Skloff Financial Group

September 1, 2026

Question of the Month

By Aaron Skloff, AIF, CFA, MBA

Q: We read ‘Top 5 Problems of Target-Date Funds’. What is a self-directed brokerage account and what are its top five benefits?

The Problem — Limited Investment Options and Target-Date Funds in 401(k) Accounts
The average large 401(k) plan offers 29 investment options, including 13 equity funds, three bond funds, and 10 target-date funds. In addition to the limited number of investment options, you may find some of those options have high costs and poor performance. Target-date funds carry the problems examined in ‘Top 5 Problems of Target-Date Funds’.

The Solution — The Hidden 401(k) Feature Most Employees Miss: The Self-Directed Brokerage Account
A self-directed brokerage account or SDBA (also known as a brokerage window) inside your 401(k) account allows you to invest in thousands of mutual funds, exchange traded funds (ETFs), bonds and stocks beyond your limited investment menu, while maintaining the tax advantages and benefits of your 401(k) account. Some plans may limit the amount you can invest in the SDBA to 50% to 100% of your assets and/or prohibit the use of ETFs and/or stocks. Some of the most common SDBAs are Fidelity Investment’s Fidelity BrokerageLink, Charles Schwab’s Schwab Personal Choice Retirement Account (PCRA) and Empower’s Empower SDBA.

Top 5 Benefits of Self-Directed Brokerage Accounts
1. Massive Expansion of Investment Choices. The SDBA provides access to thousands of individual stocks, bonds, ETFs, real estate investment trusts (REITs), and mutual funds unavailable on your limited investment menu.

2. Access to No Expense Stocks, and Low-Expense ETFs and Index Funds. Many 401(k) plans, particularly small- to medium-sized company plans, contain actively managed mutual funds with poor performance, high expense ratios, and/or revenue-sharing fees.

The SDBA allows you to build portfolios using extremely low-cost, commission-free index mutual funds, ETFs (e.g., total market, S&P 500, MSCI EAFE, aggregate bond mutual funds and ETFs with expense ratios under 0.05%). Alpha measures the difference between an investment's expected returns based on its beta and its actual returns. A **positive** alpha indicates the investment has performed better than its beta would predict. A **negative** alpha indicates an investment has underperformed, given the investment's beta.

One of the top 20 most frequently offered mutual funds in 401(k) investment menus is a fund categorized as a “Large Growth” fund, according to Morningstar. The fund has a 0.59% expense ratio, standard deviation of 16.17 and a **negative** 1.47 alpha. Its 10-year total return for the period ending 12/31/25 was **238.15%**. A similar “Large Growth” index ETF has a 0.04% expense ratio (translation: the ‘top 20 fund’ is almost 15 times more expensive), standard deviation of 16.69 and a **positive** 1.43 alpha. Its 10-year total return for the period ending 12/31/25 was **326.12%**. While past performance does not necessarily predict future returns, it can tell you how volatile a fund has been. Generally, the more volatile a fund, the higher the investment risk. Alpha is **excess return** of an investment compared to a benchmark index, like the S&P 500, **after adjusting for risk**.

3. Optimal Asset Allocation. Core investment menus often lack coverage in asset classes, such as high-yield bonds, multisector bond funds, ultrashort bond funds, Nasdaq index funds, middle sized companies and small company stock funds.

The SDBA allows you to precisely optimize the asset allocation and risk level of your 401(k) account, utilizing investments unavailable in your basic investment menu, weighted to meet your risk tolerance and return objectives.

4. Tax-Sheltered Trading Inside the 401(k) Account. Trading inside a taxable brokerage account triggers short-term and/or long-term capital gains. Trading within the brokerage window of your 401(k) account maintains the exact same tax-deferred (Traditional) or tax-free (Roth) umbrella as the rest of your 401(k) plan. No tax reporting or capital gains events occur upon buying or selling assets inside the window.

5. Professional Management. Charles Schwab’s ‘2024 401(k) Participant Study’ found 61% of retirement savers believe their financial situation warrants professional advice. **Vanguard’s 2022 ‘Putting a Value on Your Value: Quantifying Vanguard Advisor’s Alpha’ study concluded that professionally managed accounts can add 3% to 4% higher returns net of fees per year.** The Vanguard study attributed the higher performance to the components listed in the article ‘**Professionally Managed 401(k) Accounts Can Generate 3% to 4% Higher Returns Per Year**’.

Your Registered Investment Adviser (RIA) can research the optimal investments among your thousands of choices, then build and manage your 401(k) to optimize your risk and return.

Action Step — Take Advantage of Your Self-Directed Brokerage Account
Work closely with your Registered Investment Adviser (RIA) to manage your self-directed brokerage account in your 401(k).

Aaron Skloff, Accredited Investment Fiduciary (AIF), Chartered Financial Analyst (CFA), Master of Business Administration (MBA) is CEO of Skloff Financial Group, a Registered Investment Advisory firm specializing in financial planning, investment management and benefits for small to middle sized companies. He can be contacted at www.skloff.com or 908-464-3060.