Midyear 401(k) Checkup: 3 Things To Do Before the Summer Ends

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Illustration by Kiersten Essenpreis

With the stock market hitting record highs and summer in full swing, it can be easy to forget your 401(k). But if you want to maximize your gains, investing experts say there are a few moves you should make before Labor Day.

According to Fidelity Investments, the average 401(k) balance was $103,700 as of the first quarter, an 8% increase over the previous quarter. Still, investment advisors say Americans are saving too little on the whole. Here are some steps to take to make sure you're taking advantage of the current market conditions — and shielding your savings from the next downturn.

See if you're overweight in stocks — and risk

If you haven't touched your mix of stocks and bonds in years, there's a pretty good chance that your allocations might reflect more risk than you want to take on, explains Dana Levit, owner of Paragon Financial Advisors. "It's a really good time to take a look at asset allocations," Levit says, "Because most people do sort of set it and forget it."

Since investment gains are re-invested back into your 401(k) holdings, a rally in equities can feed on itself. For instance, if you had 70% of your assets in stocks several years ago, that could have crept up to 75% or more by now. With the market at all-time highs, this can be good news for your bottom line — but it also could leave you more exposed than you might expect if stocks take a nosedive. "With these huge run-ups, you're going to see that the amount of stock allocation has gone up significantly, just because the market has," Levit says. "You may be even higher in stocks than you meant to be." If that's the case, you'll want to sell some stock funds and buy some bond funds to get your portfolio back to where it should be.

One caveat: you don't need to rebalance if all your money is in a target-date fund. These funds, which are pegged to your estimated retirement date, are professionally managed; the asset mix gradually becomes more conservative over time, as you approach retirement. Similarly, if there are major market disruptions, target-date funds are quickly readjusted back to a pre-specified balance with a more appropriate risk level, so you need not act, says Rich Weiss, chief investment officer, multi-asset strategies, for American Century Investments.

Don't try to time the market

With certain economic indicators flashing red, you may be planning to make your portfolio more conservative at the first sign of trouble. But a much better approach is to rebalance as needed and then stay the course, experts say.

"I do not try to time the markets," Levit says. Retirement savers shouldn't be day trading with their 401(k)s, either. For most people, it's more painful to lose money than it is to miss out on market gains, she says, which means we're prone to responding to emotional cues (and reactions like yanking all our money out of stocks) that might not make financial sense in the long run. You may feel safe with your money out of stocks, but if you stay on the sidelines you're going to miss the market's upswing when it happens.

Investment experts say this advice rings especially true today because there are a couple of factors that make it harder, and riskier, for an individual investor to game the system. The proliferation of algorithmic trading that relies on technology rather than human traders means that markets can turn up or down on a dime, while the growth in investment offerings that benchmark a particular index can make the market riskier out there for people trying to get out ahead of market swings.

Think of index funds as the SUVs of the stock market: If you're inside one, you're safer — but if you're playing fast and loose trying to whiz around and cut them off, you risk getting squashed. Because each of these funds is required to buy or sell in order to maintain a balance that mirrors that of the index they track, market volatility is magnified because so many players are trying to recalibrate at the same time.

Use tax math to suss out potential savings

One big advantage of traditional 401(k)s is that contributions are tax-deferred, but most people don't use that benefit for maximum leverage, says Jamie Cox, managing partner for the Harris Financial Group. The 2017 Tax Cuts and Jobs Act included a recalibration of the tax brackets, so figure out if you're in a new tax bracket — and how close you are to the income threshold for that tax bracket. There are charts that illustrate at a glance how the tax percentages and income thresholds have shifted under the new law. (Need to brush up on how to calculate your top marginal tax rate — and what that means in the first place again? We've got you covered here.)

"Review where you are relative to breaks in the tax brackets… to find out how much tax benefit can be gleaned by putting more in the 401(k)," Cox says. Since traditional 401(k) money is deposited pre-tax, it lowers your taxable income. If you're not contributing the maximum, and your annual household income is just above the threshold for a higher marginal tax bracket, an increase in pre-tax contributions that drops you down into a lower tax bracket could reduce the taxes that come out of your take-home pay.

Running "what if" scenarios with your contributions at different levels can show you if contributing more to your 401(k) might boost your retirement savings with little impact to your take-home pay, Cox says. For instance, if you're a single filer with net income of $45,000 in 2019, the top $5,524 of that is taxed at a 22% marginal tax rate (compared to the 10% and 12%, respectively, at which the first $39,475 is taxed). So if you can afford to sock away another roughly $5,500 into retirement savings, you can avoid having to pay the higher rate — and you might find that it's not as much of a hit to your take-home pay as you might expect. "If you're already spending the money, why not reallocate it?" he says. "You can sometimes get more mileage out of small contribution increases."