Owning your company's stock, toxic or not?

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NEW YORK (Reuters) - Buying stock that then falls sharply is painful, especially for investors who also happen to be company employees.

Some workers at Chesapeake Energy are experiencing that pain now.

Overall, 38 percent of Chesapeake Energy's Savings & Incentive Stock Bonus Plan - the only 401(k) plan available to the majority of the firm's employees - is in company stock, far above the 10 percent many plan consultants advise.

Chesapeake stock, hit by revelations about Chief Executive Aubrey K. McClendon's business dealings, had fallen nearly 40 percent from highs of $25.58 in March to Monday's close. The shares were down another 7 percent in Tuesday afternoon trading to $14.41.

Even after scandals at Enron and MCI WorldCom derailed the retirement plans of employees who had large stakes of their assets invested in company stock, U.S. workers continue to put their retirement money into the same places where they draw their paychecks.

Financial advisers say employees like to invest in their employers for several reasons, including loyalty, hopes to profit from their work and a sense that they have a better read on the company than ordinary investors. But many advisers say that the practice increases the risk of losing your job and your retirement savings at the same time if your employer fails.

We spoke with David Kudla, the CEO and chief investment strategist at Grand Blanc, Michigan-based Mainstay Capital Management, about loading up on company stock.

Q: How popular is it for your clients to invest in company stock in their 401(k) plans?

A: We don't see it as often as we used to. There are a lot of companies that, for fiduciary reasons, have taken the option of company stock out of plans. What's happened to almost every company I know of that had a bunch of company stock in their plan (is that) a bunch of lawyers got together when it went down 40 percent or more and filed a class action lawsuit. That said, we still do see clients with 50 to 100 percent of their assets in company stock.

Q: What should be considered too much when it comes to company stock?

A: We need to get that position to be less than 10 percent of the portfolio. If the company is growing and doing well, 5 to 10 percent could be fine -- as long as it's part of a portfolio with broadly diversified mutual funds. But if the company is under financial distress, then it should be closer to none.

Q: Say a client comes in with 50 percent of assets in the shares of company where he or she works. What's your process?

A: Let's take Ford as an example. People came to us with a considerable amount of Ford stock in their portfolios in the fourth quarter. We specifically didn't sell it aggressively and instead said: "Let's let the price improve a little bit."

We use what we call value averaging, which is essentially looking for intermediate tops in the stock as chances to sell. Not that we can call all of them. But people who came in with Ford at $9 were able to wait and sell it for $12 a few months later. We think it's important to get out of the position in weeks or months, not days.

Q: What kind of pushback do you get from clients?

A: Many of them feel like their company is the one investment they know pretty well. For some people, they've used their 401(k) for years as a trading vehicle. They've been doing things like going in and out of the company stock fund, selling on a Friday and buying it again on Monday. Their thought is that if you're doing it in a 401(k), not only are you not paying capital gains but you're doing it commission-free.

If we're managing that account, then they're coming to us to take over. If all you want to do is trade your company stock, then you don't need us. We don't want any part of that. We want to build diversified, long-term portfolios that will last.