Zen and the Art of 401(k) Maintenance

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Here's how to get better returns in your retirement account: Pay as little attention to it as possible.

That was the conclusion of a study by the investment giant Fidelity, according to a 2014 article on Business Insider. The article relayed the transcript of a Bloomberg program in which the well-known money manager Jim O'Shaughnessy said that people who had forgotten that they had accounts outperformed everyone else.

Fidelity, which has received inquiries about the study ever since, without knowing why, told me this week that it had never produced such a study.

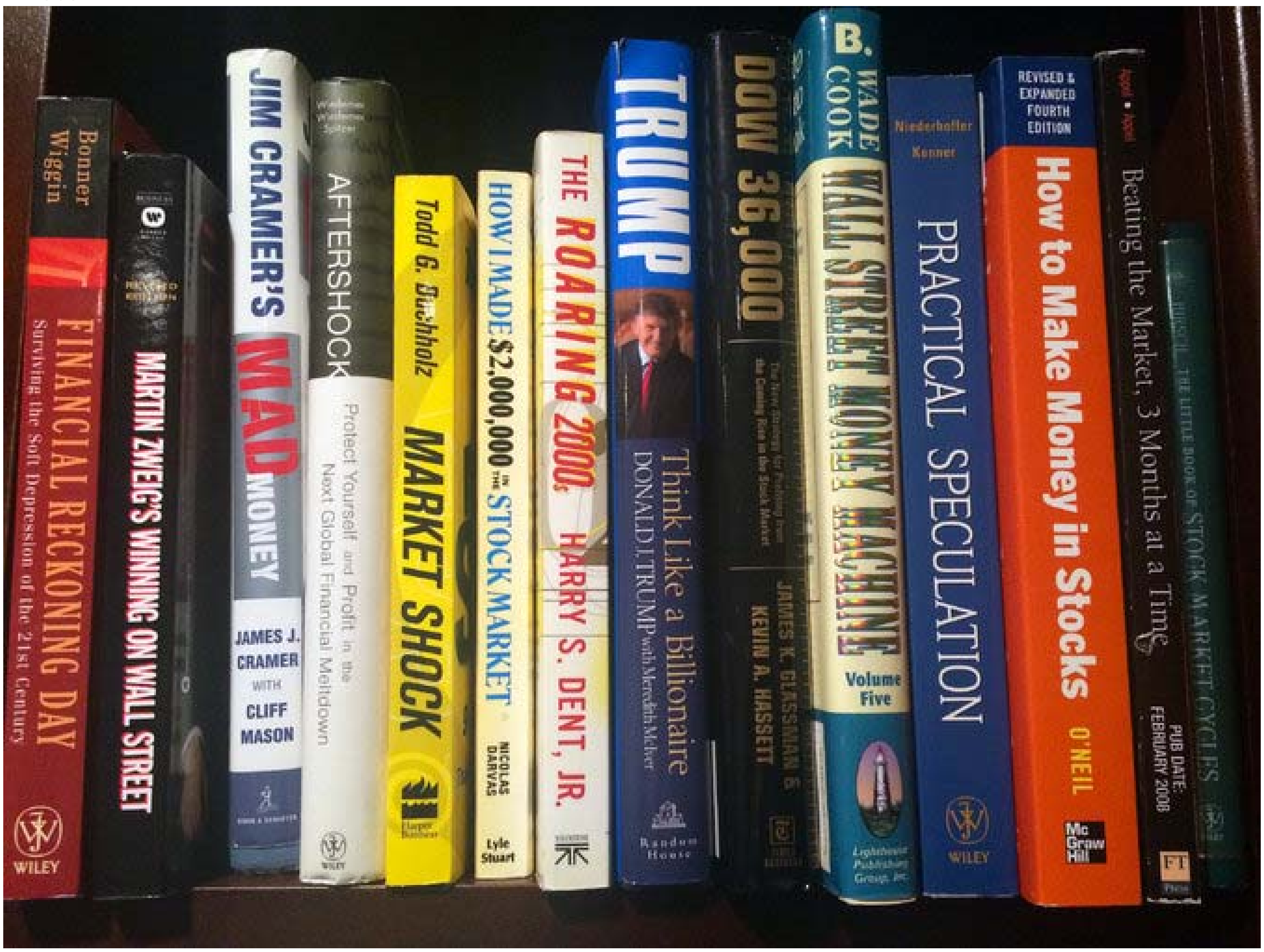
How disappointing, given how tantalizingly counterintuitive the supposed conclusion was: Perhaps chasing headlines and darting in and out of stocks and bonds as hedge fund managers do wasn't necessary after all.

