Preface

Dad, Have a Great Time on Vacation

A blessing, a curse, or a way of life…I'm not sure what I'd call it, but as long as I can remember I have always approached things from a practical, reasonable man's perspective. For the most part, my major career, financial, and personal decisions have been rational ones, taking a commonsensical viewpoint.

As with many personality traits, it's hard to say where they stem from. Is being practical genetic or a result of one's environment? If you knew my parents you would conclude that I not only inherited the "practical gene", but that it was hammered into my head, particularly by my dad.

Being the first born of immigrant parents, my dad grew up in a modest home in Montreal, Canada, with conservative values. Speaking no English and with little money in his pockets, my grandfather (my father's father) emigrated from Russia to Canada at the age of 16. He had no formal education and got a job in the clothing industry (aka "the shmata business"), ultimately owning his own business making women's dresses. My grandfather worked hard to see that his two children got the formal education he never did and he encouraged them to become professionals. My dad pursued the career of an ophthalmologist; a career that required much higher education and specialized training.

My dad's upbringing certainly had a significant effect on his psyche as he was both consciously and subconsciously determined to pass along all his practical wisdom to the next generation. The advice he imparted to me and my siblings during our formative years was practical in nature, covering many areas. Like many parents from his generation, most of the advice involved avoiding the worst case scenario.

On buying a car for a child: "Get a Volvo…it's a very safe vehicle." *Yes, I drove a Volvo in college and fortunately never had an accident.*

On purchasing clothing: "Buy a lot of the same color and type of socks so if you lose one or get a hole in it, you can always match them up." *I've got a drawer full of blue and beige Gold Toe socks that I can match up at a moment's notice.*

On avoiding luggage theft: "Mark the outside of your luggage with bright colored duct tape so you can tell it's your bag on the carousel. Someone else won't go walking off with it!" *Still can't bring myself to do this "I just don't care anymore" move; maybe when I'm over 50.*

As you can imagine, my dad's career advice also reflected his conservative upbringing and practical nature. "Become a professional of some kind with some credentials after your name in case you ever need to put up a shingle to work." *This turned out to be particularly prescient advice as I became a Chartered Financial Analyst in 1996; a professional credential I utilized to start SMS Capital Management in 2002.*

On being successful in one's chosen career: "If you do a good job and are consistent, you will succeed no matter what. You will have to try and screw up." With this philosophical outlook, he boiled the ability to succeed down to two things that were well within one's control: consistency and dependability. They were his formula and he proved it to be a successful one for him.

He viewed intelligence as important, but not the deciding factor in one's success. He told me about how he never viewed himself in school as necessarily the smartest guy in the class, but he worked hard and liked to hang out with the smartest guys in the class. He figured that that they would help drive each other to do better and "carry each other along with the rising tide."

With regard to financial and personal finance matters, both my parents were also conservative and practical, but not very experienced. My parents owned their home and built a successful ophthalmology practice (my mother, a former nurse, managed my dad's practice for many years), but were not much into investing. My dad's conservatism led him to shun debt and stay clear of risky investments and the opportunistic promoters that pitched them. That's not to say my parents did not take calculated risks.

In their early 40's, after spending ten years building up a successful practice in Toronto, Canada, my parents decided to move our family to Houston, Texas. They did their research before moving and assessed their upside and downside scenarios. They figured it would take a few years of living off of savings while my dad built up his practice and reestablished himself. If things went well he would be earning more than he could have in Canada where socialized medicine was beginning to cap his earnings potential. The downside, if it came down to it, meant moving back to the safety of Canada and rejoining his old practice. Ultimately, my parents decided that moving to the land of opportunity was a risk worth taking. So, in the summer of 1978, we moved to Texas in search of a better life.

Thankfully, after a few years my dad's practice began to thrive. Over the next thirty something years, he along with the help of my mom and some key staff, built up a successful practice that he ultimately merged into a larger eye care institute. Indeed, moving to Texas was a decision my parents have never regretted and it ended up being a very smart calculated risk for them.

One of my favorite stories about my dad's inherent pragmatism and need to assess risks and plan accordingly was when he and my mom were getting ready for their vacation to Italy. I was in college in Austin at the time, but was visiting them back in Houston over the summer break. The evening before they left, my dad summoned me into his room.

"Looks like you're about ready to go," I said.

