Stable Value Funds

One of the advantages of participating in a 401(k) plan is the possible presence of a stable value investment option. Stable value is a fixed income investment, like a bond, but the value of your original investment amount does not change. For the fixed income aspect of your 401(k) asset allocation, stable value funds are an important investment choice because they provide a higher rate of return with virtually no risk.

Like short-term or intermediate-term bond funds, stable value funds may be invested in U.S. government and agency securities, corporate bonds, and mortgage and asset-backed securities. Unlike bond funds, however, they may also be invested in interest-bearing contracts purchased directly from banks, insurance companies, or mutual funds, which guarantee to maintain the value of the principle and all accumulated interest. These also are called guaranteed investment contracts (GICs). The stability in all of these kinds of stable value funds is that they do not go down in value. By contrast, the value of bonds or bond funds can drop if interest rates increase, or rise if interest rates go down.

Stable Value Investments

Stable value fund investments are considered very steady and have remained at an average 4.8 percent rate of return for the past five years. Over the last 25 years, the highest 5-year average rate of return was 11.5 percent, and the lowest was 4.8 percent, as shown in Figure 7.1. While stable value returns are subject to changes on a quarterly basis, they rarely fluctuate more than 1 percent a year. In fact, stable value yields for the next year are fairly predictable and should be quoted to you by any fund you are considering as an investment.

Figure 7.1: Historical Rates of Return for Stable Value Funds

Year	Return	Year	Return
1978	8.5%	1993	7.0%
1979	8.4	1994	6.5
1980	9.4	1995	6.5
1981	10.1	1996	6.1
1982	11.4	1997	6.2
1983	11.2	1998	6.1
1984	12.0	1999	5.9
1985	11.9	2000	6.5
1986	10.9	2001	6.2
1987	9.8	2002	5.6
1988	9.0	2003	4.7
1989	9.1	2004	4.3
1990	8.8	2005	4.4
1991	8.5	2006	4.8
1992	7.8		

Stable Value annual returns from PSCA Annual Survey, 1980-1999. 2000-2006 numbers are from Hueler Companies.

Stable Value versus Other Funds

While the stable value option has been likened to bond funds and money market funds, stable value funds have the positive attributes of both kinds of investments with few drawbacks. Stable value investors receive interest income comparable to that earned on a shortterm or intermediate-term corporate bond fund, but stable value provides more diversification. This allows for less market risk than bond funds, which have risen and fallen alongside equity investments. Stable value funds may also incur less expense than bond funds, which have an average expense ratio of 1 percent, compared to 0.3 percent for stable value funds. In comparison to money market funds, stable value investments have equal liquidity and stability, but significantly higher average interest rates (1 to 2 percent more).

While stable value investments provide a good rate of return, they are no substitute for stocks. However, when used in conjunction with equity investments, stable value funds lower the overall market volatility risk of your portfolio. Replacing the fixed income aspect of your asset allocation (such as bond funds) with stable value choices allows you to devote more of your assets to equity investments, which increases your return, without increasing your risk.

Transfers and Withdrawls

When you transfer your stable value assets into another fund in your 401(k), movement of your assets into a money market fund may be restricted, require transfer to an equity for a limited time first, or involve a penalty. These rules are used to prevent you from constantly switching in and out of stable value funds, as this defeats the purpose of the investment as a long-term generator of earnings.

In general, stable value investments have no withdrawal restrictions other than the plan withdrawal rules for 401(k). Stable value investors usually have access to their accounts at full value for withdrawals and transfers without penalty. However, because some stable value funds are purchased contracts, in special cases the plan itself may impose additional withdrawal restrictions to comply with the terms of the contract. This may delay a distribution of your funds when you leave the plan.

Who Invests in Stable Value?

If your primary investment goal is to minimize any potential loss of money or to provide income, you may want to consider a stable value fund. Older plan participants invest a greater percentage of their 401(k) assets in the stable value option than younger employees. Why? For anyone nearing retirement, or retired but retaining their funds in their former employer's 401(k) plan, stable value funds make sense. These participants may not be able to keep as much of their investments in equity because of a shortened time horizon that makes them more vulnerable to short-term market fluctuations. At the same time, they need to earn a predictable rate of return that will provide them with income in retirement. At a time when participants are changing their asset allocation to more conservative choices, stable value funds provide security along with a steady, high rate of return. If you are approaching retirement, make sure to find out whether you can leave your 401(k) assets in your plan after you retire to take advantage of the stable value option. However, keep in mind that a 65-year-old retiree with a life expectancy of more than 20 years may need growth in their assets as provided by equities and should not exclusively invest in fixed income investments.

Stable value funds are also useful for 401(k) participants who are uncomfortable with the ongoing ebbs and flows of the stock market. If a sudden downturn has made you feel insecure, having some of your money in a stable value fund may provide you with more confidence in the stability of your portfolio because the value of your original investment amount does not change.

If you are thinking of saving more in your 401(k) and are concerned about market volatility, put your new savings initially into the stable value fund. After you have been a 401(k) investor for a time, you will observe that stock market ups and downs are short term. Because of your stable value investment, you will feel more secure investing more of your 401(k) assets for long-term growth.

How Secure Are Stable Value Funds?

There are rules governing how companies can invest stable value funds, and there are contingencies so that 401(k) participants will be fully compensated. In isolated incidents where stable value fund assets were not immediately available, 401(k) participants were eventually made whole.