

Stable Value Funds OK In Bear Market, But Are They Safe?

By Sandra Block, USA Today

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Before you open your quarterly 401(k) plan statement, plan ahead. Take a few deep breaths. Put away knives and other sharp objects. Turn up the radio so your children won't hear your cries of anguish.

Once you've stopped sobbing uncontrollably, you'll probably notice that few of your investments have been spared by the bear market. Large-company stock funds, small-company funds, international funds, even bond funds. Down, down, down.

But amid the gloom, you may detect a ray of sunshine: your plan's stable value fund. These funds, which are offered by most large 401(k) plans, were up an average of 5.2% through September, according to the Stable Value Investment Association.

Like bond funds, stable value funds typically invest in corporate and government bonds. In addition, though, they buy contracts from banks and insurance companies, known as wrappers, that guarantee the principal and accumulated interest even if the underlying investments decline in value.

Stable value funds invest in high-quality bonds with an average maturity of 2.8 years, says Gina Mitchell, president of the Stable Value Investment Association. This enables them to deliver better returns than money market funds, which typically invest in fixed-income securities that mature in 30 to 90 days, she says.

Concerned investors

Unable to stomach the stock market's violent behavior, investors have flocked to fixed-income investments, including stable value funds.

In September, 401(k) plan investors moved \$921 million out of equities into fixed-income investments, and nearly 70% of that amount went into stable value funds, according to the Hewitt 401(k) Index, a barometer of investment activity in large 401(k) plans.

But after the government bailout of insurance giant AIG — and reports that other insurers are having financial problems — some investors are concerned about the stability of stable value funds. While losses in stable value funds are rare, the funds aren't guaranteed by the federal government.

Does that mean you should worry about your stable value fund? Probably not.

First, the assets in a stable value fund are owned by the 401(k) plan, not the banks and insurance companies that provide the wrap contracts, Mitchell says. If a wrap provider filed for bankruptcy, creditors wouldn't have access to the stable value fund's assets, Mitchell says.

In addition, the typical stable value fund has up to 10 different wrap providers, according to the Stable Value Investment Association. Consequently, stable value funds "typically have low exposure to any single wrap insurance company or bank," says Kelli Hueler, chief executive of Hueler Cos., which tracks stable value funds.

Finally, the funds are available only in tax-deferred savings plans, such as 401(k) and college savings 529 plans. That makes them less vulnerable to a "run" by nervous investors, says David Wray, president of the Profit Sharing/401k Council of America.

In September, massive withdrawals from money market funds led the Treasury to temporarily guarantee assets in those funds. That's less likely to happen to stable value funds, Wray says, because 401(k) plan participants have only two choices: move the money to another fund in their plan or take the money out, which would trigger taxes and early-withdrawal penalties.

Drawbacks to stability

While returns from stable value funds have remained relatively, well, stable over the past five years, declining interest rates could lead to lower returns in the months ahead, Hueler says.

Even so, some shell-shocked investors may be tempted to seek refuge in their 401(k) plan's stable value fund. If you're still many years from retirement, though, a stable value fund should occupy only a small slice of your 401(k) plan, Wray says. Otherwise, your returns may not keep up with inflation.

In fact, if you use a stable value fund for the fixed-income portion of your portfolio, you can invest more money in stock funds, Wray says. That's because even a modest investment in a stable value fund will reduce volatility in your portfolio, he says.

Of course, if the stock market ever comes roaring back, your stable value fund will be left in the dust. But that's the price you pay for predictable returns.

When you invest in a stable value fund, Mitchell says, "You give up some of the upside for downside protection."