"We're getting there," he said in his dry, serious tone.

Then, he looked me in the eye and said, "In the event that anything happens to us while we're away, I want you know where we keep all our important papers and documents."

Over the years, I'd been in their room a lot and seen him open and close his filing cabinet drawers, putting things in and taking things out. I never really got into thinking what he was filing and he never offered up any information. Of course, when you're a kid, you don't particularly care too much about your parent's paperwork either. However, it wasn't lost on me that other than the bathroom doors; my dad's filing cabinet was the only other thing inside the house that was ever locked.

He opened up his second desk drawer and reached deep in the back. He pulled out an old worn-out leather key chain case. He unsnapped the case and opened it up. There were five keys of various shapes and sizes in it. He picked out the small silver one in the middle and proceeded to open up the top drawer of his black fireproof filing cabinet. In it, all his records going back since the beginning of time, including tax returns, insurance forms, bank statements, etc. They were all nicely alphabetized and neatly filed away in clearly labeled white manila folders.

"Everything you need will be in this drawer," he said.

I'd already had my bar-mitzvah, but at that moment I truly felt like I had become a man in my dad's eyes. He now had enough confidence in me to grant me access to his coveted filing cabinet.

"Okay," I said, not sure how else to respond.

And with that, he closed the filing cabinet door, pushed the lock back in, folded up the keys, and hid them deep in his desk drawer. Then he moved on to other pressing matters. "You know there's a lot of pick pockets in many of the tourist areas of Italy we'll be going to," he said with a baiting tone.

I advised him that concerned tourists like him should wear money belts to protect their valuables while travelling abroad.

"Money belts are predictable and can be easily accessed if you're in a swarm of people," he said dismissingly. "My friend had someone cut a hole in his backpack and stole his money when they went to Italy last year," he added.

He proceeded to lift up his pant leg to expose a grey, calf-high sock, and his trademark Wallabee shoe.

I immediately noticed the big bulge in his left sock. “Is that a wallet in your sock?” I asked with amusement.

“Yep, what do you think of that? And just to throw them off my trail, I’m going to carry this other wallet in my pant pocket.” He pulled out a cheap Velcro wallet that you’d take to the beach with you and stuck it in his back pant pocket.

“A decoy?” I asked.

He started laughing with pride. “That’s right,” he said with a look of satisfaction on his face.

Having a second decoy wallet in his pant pocket and his real wallet safely tucked away in his sock was what my dad needed to feel that he was prepared for the roaming bands of pick pockets he would surely encounter on his trip. To my dad, it was perfectly rational to carry around both a real and fake wallet. Whether or not the wallet in his sock was uncomfortable or even necessary is irrelevant. Taking control of a possible situation by placing his real wallet in his sock would help him handle something outside of his control, such as running into a mob of thieves. By doing this he was able to relax, relieve his anxiety, and enjoy his trip.

Unfortunately, practical guys like me and my dad generally don’t get rich quick. We tend to build wealth gradually and prudently over time. The upshot is that while economic losses and other setbacks will undoubtedly occur over time, they are unlikely to capsize the ship. Your wallet in the sock prevents that from happening. In fact, adverse events may even turn into opportunities if you are properly prepared to seize them. In my dad’s case, pragmatism and his wallet in the sock has served him well. He recently retired and now enjoys his days surfing the internet, sending out emails to friends and family warning them of every imaginable scam that will surely come their way.

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Introduction

As a financial advisor, I routinely apply my dad's "wallet in the sock" (WITS) thought process when working with clients on their wealth management issues. I don't mean that I'm encouraging my clients to actually walk around with a fat wallet stuffed in their socks. Rather, the WITS metaphor suggests that we all need to take control by having the right safeguards and financial plan in place. That is what gives us the ability to move forward with confidence as we seek to achieve our long term financial objectives.

If we are set up properly, we will be more at ease. Less anxiety translates into better odds of sticking with our financial plans and achieving our goals; regardless of the unexpected curveballs life and the financial markets might throw our way. **In other words, having your WITS will help you keep your wits about you!**

The key for you is to figure out what belongs in your WITS, as each person or household may have a different view of risks and what it takes to mitigate them. Personal financial planning is indeed "personal." Therefore, it is not only the reality of risks, but also the perception of them that must be addressed.

