San Francisco Chronicle

What does stock market's record high mean for your 401(k)?

More cash-strapped Americans tapped their retirement accounts to stave off foreclosure, cover medical expenses, or pay for tuition or funerals, even as experts say you should stay the course on investing in your 401(k).

By Carolyn Said
Dec 15, 2023

After months of turmoil and downturns, the good times are rolling again on Wall Street. Heartened by news of future interest-rate cuts, investors this past week drove up stocks, with the Dow Jones Industrial Average notching an all-time high and the Standard & Poor's 500 hitting its highest level since January 2022. The Dow is up about 12% for the year, while the S&P 500 is up 22.6% in 2023. Meanwhile, the tech-oriented Nasdaq Composite has risen more than 40% since Jan. 1.

For the average person, whose main stock market exposure is likely in their 401(k) retirement plan, this obviously is good news. Their portfolios are regaining losses incurred during the plunge that started last year. Those close to retirement or already depending on withdrawals from their accounts can breathe a little easier.

Overall, experts say, everyone should simply accept the normal ebb and flow of stock markets, rather than rushing to react to either ups or downs.

"It's a roller coaster right now for sure," said Peter Gallagher, managing director of Unified Retirement Planning Group in Westchester, N.Y. "My advice is to have a plan and stick to your plan."

Likewise, Sarah Behr from San Francisco's Simplify Financial Planning, said: "I would hope that no one stopped contributing to their 401(k) (during the downturn). You don't want to panic and make dramatic changes simply because of the stock market."

Of course, not everyone has the luxury of being able to stay the course. Among people scrambling to make ends meet, those who have a 401(k) may need to use it as a back-up plan for life emergencies.

Hardship withdrawals from 401(k) accounts rose this year. Cash-strapped Americans tapped their retirement accounts to stave off foreclosure, cover medical expenses, or pay for tuition or funerals, the main circumstances under which these emergency disbursements are allowed by the IRS.

Some 2.3% of workers took hardship withdrawals in the July-August-September quarter, up from 1.8% during the same quarter a year earlier, according to Fidelity Investments, one of the largest managers of retirement accounts, which handles 45 million IRA, 401(k), and 403(b) retirement accounts.

Meanwhile, loans from 401(k)s were also slightly up, Fidelity said, with 2.8% of participants borrowing from their accounts in the third quarter, compared to 2.4% a year earlier. Workers with outstanding loans now stand at 17.6%, compared to 16.8% a year ago.

This reflects a U.S. population in which only 63% of adults have enough savings to cover a $400 emergency using cash.

Alex Lawson, executive director of Social Security Works, which lobbies to protect and expand Social Security, Medicare and the like, said that the volatility of 401(k)s underscores the importance of those government benefits.

“401(k)s work incredibly well for the very wealthy,” he said. “For most everyone else, they won’t be adequate for a person’s retirement. You can outlive your savings, but you can’t outlive your Social Security. It’s forever and inflation protected.”

A surge in spending may be one impact of the rising stock market.

“As the stock market improves and they feel wealthier, people tend to spend more even if actual incomes haven’t gone up,” said Jesse Wheeler, senior economist at Morning Consult, a decision intelligence firm. “They feel more confident that they can spend a larger portion of their incomes.”

The reverse is true, too.

“When the stock market dips or we go into a recession, one mechanism that makes a downturn worse is that people begin to pull back on spending, as they are fearful an economic downturn will affect them,” he said. Then there are many people who may be forced to cut spending due to job losses or other circumstances.

That mindset can result in poor investment decisions.

“Historically people tend to sell when asset prices fall and buy when they rise, especially retail at-home investors who may not have the discipline or expertise to stick” with a plan, Wheeler said.

Data show that the retirement accounts that do best are those that are barely touched other than making regular contributions.

“The ones that perform the best are from people who forgot their passwords and were locked out,” Wheeler said.

Reinforcing that perhaps-apocryphal wisdom, overall stock market gains in the past five years have been unusually robust.

“On average over a 30-year period, we look for an 8% return in a 401(k),” said Behr of Simplify Financial Planning. “It was 20% annually over the past five years, including the downturn. It confirms that over 10 or 15 years, keeping your money invested — rather than reacting to a six-month or 12-month downturn — will be better.”

There are some ways people in or near retirement can manage their 401(k)s to protect against downturns, experts said.

“We help people set up ‘buckets’ so they have fixed income, like individual bonds or bond funds,” Gallagher said. “If they need to make withdrawals, then they’re not having to take money out (of equities) in a down market, which could be a terrible thing to recover from. It takes some guesswork out of what to do if the market goes down and you have to take money out for retired minimal distributions or living expenses.”

While consumer confidence usually rises in conjunction with a surging stock market, right now that is being tempered by the nose-bleed hikes in the costs of, well, just about everything. “Inflation has crowded everything else out in the minds of consumers,” Wheeler said.

Reach Carolyn Said: csaid@sfchronicle.com; Twitter: @csaid