WASHINGTON, DC • BRUSSELS • LONDON • WWW.ICI.ORG

Asset Allocation and Continued Contributions Muted Effects of Bear Market on 401(k) Balances, September 2003

Asset Allocation and Continued Contributions Muted Effects of Bear Market on 401(k) Balances

Washington, DC, September 12, 2003 - Asset diversification and continuing contributions generally muted the effects of poor equity market performance on 401(k) accounts, according to new research released today by the Investment Company Institute (ICI) and the Employee Benefit Research Institute (EBRI).

The EBRI/ICI Participant-Directed Retirement Plan Data Collection Project is the nation's largest database on 401(k) plan participant accounts. The new report analyzes asset allocation, account balance, and loan activity information on the 15.5 million – about one-third of all participants – 401(k) plan participants in 46,310 plans in the year-end 2002 database. The study also provides an opportunity to evaluate changes in asset allocation and account balances among a large and representative sample of 5.3 million participants who held accounts since year-end 1999.

Account Balances

While broad equity market indexes fell 22 percent in 2002, the average 401(k) balance fell 7.9 percent among workers who have maintained accounts since year-end 1999. The average balance declined a total of 10.0 percent between year-end 1999 and year-end 2002 versus a 40 percent drop in broad equity indexes.

Average account balances vary by workers' age and job tenure. Older workers with longer job tenure tend to have higher account balances than younger workers and those with fewer years on the job. Changes in account balances also vary with participant age and job tenure.

- The average balance rose 4.3 percent in 2002 for workers in their twenties.
- For workers in their thirties, the average balance declined 6.2 percent in 2002.
- For workers in their forties, the average account balance declined 7.9 percent in 2002.
- For workers in their fifties and sixties, average account balances also declined in 2002, 9.0 percent and 10.0 percent, respectively.

Because contributions tend to be large relative to balances among younger workers and those with lower job tenure, their account balances tended to rise in 2002. Older age groups lost ground in 2002 because of the greater importance of investment returns as their balances tend to be large relative to their contributions.

Asset Allocation

The nation's 401(k) plan participants appear to have made few significant changes in the way they allocated their plan balances in 2002. Although the average allocation to equity investments declined in 2002 reflecting the performance of equity markets, the vast majority of 401(k) participants with accounts at the end of each year since 1999 appear not to have changed their asset allocation.

Overall, the largest share, 62 percent, of plan balances was invested directly or indirectly in equities at year-end 2002. Specifically, at year-end 2002, 40 percent of plan balances were invested in equity funds (equity mutual funds, commingled trusts, separate accounts, and any pooled investment primarily holding equities), 16 percent in company stock, 16 percent in guaranteed investment contracts (GICs) and other stable value funds, 9 percent in balanced funds, 11 percent in bond funds, and 6 percent in money funds.

Account asset allocations vary considerably with participants' age. Younger 401(k) investors tend to favor equity funds while older

401(k) investors are more likely to invest in fixed-income assets. At year-end 2002, individuals in their twenties had 51 percent of their assets in equity funds as compared to individuals in their sixties who held about 30 percent of their account balances in equity funds. With respect to fixed-income securities, participants in their twenties had only about 23 percent of their account balances in fixed-income securities (bond funds, GICs and other stable value funds, and money funds), while participants in their sixties held 48 percent of their accounts in such assets.

Loan Activity

Despite continuing volatility in financial markets and generally weak economic conditions, 401(k) plan participants' loan activity in 2002 was essentially unchanged from earlier years. Only 17 percent of eligible participants had outstanding loans at the end of 2002.