This book is divided into four sections: Getting Set Up to Be Knocked Down, Knowing Your Objectives and Risks to Obtaining Them, College and Retirement, and A Line of Defense between You and Your Money.

Each chapter offers some practical insights, WITS Wisdom, that I hope will help you move forward confidently as you seek to build and preserve your wealth over the long term. This book is addressed to those that should have enough resources to reach their financial objectives during their lifetime, but not so much that they can afford to make big mistakes along the way. By focusing on those things you can control, rather than reacting to those things outside of your control, you can position yourself for a smoother, less anxiety ridden, ride to achieving those goals.

Section One

Getting Set Up to Be Knocked Down

A core tenet of WITS thinking as it pertains to personal finance is making sure that you are set up to withstand bad events if they should occur. Unfortunately, distressing situations and adverse events can and do happen, despite our best intentions to avoid them. At times they are entirely within our control, but that is not always the case. If you are set up properly, adverse events might not be so bad. In fact, with the right perspective they may even be the opportunity you've been waiting for. However, you will need to be in a strong financial position if you are to have the opportunity to make something of it.

In this section, I cover key topics related to building and maintaining a strong financial position; including:

(i) Financial exposure to one's employer.

(ii) The appropriate level of cash reserves/emergency funds.

(iii) Personal debt and net worth.

Chapter 1: Me, My Dad and Enron

It's hard to believe that over a decade has passed since I put up a shingle and opened my own financial advisory firm. Before starting SMS Capital Management in 2002, I worked for a company here in Houston called Enron. Perhaps some of you have heard of it. The time that I worked at Enron, from May of 1997 through December 2001, happened to coincide with a colorful and eventful time in the company's history; known by many as "the rise and fall," due to the notoriety the company gained at that time for being the largest U.S. corporation ever to seek bankruptcy protection.

So what does the Enron tragedy have to do with personal finance and the wallet in my dad's sock? In a word: EVERYTHING!

We all have our own personal journey and Enron was an integral part of mine. Enron's demise was the catalyst I needed to transition my career from being an investment guy with a big company to being a financial advisor with my own firm. However, that would not have been possible if not for some practical WITS decisions I made during that time.

My job at Enron wasn't managing individuals' money; rather it was to invest some of Enron's. I spent the majority of my five years there working in a small group called, Enron Principal Investments. Our job was to make Enron a good return on its capital by making privately negotiated investments in other private or public companies that operated in similar industries to Enron. It was an investment job within a giant trading company.

While there are many memorable and dramatic moments during my five years at the company, one defining event as it pertained to my own personal financial management truly stands out. It was when I struggled with deciding whether or not I should sell my Enron stock options.

It was late 1999. We were in the final innings of the great bull market that began in 1982. The tech and internet boom were still in full swing and creating massive amounts of personal wealth on paper for stockholders of companies that defined the "New Economy." New economy companies relied on technology, rather than hard assets, to disrupt established markets and establish new ones.

Enron, a once sleepy pipeline company, was not only the talk of Houston. Wall Street had fully embraced Enron as the poster child for the "New Economy" with its propriety electronic energy trading platforms, innovative thinking, and bold moves to enter and conquer new markets. Over the last couple of years, Enron's stock had taken off with all the hype about Enron's move into telecom and related trading markets. Enron's mission was no longer simply to be the "World's Leading Energy Company," but to be the "World's Leading Company."

Some of the stock options I received when I started at the company in early1997 (when the stock was in the $20's) and later received as part of my annual bonuses were "fully vested" and significantly "in the money." That meant the options had a lot of value and I was free to sell them if I so desired. The stock was now in the $80's and still rising. By most traditional valuation measures, the skyrocketing price couldn't be justified. But those weren't normal times. The CEO, Jeffrey Skilling, predicted it would climb to $120 within the next 12 months.