But when the Standard & Poor's 500-stock index hits a record high, as it did on Friday, we ought to be reminding ourselves of the near certainty of stock market declines that will test us just as the ones that began in 2000 and 2007 did. The apocryphal Fidelity study still suggests two questions that we should all be asking ourselves: How often *should* we look? And if we do check the performance of our investments, how often should we make any changes?

Michaela Pagel, an assistant professor in the division of economics and finance at Columbia Business School, answers the first question as the phantom Fidelity researcher might: Check your account statements as seldom as possible, especially when markets are falling.

We humans tend to experience pain from losses much more acutely than whatever joy we might experience from an equal-size gain. “If you’re watching as the markets go down, you are twice as unhappy as you would be happy if they went up by the same amount,” Professor Pagel said. “So looking at the market is, on average, painful.”

Photo



So stop looking so much. Consider turning off paper statements and email notifications for retirement accounts that you won’t need to draw on for several years. Most people’s accounts fall into that category — even those on the brink of what will hopefully be a multidecade retirement. The less we look, the less tempted we'll be to act to try to alleviate that pain.

But many of us will look anyway. We are rubberneckers, masochists, cravers of information. We convince ourselves that since the facts are different this time, then perhaps our behavior should be, too.

So should we touch our investments the next time markets take a prolonged dive? This is something Fidelity actually has studied. After the stock market collapse in 2008 and early 2009, the company noticed that 61,200 401(k) account holders had sold all of their stock. So the company started tracking them to see whether that move would pay off.

Since then, 16,900 had not bought stocks in their retirement accounts through the end of 2015. About 13,000 of them are under 60, so they probably didn't just cash out and take early retirement either. Through the end of 2015, their account balances rose by 27.2 percent, including new contributions.

People who had at least some stock exposure, however, saw their accounts jump 157.7 percent. That left them with an average balance of $176,500, $82,000 more than the people who got rid of all their stock. Now imagine that $82,000 difference compounding over 20 or 30 more years, and think hard about whether you want to touch the stocks in your retirement fund the next time the markets fall far.

This is an extreme example but an important one, given that plenty of smart people capitulate when faced with the pain of looking too hard at fast-falling balances. Even when market moves aren't quite as severe, people still tend to fiddle with their holdings. In the second quarter of this year, 13 percent of Fidelity 401(k) account holders did so.

One group is not counted in those numbers, though: the people who keep all their retirement money in target-date funds. These funds are designed not to be touched, since they maintain a prescribed mix of investments that shifts slowly over the years as you age and need to take fewer risks. In other words, they buy and sell only when they are supposed to, according to the investment mix that corresponds to your age. And sure enough, only 1 percent of the Fidelity account holders in those funds made any moves during the second quarter. If this sort of investing is attractive to you, automated investing firms like Betterment and Wealthfront work in similar ways.

Left to our own devices, picking and choosing among a variety of funds, we're likely to change our minds often and flit in and out of things. According to Morningstar data examining 1,930 stock mutual funds over 15 years ending in June, the difference between what the funds would have delivered to steadfast investors and what the average investor (who did not hang around for that long) actually earned was 0.99 percentage points. That doesn't seem like much, but a one percentage point difference in returns can mean missing out on many hundreds of thousands of dollars in returns over the decades.

So why do we keep touching? It may be because it's so easy to fall under the influence of people who seem to know what they are talking about. In the "Seers and Seer Suckers" chapter of his new investing guidebook, "Heads I Win, Tails I Win," Spencer Jakab explains in fine and uproarious detail how consistently most of them fail to predict the future.

He should know, as he used to be one. A former top-rated stock analyst in what he describes as the "fortunetelling business," Mr. Jakab reveals in the book that he actually had no idea how his stock picks performed against any kind of market average, and still doesn't. No one at his firm kept track, and neither did he. He's now doing more honest work in the Wall Street Journal newsroom. He also keeps a shelf of books at home filled with what he believes is bad investment advice — just to remind himself how hard it is to achieve any kind of genius.

While Mr. Jakab did not repeat the legend of the Fidelity study in his book, it did show up on a Columbia University webpage promoting Professor Pagel's research. She hadn't known its origins either. (Turns out Mr. Shaughnessy first heard about it from a now former employee, who has not returned emails about where he heard of it, according to a spokeswoman.)

But when I told Professor Pagel that Mr. Shaughnessy's interviewer, Barry Ritholtz, had wondered whether the punch line to the study might be that the most successful Fidelity account holders were the dead ones, she thought he might be onto something. "Even if it's not true, it's actually true," she said. "Dead people can't get upset from seeing the market go down."