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Treasure or trap

Multitude of choices can be bane of many who invest in self-directed retirement accounts

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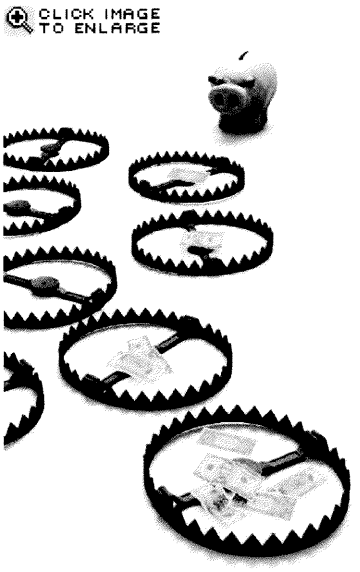
By PAMELA YIP / The Dallas Morning News

Tired of what seems like the poor handful of mutual funds available in your 401(k)?

You may have more choices than you think when it comes to saving for retirement.



TROY OXFORD/Staff Illustration

With something called a self-directed IRA, you can invest in any mutual fund you want, in individual stocks and bonds – even in real estate.

The question, of course, is whether it's a good idea to send your retirement funds into such a minefield of risk. A self-directed Individual Retirement Account can go a long way in setting you up for a comfortable retirement – or, if you don't know what you're doing, it can forever assign you to the poorhouse.

For someone just starting out, the 401(k), or 403(b) plan for teachers, remains the best way to build a portfolio. And savers should always take advantage of the investment match that many companies offer in 401(k)s, even if the only choice to invest it is in Manny's Money Market fund.

Moving into a self-directed IRA as a way to supercharge retirement savings because you've gotten a late start in saving would be asking for trouble.

"The self-directed IRA is not a good starting point for someone just beginning retirement savings," says Greg McBride, senior financial analyst at Bankrate.com, which tracks consumer interest rates. "The self-directed IRA is a better alternative for the investor who has a well-diversified and properly allocated retirement portfolio, such as a 401(k) or existing IRA."

LEVELS OF CONTROL

Little control: Your 401(k) is "self-directed," in a way. Even if you have few choices, you can move your money between funds based on market conditions.

More control: In an IRA, you have more choices of mutual funds, and depending on whom the account is with, you may be able to buy individual stocks.

Don't get out of control: Some specialty advisers are advertising full "self-directed IRAs" that let high-net-worth individuals invest in businesses and real estate while maintaining the tax advantages.

DO-IT-YOURSELF INVESTING

Although the Individual Retirement Account has been around since 1974, some people still don't grasp its essence.

"I still have people who say, 'Where do I buy an IRA?' " says Bryan Clintsman, a certified financial planner at Clintsman Financial Planning in Southlake. "They don't get it that it's an account. You get to choose who holds the bucket, and you get to choose what to put in it."

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VERNON BRYANT/DMN
Dana Jurak has taken an adventurous route with her IRA, investing in a beachfront lot in the Virgin Islands.

For most folks saving for retirement, that means following the advice of a financial adviser and putting the money in a few well-balanced mutual funds.

That's what Michael Kleiman does.

"I don't believe that I'm smart enough or willing to spend the time to do a better job than the folks who are doing it professionally," the Dallas marketing manager says.

But others are more adventurous. Specialized advisers are advertising "self-directed IRAs" that let usually high-net-worth individuals set up tax-advantaged accounts to invest in businesses and real estate.

That's what Dana Jurak did.

"It's a relatively complicated process, and when you choose to put your money in a self-directed IRA, you'd better have a pretty good handle on the direction," says Ms. Jurak, who lives in the town of Lucas in Collin County.

She and her husband, Scott, who own Jurak Remodeling in Plano, bought a one-acre beachfront lot in St. Croix in the U.S. Virgin Islands by joining with six other family members and establishing a limited liability corporation. They used money from eight separate IRAs to buy the land.

"Make sure you educate yourself," Ms. Jurak says. "You could lose everything. You have no guarantees whatsoever."

There are many restrictions over what type of real estate you can put in your IRA, and if it's not structured properly, you could be surprised by tax penalties that wipe out your IRA.

"It's not for most people, and especially for the average investor," says Ed Slott, a certified public accountant and IRA expert in Rockville Centre, N.Y. "You could end up unknowingly engaging in a prohibitive transaction, and you could lose your IRA."

Simple vs. complex

When investors aren't getting what they want from the financial markets, they search elsewhere for fatter returns. That has sent some into complicated accounts like Ms. Jurak's.

But a self-directed retirement account doesn't have to be that complex. Someone saving for retirement can exercise more control even in a typical 401(k) or IRA.

Many companies offer a "brokerage window" for 401(k) savers that lets them buy individual stocks. And some mutual fund companies and brokerages now let IRA investors shop at a fund "supermarket" – that is, invest in funds outside the company's offerings.

But before the average investor wades into the world of more choices, experts advise caution.

First of all, during the early years of building retirement assets, savers should use no-load mutual funds as their primary investment vehicle, says Greg McBride, senior financial analyst at Bankrate.com, which tracks consumer interest rates.

"It gives them access to and diversification within a large class of stocks or bonds with a very modest investment. ... Individual investors tend to trade excessively, increasing investment costs and eroding returns."

Buying individual securities also won't give you the diversification and proper asset allocation you need in your retirement account.

"If someone has never had a self-directed account before, they should take things slow," says Michael Busch, president of Vogel Financial Advisors in Dallas. "There is often a temptation to start wheeling and dealing in individual securities. For some, the euphoria of being right on a few picks is intoxicating."

Before deciding what to put in your IRA, make sure you're participating in your employer's 401(k), especially if it matches your contribution.

Then look to an IRA if you have funds left over for savings.

Tax efficiency

"The key is to think about what that IRA wrapper offers you and plan to take advantage of the benefits that it offers," says Christine Benz, associate director of fund analysis at Morningstar, a mutual fund research firm. "The key thing you want to take advantage of is the tax deferral [of the traditional IRA] or, in the case of the Roth IRA, the tax-free compounding."

Tax efficiency is important because you want investments that won't cause you to pay a lot of taxes. But never let that be your major consideration.

"It makes sense to consider placing inside your IRA account – or other tax-sheltered account, if you have one – those funds that tend to kick off a lot of income and capital gains," Ms. Benz says.

For example, individual bonds and bond mutual funds tend to throw off a lot of income, which would be taxed at your ordinary income tax rate. Don't look at your IRA in isolation from the rest of your retirement assets. You need to have a complete picture of where you stand so that you can coordinate your savings moves.

"Look at asset classes that are underrepresented in your company plan and think about adding exposure to those sorts of areas," Ms. Benz says. "If the plan doesn't have much in the area of good quality international stock exposure, you might want to add that" in the IRA.

Of course, even though you have the final word on what goes into your IRA, it's wise to work with a financial adviser to help pick the investments.

"My advice would be to make sure that people you're working with have a sincere interest in your account," says Wyatt Truscheit, finance chief at a Dallas software company, who has a self-directed IRA at Merrill Lynch. "The most important thing is to make sure that you're in alignment with whomever your adviser is."