I was single, in my early 30's, earning a nice salary, and saving lots of money. Even so, the proceeds I would receive from selling my options would have a material impact on my net worth. I still remember the agonizing mental debate I had in my mind about what to do:

Why should I sell now? The stock just keeps going up. Jeff Skilling is telling everyone it's going higher. He's smart. He's rich. Worth Magazine just put the guy on their cover, naming him one of the "50 Best CEO's." I'll be leaving so much money on the table. I'll be passing up a shot at making millions. When people talk about all those filthy *rich Enron employees many years from now, they could be talking about me. Just like all those "Dellionaires" at Dell, but what would they call us, "Enronaires?" The stock would have to plunge for my options to be worthless. That won't happen. Everyone loves us. Be Greedy. Don't sell, don't sell, don't sell!*

But, what if we go from being the "in" company to the "out" company; the "darling" of Wall Street to the "dog"? What if all those Wall Street analysts and everyone else talking up the company are wrong about Enron's growth prospects? The stock could go down a lot and my options would expire worthless. If I sell now, I may not make millions, but I'll at least have enough for a big down payment on a house and could pay off the loan on my shiny, new black Audi A4. That would be nice. Plus if I keep working here and things continue to go well, I'll even get more options and stock over time. Don't be greedy. Be practical. Sell, sell, sell!

The internal debate was maddening, as you can likely tell. It just so happened that at the same time as I was contemplating what to do about my Enron holdings, I was being courted to become a client of a young stock broker at UBS Paine Webber. Despite my own abilities and my history as a "do-it-yourself" investor, I was entertaining the idea of enlisting the help of a financial advisor. I was a busy professional and was open to turning over management of my personal funds to an advisor. Since UBS was the custodian for the Enron employee stock option and restricted stock plan, UBS brokers would routinely cold call Enron employees looking for prospects. I was skeptical of stock brokers, mostly due to hearing about my dad's distrust of them. He had bought a few stocks and limited partnerships from stock brokers over the years that never played out particularly well, at least not for him.

Regardless, I agreed to a lunch after fielding several calls from a young aggressive UBS broker. I tried to keep an open mind and figured it wouldn't hurt to hear their pitch, as well as get some input on what to do about my Enron options.

When I showed up for lunch the junior guy wasn't alone. He brought along a much older colleague. His grey haired partner was easily in his 70's and resembled a crusty, old school stock broker right off the movie set of Wall Street. I kid you not; this guy actually downed two warm bourbons before we even ordered our lunch.

After the two rambled on about all the Enron executives they worked with, I finally got an opening to ask them their thoughts on what to do about my options. As the old-timer slurped down his third bourbon, he assured me that the UBS research analyst had a "buy" rating on Enron stock so they were advising their other Enron employee clients to hold on to their options despite the surging stock price. Unfortunately, that did not assure me of anything since research analysts with large brokerage firms were known to be overly generous with their "buy" recommendations. A favorable rating would help the brokerage firm secure lucrative investment banking fees when public companies like Enron needed their services.

I was hoping to get better insight from the two brokers, but their response highlighted the fact that they had an inherent conflict of interest. If their analyst was promoting the stock, would these brokers ever recommend selling it under any circumstances? I would never know where their allegiances lay, with their firm or their clients? That lunch was the closest I got to those UBS or any other stock brokers managing my money.

After several more weeks of batting the pros and cons around in my head, I was still unclear about what to do. Greed excited me, but practicality grounded me. Since my stock broker consultation was a bust, I was largely on my own to figure it out. My answer came in the form of a vision of my future. I tried to look out ten years and imagined my life at that time. I would likely be married with kids and have more financial responsibilities. I thought about what that guy in the future would look back and say to me now if I didn't sell my options and they turned out to be worthless. The future version of me looked me straight in the eye and said, "*Steven, YOU (bleeping) IDIOT!*" And with that cold, blunt statement, I pulled the trigger and sold my options.

In the end, coming to the right answer boiled down to practical, financial decision-making, not some intricate financial model or complex formula I learned in business school. Plus, the fact that the future version of me was a straight talking, no-nonsense guy didn't hurt either. **The bottom line was that I was not mentally prepared to accept the worst case scenario - my options being worthless after having been worth a lot.** The destiny of Enron and ultimately the value of my stock and options were not in my hands. However, the ability to lock in the current value of my holdings was fully within my grasp. **In essence, selling my options represented a transfer of value from stock to my WITS (ultimately my bank account).** In doing so, I relieved some anxiety and gained peace of mind.

