

Your 401(k) Could Be Costing You More Than You Think

NOVEMBER 22, 2021 ([HTTPS://OPTIONPIT.COM/YOUR-401K-COULD-BE-COSTING-YOU-MORE-THAN-YOU-THINK/](https://optionpit.com/your-401k-could-be-costing-you-more-than-you-think/)) BY MARK SEBASTIAN ([HTTPS://OPTIONPIT.COM/AUTHOR/MARK-SEBASTIAN-2/](https://optionpit.com/author/mark-sebastian-2/))

Hey Traders,

Saving for retirement is important.

And using tax-advantaged accounts is one of the BEST ways to help you save for retirement.

Traditional and Roth IRA accounts are great options that nearly anyone can open (there are some restrictions, especially for Roth accounts, which have an income cap) ...

But perhaps the most well-known is the almighty 401(k) ...

401(k) accounts offer tons of benefits ... especially if your employer offers to match a percentage of your contributions!

However, 401(k) accounts can have a hidden dark side ...

Are you paying too much to save?

Fees, Fees, Fees

Fees can be killer in a 401(k) ... especially if you opt for a high expense ratio fund.

Just like compound returns can be magical over the long-term ...

Fees can do just the opposite.

In fact, while 401(k) fees might not sound like much at first ...

When you do the math, they can cost you thousands of dollars over the years!

There's generally three types of fees you'll find your account subjected to: individual service fees, plan administration fees, and investment fees.

Individual service fees are fees that are charged for individual services on your account. For example, you may be charged a fee for taking a distribution from your account, or for taking out a loan from your account.

While pesky, since these typically are one-off transactions, they aren't quite as detrimental to your overall account balance as ones that accrue over time.

There's also administrative fees, or fees that your 401(k) provider charges in return for basic operating expenses such as record keeping, accounting, and so on.

If you're lucky, your employer might pay these fees for you.

However, it is more likely you're footing the bill in terms of either a flat-rate fee, or paying a percentage of your total balance.

This is something you will want to keep an eye on, especially if your administration fee is balance-based.

In general, you can expect to pay about 0.5% to 1% of your account balance in administrative fees each year (though of course some are lower, and some are much higher).

Obviously, the lower you can keep these administrative fees, the better, but you are often limited to what is offered through your employer.

What you CAN control, however, are the investment fees.

When you enroll in your 401(k), you'll be asked to allocate your contributions to specific investments, such as mutual funds, stocks, bonds, target-date funds, and so on.

This is where you want to really go through with a fine-tooth comb.

For example, in Plan XYZ, the expense fees may range from 1.20% to 0.04%.

Typically, something that requires more active management on behalf of the plan administrator, such as a target date fund, will have higher fees.

Index funds, such as Vanguard Mid Cap Index Admiral, often have significantly lower fees.



Now, the difference between a 1.2% and 0.04% might not sound like a lot on the surface ... after all, a 1.2% fee is still only just over a penny out of every dollar.

Small potatoes, right?

Not so fast.

Take a look at the difference in total fees paid over a 30-year period between a 0.04% and 1.2% expense ratio, assuming you deposit only \$5,000 per year. (By the way, you can find the calculator right here.)



The 0.04% expense ratio plan will cost you an average of \$3,418, while the high expense investment will cost you almost \$91,000 over the course of your savings timeline.

Now, 1.2% is a rather extreme example ...

So let's look at something a little more middling, like 0.6%.



That still works out to a difference of nearly \$45,000 more for the high-fee investment!

And if you contribute the maximum amount (currently \$19,500 per year, moving up to \$20,500 per year in 2022)?





That's a difference of \$151,002!

Now, you might say, "but Mark, my timeline isn't 30 years! I'm much closer to retiring than that. Is there that much harm in choosing a high-expense fund for a shorter duration?"



The \$7,567 difference may not seem as extreme as \$151,000 in the example above ...

But you're still paying \$8,116 for the high-fee, rather than the \$549 for the low-fee fund.

The argument, of course, is that these higher-fee funds will automatically rebalance for you. And that's true. If you're a very hands-off investor ... well, maybe you don't mind paying a super premium to have someone else manage your book for you ...

But, given that you're here, reading this, I don't think you fit the bill.

The other argument, of course, is that the high-fee funds will see better returns over the long-run.

This assumption is dubious, at best.

In fact, evidence that active funds outperform index funds is hard to come by, and often limited to just one or two specific sectors, like bonds or real estate.

So before you sign up for the super-high-expense fund, thinking that surely, it must charge so much because it outperforms ...

Think again.

Looking at a real-world example, a 2025 target date fund offered by a 401(k) provider who shall not be named, charges a 0.61% expense ratio.

It's 10-year average return is 8.92% ...

Meanwhile, a Vanguard Large Cap fund offered with the aforementioned 0.04% expense ratio has a 13.71% annual return.

Yes, we're skewed by the historic bull market we find ourselves in ...

But the chances of that trend reversing to the point where it's worth it to pay an extra \$151,000 over the course of my career to be in the ac managed fund is slim to none.

So I encourage you to pay extra close attention the next time you receive your 401(k) statement.

Don't overpay for services that aren't actually doing you a service.

Your Only Option,

Mark Sebastian

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