2002 Defined Contribution Plan Survey Shows Disturbing Trends

John Hancock's latest national survey of defined contribution plan participants tracking their investment knowledge and behavior shows disturbing trends: Basically, while most participants have learned to save, they haven't learned to invest. In a three-part series, Wayne Gates, general director, Market Research and Development, discusses the findings, implications for 401(k) plan participants and opportunities for financial services professionals.

In its continuing attempts to evaluate the expertise and behavior of participants of defined contribution plans (401 (k)s) John Hancock hired Mathew Greenwald & Associates to conduct a nationwide telephone survey of 801 people.

Basic Survey Parameters
Respondents were:

- chosen randomly from the population of 25 to 65 year olds;
- were currently contributing to their employer's retirement savings plan;
- and had a choice of investment options.

The interview included more than 60 questions and lasted about 20 minutes. Some questions assessed knowledge of investments, perceptions of the relative risk of investments, preparation for retirement and reaction to recent events. Last year, questions were added to see what people expect their retirement investments would earn in the future. This year, questions also assessed the desire for assistance in managing their retirement investments.

Demographics of the respondents are similar to previous surveys.

- 47% were female; 53% were male;
- Average salary was $62,000.
- Average age was 43;
- 48% had at least a college degree,
- And 59% were covered only by a defined contribution plan.

A General Lack of Investment Knowledge and Skill
"Each time we conduct a survey, I hope that results will improve, but they haven't," says Mr. Gates. "After eight surveys in 11 years, the results still show a general lack of investment knowledge and skill. Most participants remain unprepared to manage their retirement investments successfully entirely on their own."

Survey participants continue to show many of the same mistakes shown in previous surveys. For example:

- 40% still believe that money market funds invest in stocks (They invest only in short-term, highly liquid, relatively low-risk debt instruments sold by governments, financial institutions and corporations.).
- 78% don't understand the relationship between bond prices and interest rates
- And a growing percentage admits to knowing little or nothing about investing.

Says Gates, "Part of this may be because they spend so little time and effort - 50% say they spend half-an-hour or less a month managing and monitoring their retirement investments."

Good Savers, Not Good Investors
Gates notes that even though the 401(k) has made many participants good savers, most have not become good investors.

"The survey shows that the participants' responses and actions were not those of people with a good grounding in the fundamentals of investing. They don't rebalance their portfolios and they

say that they will do things that are indicative of chasing performance, or buying high and selling low. Luckily, however, many haven't followed through by doing what they said they would. Still, those few that did make changes were more likely to move or shift in the wrong direction."

In addition, even though respondents have reduced their return expectations, those expectations are still much too high.

"Respondents expect stocks to earn 16% per year over the next 20 years, which is down from nearly 20% per year from last year's survey, but still nowhere near the actual 10% historical returns from 1926-2001."

Market Volatility Causing Concern But Little Action …
While survey respondents realized that the stock market has become more volatile, and expressed concern about it, says Gates, they haven't done much to change their asset allocations in response.

"The share of respondents to each survey who some portion of their retirement funds invested in stocks has continued to rise – from 42% in 1992 to 76% in 2001 and 77% in 2002, so the growth rate has slowed."

More important, he says, is the average amount of retirement investments respondents say should be invested in stocks and principal-protected investments. From 1993 through 1999, the average intended allocation to stocks consistently increased, while that for the principal-protected investments consistently decreased. But both those trends reversed in the 2001survey and continued with that reversal in 2002.

"So there's a desire for more diversified and less risky portfolios. That desire also reinforces the notion that participants chase performance because the trends follow the higher performing asset class."

Gates notes that most plan sponsors and stable value managers have witnessed increased cash flow to stable value funds over the course of the past year as a result. "But, this is not the result of a huge shift out of stocks into fixed income; it's more likely the redirection of future contributions and relatively modest transfer activity."

More significantly, when asked if they have implemented and stuck to their asset allocation targets, a consistently growing share said no, with nearly three-quarters having more invested in stocks and nearly two-thirds have less invested in the principal-protected assets.

"Therefore," says Gates, "most portfolios remain over-weighted in stocks and under-weighted in fixed income, as respondents have not implemented their intentions."

… Which is Not All Bad
Ironically, that bad news may also be good news, says Gates. "The actions most respondents indicated they would take – if they acted – would be the worst action to take from an investment standpoint.

"First, we asked those with stock investments if they would change their investment strategy for a decline of 10%, of 20%, of 30%, or by any amount greater than 30%. We then asked those who would change whether they would buy or sell stocks after the decline, and whether they would contribute more or less to stocks after the decline.

"Nearly 80% say they would change their stock investment strategy for some level of a stock market decline. Unfortunately, significantly more said they would sell stocks after the decline and contribute less after the decline. Once again, they're saying they'd buy high and sell low."

But, he reiterates, that doesn't show in their activity levels.

"While the S&P declined by more than 10% in 2000 and by another 13% in 2001, the share of respondents transferring between investment options or changing future contribution allocations didn't really change. Once again, most participants didn't do what they said they'd do. Unfortunately, though, those who did were more likely to shift from stocks to fixed income, and by a margin of 3 to 2.

Has the Enron Debacle Affected Investment Decisions?
Since 1992, participants have been asked to rank the risk of the various investment options in their plans on a scale from 1 to 5, where 1 means no risk, and 5 means extremely risky.

"Company stock has always been considered less risky than either diversified domestic stock funds or international stock funds," says Gates. "Somewhat surprising, the relative rankings have remained the same and there has been no closing of the gap. And this is even though 90% of respondents were aware of the Enron situation and its bankruptcy."

He attributes that to the "halo effect of company stock" that has been clearly evident in all Hancock surveys.

"There appears to be the feeling of, 'Hey, that may have happened at Enron, but it couldn't happen at my company.'"

The ultimate conclusion, says Gates, "The recession and the stock market decline have created concern, but participant behavior has been characterized by a lot of talk but little action."

Next: *How well are people preparing for retirement?*