because?. **5). You forfeit the ability to diversify from a tax perspective.** You see, once you intend to re-create a paycheck and focus on portfolio distribution vs. accumulation, having the ability to draw from various buckets that are taxed at different rates or not at all, provides tax control. As opposed to having every dollar taxed as ordinary income and then forced to take large required minimum distributions at 70 • from retirement accounts, what if you had a bucket of after-tax dollars and Roth conversion IRA money to generate a retirement paycheck in the most tax-efficient manner? Five years from retirement is an opportune time to stop funding a traditional 401(k) and investigate your employer?s Roth 401(k) alternative or reduce contributions to pre-tax accounts to fund the coffers of after-tax alternatives. And finally. **6). An employer match isn?t ?free money? whatever that is. It may turn out to be a lid on earning potential and job satisfaction.** This may be a controversial point but my objective is to get you thinking. Yes, even I?ve been guilty in the past of calling an employer 401(k) match ?free money,? when I know (as well as you), nothing is free. What I?ve realized is that in some situations, a match is a chain to a job or career that creates mental distress or inhibits an employee from reaching his or her greatest human capital earnings potential. I hear it often: ?I need to stay at my job. My reasons are blah, blah, blah, employer 401(k) match.? Your employer receives a tax deduction for retirement plan contributions. The incentive for you is to stick around through a vesting schedule to collect them. The question is when you objectively assess where you are financially, the possibility of greater earnings potential (even if it means changing careers), and current job satisfaction, is a match truly worth it? Instead of considering what you gain from it, think about what you may be giving up. I?m not a raving fan of 401(k) plans as a primary focal point of wealth accumulation. In the financial services industry, we preach ad nauseum the diversification of investments but why do we rarely discuss the diversification of accounts? Many professionals are failing to help clients understand how having every investment dollar in tax-deferred accounts can be detrimental to financial health in retirement. It?s time they spent greater effort studying their craft and less time selling their wares which may mean financial experts need to consider a change of employment and join their brethren on the fiduciary side of the fence.