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Don't over-invest in company stock

October 29- The testimony of former Enron employees at the sentencing of ex-CEO Jeffrey Skilling this week is a stark reminder not to invest too much in your company's stock.

Thousands of workers believed in Enron, acquired the energy company's stock and lost everything. Even if a business doesn't go through bankruptcy like Enron, workers with too much company stock expose themselves to unnecessary risk.

"It's a very significant problem," said Pamela Hess, director of retirement research at Hewitt Associates, a human resources consulting firm. "The upside benefit isn't worth the downside risk."

The number of plan sponsors offering company stock as an investment option in a 401(k) plan dropped to 8 percent in 2005 from 24 percent in 1999, according to a 2006 report by Hewitt. However, three quarters of the larger plans offer company stock, and when available, company stock accounts for more than 37 percent of employees' 401(k) assets.

Hewitt also found that the longer the employee's tenure, the higher the concentration of company stock. A quarter of participants with 30 or more years of tenure had invested half or more of their 401(k) balances in company stock, according to Hewitt.

That's risky. Not only can companies go into bankruptcy, but the stock could also deteriorate slowly, or simply stagnate while other investments continue to gain.

"The company has risks on two counts," said Stephen P. Utkus, principal at the Vanguard Center for Retirement Research. "It could go bankrupt, but it also could massively underperform for years."

Employees often resist diversifying out of company stock from a sense of loyalty.

Many Ford Motor Co. employees invested heavily in the 1990s when the company stock was performing well. At the end of 2005, the Ford 401(k) plan had $11.79 billion in assets, of which 22.5 percent was in company stock, said David Kudla, chief executive at Mainstay Capital Management LLC of Grand Blanc, Mich., which provides investment advice to hundreds of workers in the plan.

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But the return on Ford stock including dividends was a negative 11.02 percent, annualized, over the five years ending Sept. 30, according to Morningstar. Most mutual funds did far better. Consider that Ford recently announced it would pull the Fidelity Magellan Fund from its 401(k) plan. The fund had an average annualized rate of return over the last five years of 4.34 percent, and 8.98 percent for the last three years -- underperforming the Standard & Poor's 500 Index, but outperforming Ford stock.

Diversification is a key financial principle. Stuart Ritter, a financial adviser with mutual-fund manager T. Rowe Price Group Inc., said, "We tell people to have no more than 5 percent to 10 percent in any single security. And if you have stock in your company, that should be at the lower end of the range."

He said investors forget that by "buying that much in one stock, you're taking on a lot more risk without getting more reward for it."

While employees frequently amass large amounts of company stock by choice, they also may get it when the company matches 401(k) contributions with company stock. Workers incorrectly assume that company stock is less risky.

"They feel that if there's one stock they know, it's their company stock," said Kudla of Mainstay. "Employees think they have a feel for where the company is going."

But as the Enron collapse shows, many don't. In 2001, almost 60 percent of Enron's 401(k) plan assets were in company stock. At its peak, the stock traded at $90 a share. The bust wiped out thousands of jobs, billions of dollars in pension plans and all Enron's common stock, which is no longer traded.

Litigation over falling company stock is becoming more widespread, said Robyn Credico, national director of defined contribution consulting for Watson Wyatt. As a result, some businesses are eager to educate workers about diversification.

Many companies, Credico said, are even limiting the amount employees could invest in company stock. They're also offering managed account options, which though more expensive than company stock, which doesn't incur management fees, automatically reallocate 401(k) investments.