After I sold my Enron options, I started working over my colleague, Patrick Hickey, into selling some of his as well. Patrick had worked at Enron since 1991(6 years longer than I) and had accumulated a lot more options and stock. Until that point, he had never sold anything despite his stock and options being vested. Of course, until then the stock hadn't really done all that much and Patrick had a long term investor mindset. I recall a period of several weeks where the stock would go up every day. Each day I would ask him, "Have you sold any yet?" Each time he said "not yet" and went about his business. Finally, one morning he informed me that he "sold a slug." I remember him appearing relieved when he told me about it. I'm not sure if that was because he was tired of me bending his ear about it or whether he felt better knowing he had taken some chips off the Enron table and put them in his WITS. Probably a little of both.

While there are those that did manage to sell down some of their holdings like me and Patrick, the vast majority of employees never sold any options or stock as the company plunged into bankruptcy in 2001. Since we were not officers or "insiders" we weren't restricted on when we could sell like the vast majority of Enron employees. There were even those that bought stock in the company as it went into its death spiral thinking that they were getting the deal of the century and would surely make a fortune on the imminent recovery. That recovery never came.

Some of the most brilliant and respected financial minds in the world worked at Enron. However, when it came to being responsible stewards of their personal wealth, many of these same people were hopelessly lost and paralyzed. In fact, most employees didn't even contemplate selling their stock or options even though they were fully vested. They just figured it was part of their "retirement plan" and didn't pay any attention. These employees learned a terribly painful lesson about being diversified and the risks associated with putting their career and their net worth in one basket. Greed and lack of proper oversight over their own personal finances were the main causes of their net worth's demise.

Unfortunately, this sad tale repeated itself with the implosion of Lehman, AIG, Bear Stearns, Washington Mutual, and several others years later in the financial crisis of 2008. The unthinkable financial version of the sinking of the Titanic is a story that has played out many times throughout history and destroyed the financial security of far too many. Rest assured, it will happen again, but could it happen to you?

Using My WITS

In the aftermath of the Enron bankruptcy, I found myself in the unenviable position of being in my mid 30's and unemployed. Not exactly where I ever thought I would be. Losing my job with essentially no notice, and only two weeks' severance was a scenario that I would never have imagined. While Enron's bankruptcy was an enormous corporate disaster, it could have turned into an even bigger personal disaster for me and my wife, Linda, if we had not been financially prepared.

Finding another job can be trying enough, but hitting the reset button on your nest egg at the same time can be a financially and emotionally devastating experience. The uncertainty surrounding my next career move was deeply unsettling; at least I did not have much in the way of financial stress since we were in a solid financial position. I would say it was "fortunate" that Linda and I were in such good financial shape, but that implies an element of luck. Getting ourselves into a good financial position was not "lucky." It involved prudent conscientious decision making every step of the way.

There are lots of things we could have done or not done that would have made my sudden job loss a much worse situation. Namely, we could have bought a lot more expensive house with a much bigger mortgage, not saved money over the years, used credit cards to "live it up," not sold any Enron stock/options, and had the bulk of our money in high flying tech stocks. All these things were within our control alone, involving the choices we willingly made for our personal financial situation.

We made different choices that set us up to deal with adversity should it come our way. We had our WITS. Despite losing my job, we still had decent household income that would cover our monthly overhead. Linda was still working in pharmaceutical sales and her job was relatively stable and secure; unlike all those in the technology and Internet startups that were still losing jobs in droves. Our savings were in good shape and we had a manageable amount of debt on our home. All I really had to worry about was figuring out what to do about transitioning to a new job. Yes, compared to many, my family was fortunate, but we'd planned for being fortunate.

Plotting a New Course

I knew the carnage from Enron would make finding another investment job with a Houston-based energy company challenging and the mere thought of it was unappetizing. Rather than jump at the first job opportunity, our sound financial situation gave me the flexibility to take some time to go through a self-reflection and career evaluation process. It didn't take much time for me to decide that I wanted more control over my career. I always had the entrepreneurial bug, and seeing firsthand how terrible decisions by senior management can destroy a company pushed me further in the direction of having my own business.

I also wanted to transition my career from transactional-based investing into personal financial management, an area that was more aligned with my long time passion, skill set, and personality.

The Enron debacle made me realize that my experience and practical nature saved me from financial ruin at Enron and I could help people make good financial decisions and invest prudently for their future. Within a year and after some research, I took the plunge and started my own investment management and financial advisory firm, SMS Capital Management, LLC (SMS).

