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focus on Retirement

Borrowing from Yourself—Not Always a Good Idea

Where can you turn if you need cash in an emergency? Some people turn to their 401(k) plans. After all, you're borrowing your own money and paying it back to yourself with interest.

But taking a loan from your 401(k) plan may put you at risk of not reaching your retirement goals. Before you take any money from your retirement account, take time to review its impact and the rules associated with 401(k) plan loans.

On the Plus Side

If your plan permits loans (and not all plans do), you'll generally be able to borrow up to half of your vested plan balance, capped at $50,000. Taking a loan from your plan may be easier and faster than getting a loan from a traditional financial institution. And you'll usually repay the principal and interest to your plan account through automatic payroll deduction.

On the Minus Side

The money you borrow will no longer be in your account benefiting from tax-deferred growth. Plus, you'll be repaying the loan with *after-tax* dollars.

That means the money used for repayment will be taxed *twice*, since you'll pay tax on it again when you withdraw it at retirement. And, if you have trouble contributing to your plan account while you're making loan payments, you might end up with less saved for retirement than you need.

And the *really* bad news? If you leave your employer for any reason, you'll usually have to repay the entire loan balance within 90 days or it will be considered a taxable distribution, requiring you to pay income tax on the amount of the loan. Furthermore, you may potentially owe a 10% early withdrawal penalty on the amount in addition to taxes.

Hardship Withdrawals: A Last Resort

If you're faced with a financial emergency and you've already borrowed all you can, you may be able to take a hardship withdrawal from your 401(k) plan account. You must have an immediate and heavy financial need, such as medical expenses that aren't covered by insurance.

You usually can withdraw the money you've contributed, but not employer contributions or earnings. You'll owe income tax and, possibly, an early withdrawal penalty. You won't be permitted to make contributions to your plan for six months after the hardship withdrawal is made. And, unlike a plan loan, withdrawals cannot be repaid to the plan.

Look at the Big Picture

When the stock market is especially volatile, you may find yourself focusing only on recent events. Large drops in the market are unnerving, and you may have considered moving out of stocks into less risky investments. Or maybe you've even thought about cutting back on the amount you're saving for retirement. Before you make any decisions, take time to look at the big picture.

The Long View

The economy and stock market tend to be cyclical. Past downturns often have been followed by periods of growth. Investors who didn't move their money out of stocks during previous lows had the opportunity to see their investments benefit from market increases. For example, from 1996 through 2015, the stock market* suffered four years of losses ranging from -9.11% (2000) to -36.99% (2008). Yet $1,000 invested for the entire period might have grown to $4,722.** If retirement is still a long way off, you probably have time to ride out market downturns.

Put Losses in Perspective

Paper losses are not real losses. When a fund's or portfolio's share price drops, it's only a loss on paper. It doesn't become a real loss until you actually sell the investment and move your money elsewhere. If you stick with the investment and it later rebounds, the paper loss may be erased — and you may even develop a "paper gain."

See Your Opportunities

There is a bright side to a downturn: When prices are down, your contributions can buy more shares. If stocks rebound, you'll then be positioned to benefit from the recovery. But, if you move your money out of stock funds, you might miss out on future gains.

Staying focused on your future is hard when the markets are jumpy. But keeping your eye on your long-term goals, maintaining an appropriate asset allocation, and continuing to contribute as much as possible to your plan will help you prepare for your retirement years.

* *As measured by the S&P 500, an unmanaged index of the stocks of 500 major corporations*.

** *Based on a hypothetical investment earning the same annual returns as the S&P 500, which carries no expenses. You cannot invest directly in an index.*

"Retirement—a time to do what you wanted to do, when you want to do it, where you want to do it, and how you want to do it"
- Catherine Pulsifer

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