For me, unforeseen unemployment turned into an opportunity to start my own business because I was in a financial position to take that path. Foregoing another salaried job and starting from scratch meant a big drop in income for a period of time. I was nervous because Linda and I were expecting our first child, but I was confident that if things went well we would be trading in short term uncertainty for a better long term scenario in terms of lifestyle, income opportunity, job security, and personal satisfaction.

Having the CFA designation, a credential I got years earlier, enabled me to start a Registered Investment Advisory firm. That, combined with a solid personal financial foundation, were key reasons I was able to take my best shot. Fortunately, my WITS had enough in it to give me the confidence and resources to take a crack at starting my own business venture!

***WITS Wisdom*:**
A solid personal financial position gives you the peace of mind of knowing you will not only survive adverse events (like losing your job when your employer goes down in flames), but also be in a position to take advantage of or create opportunities that may result from them.

Chapter 2: Doubling Down at the Office

As I described in the last chapter, there was no shortage of Enron employees that made the company's stock and option holdings the cornerstones of their nest eggs. When the company went down, those employees not only lost their jobs, but also their incomes and benefits. If that was not bad enough, they lost a big chunk, if not all, of their net worth that was tied up in Enron stock and options. Sadly, while losing their jobs when the company imploded was beyond their control, losing their net worth in the process was not.

Clearly, employees need to be aware of the financial exposure they have tied to their company. Moreover, limiting that exposure where practical and possible should be part of their WITS.

Let's explore in more detail.

Restricted Stock and Options

Companies are no longer as generous with granting stock options as they were in the roaring 90's. There was a time when companies, especially those in the Internet and tech sector, were dolling out stock options like crazy. Everyone got some. Executives, senior-mid level management, and rank and file employees all got their more than fair share of stock options.

While times have certainly changed, many companies still reward executives and high performing employees generously with restricted stock grants as part of their overall compensation package. At Enron, employees had the option of taking their annual bonuses in cash, restricted stock, or options. Many elected to forgo cash altogether and take their entire bonus in stock and options. That option was rare because most corporations do not give employees a choice. They give employees restricted stock or options as part of their bonuses and compensation whether the employees want it or not.

Typically, restricted stock and options are granted in one year and become unrestricted (vest) over a period of subsequent years. By granting restricted stock or options to employees, the employer wants to incentivize employees to stay around long enough to get the value of their shares or options. The employer also hopes that the employee will work hard and in doing so will help increase the value of the firm, and ultimately the stock price.

In the case of restricted stock, an employee is not taxed on the value of the stock until the year the shares become unrestricted. As the vesting day approaches, the employee typically receives a notice from the benefits department informing him or her of the amount of the shares becoming unrestricted and requesting if shares should be sold, held, or partially sold to cover the income tax due. The employee will be taxed on the value of the unrestricted stock as if it were ordinary income (just like their regular salary). If none of the shares are sold to pay for the tax due, the employee will have to use cash from elsewhere to pay the tax. Options work a little differently in that the employee pays no tax until the options are exercised. Generally, if the employee does not give any directions, the default is for enough shares to automatically be sold to cover the employee's withholding tax due on the shares as if it were compensation paid to the employee.

So here's the question: If your company gave you a $50,000 cash bonus as part of your annual compensation, would you take the money, pay the income tax, and then use the proceeds to buy your company's stock? I often ask this question to clients when I see that they are holding large amounts of their company stock as a result of stock grants because that is essentially what they did. It doesn't usually make logical sense to them when they hear it phrased that way either.

The employee may have no choice but to hang on to the stock until it becomes unrestricted; however, holding the stock once it is vested (became unrestricted) is another story. Again, it is just like receiving cash and using the cash to buy the stock; something the employee would not otherwise do.

Here are some practical steps to take with regard to dealing with restricted stock and options if you have them:

1. **Make sure you know what you have in terms of type of security (restricted stock or options).**

2. **Track your vesting dates. Even though you should be notified by your benefits group of when vesting dates are coming due you should still be proactive in knowing those dates.**

3. **Sell your restricted stock (or do a "cashless exercise of stock options) as soon as it vests (become unrestricted) at the market price.**

The key is to form a plan of action unencumbered by emotion. In doing so, you can lock in value without having to struggle with making a decision each time shares or options vest. If you don't sell at vesting time, you might fall into the trap of trying to time your sells. You will likely find yourself thinking things like, "I'll just wait until the stock bounces back up to the price where I got the grant" or "the stock is going up, I should hold for a while longer." This line of thinking will only lead to accumulating more shares and increasing your exposure to your company. It is better to lock in the value and move on.

401(k) Contributions

Not selling options wasn't just the only mistake many Enron employees made. Most employees routinely bought Enron stock in their 401(k)'s instead of spreading their holdings over other investment options offered in the retirement plan. While the company automatically matched employees' 401(k) contributions with Enron stock, employees could direct their retirement funds to buy several other mutual funds in addition to the company stock. Many purposely chose to load up their retirement plans with Enron stock.

The employer match is definitely a wonderful perk, as it essentially providing the employee with a 100% return on their contribution. However, the downside of this arrangement is that employees tend to hold the match they receive, rather than sell it and reinvest in another retirement investment option. There are other options that you can explore.

Like all other Enron employees, I was essentially forced to take the matching portion of my 401(k) in Enron stock. However, I didn't add to my Enron holdings with my retirement contributions. Rather, I diversified my holdings with a variety of stock, bond and cash oriented mutual funds. When Enron's stock started its descent, I even went online and tried to sell the Enron stock I had in my 401(k). The online system wouldn't let me do it so I made a call to the 401(k) plan administrator (Hewitt Associates) to find out how to sell the vested matched portion. A Hewitt representative informed me that I couldn't because according to the plan rules, only those over 50 years old could do so.

Interestingly, largely as a result of Enron, the Pension Protection Act of 2006 included a provision that required companies to allow diversification away from a company's stock in 401(k) plans.

Since many employers still offer 401(k) contribution matching in the form of the company's stock, many people accumulate large amounts of their company's stock because they do not sell it as the match becomes vested (in some cases, the company match may even vest immediately).

Furthermore, many employees are still inclined to accumulate and hold significant amounts of their company's stock. In some cases, that's all they hold. According to data from the Employee Benefit Research Institute, 5% of employees allocated more than 90% of their portfolio to company stock in 2010.

So why is it that an employee would choose to own a large amount of their company's stock that they wouldn't have otherwise purchased with their cash if they weren't working at their current employer? For example, would you be comfortable taking $50,000 of cash and buying a huge chunk of Merck's stock? The answer is probably no, but if you worked there you very well may have that much of Merck stock or more tied up in your 401(k) plan. Go figure. Ironically, this is just the opposite of what you should be doing –diversifying risk away from your employer, which is the source of your primary income.

So why do employees routinely accumulate stock in their 401(k) plans?

- First, employees might feel that they know more about the company they are working for and therefore feel comfortable betting on their employer's future with their retirement funds instead of the broader markets.

- Second, employees might receive the matching portion of their contribution in their company stock, but not realize that they are free to sell it at some point. What ends up happening is that they just hold the stock without thinking about it. It requires action to sell or exchange it into other holdings, but inertia prevents the employee from actually doing it.

- Lastly, I believe employees choose to buy their employers' stock simply because it's on the list. If there are ten investment choices on an employer's 401(k) plan and one of them is the company's stock, employees just allocate some funds to it along with everything else. Some twinge of corporate patriotism comes over them and they react by allocating a percentage of their contributions to the company stock.

Company Discount Purchase Plans

Another reason why employees accumulate exposure to their employers' stocks is that some companies offer a discount purchase program in which employees can arrange for a payroll deduction to buy stock at discounts to the market price (sometimes as high as 15% discount). While this arrangement can be a great deal for buying below market price, the problem is that many employees will buy the shares and then hold the shares long after they are entitled to sell them, which might even be immediately. Over time the employee ends up with significant exposure to the company and if the stock falls, it can quickly wipe out the discount and the reason for buying. Even if the stock does not fall but seriously underperforms other investment opportunities, it raises the question as to whether it was worth allocating a great deal of your resources to your company's stock. Again, would you be buying if not for the discount?

If you still feel inclined to voluntarily hold some restricted stock, add exposure through the discount purchasing plan, or add exposure through 401(k) contributions, **make sure you limit the total exposure to your company to no more than 5% of the value of your investable assets.**

WITS Wisdom:

Quantify the financial exposure you have tied to your employer in the form of vested and unvested stock and options.

Systematically reduce that exposure on key vesting dates.

If you choose to hold some stock and options, limit it to 5% of your investable assets.