How to Become a 401(k) Millionaire

Follow these rules to make your money work as hard for you as you do to earn it.

By Suzanne Gerber

Have you heard about the Stanford Marshmallow Study? In that famous experiment from the 1960s, researchers offered four- and five-year-olds either one marshmallow immediately or, if they would wait 15 minutes, two marshmallows. The academic left the child alone with the treat on the table and returned a short while later.

A videocamera recorded the reactions, which ranged amusingly from unabashed marshmallow grabbing to nervous squirming and eye-shielding to patient waiting. (Most kids couldn't delay their gratification, though several did.) But the truly fascinating part of the experiment is its long-range conclusions.

The researchers tracked each participant for more than 40 years and found that the group who'd waited patiently for the second treat had greater success in every area of life measured: from SAT scores (an average of 210 points higher), social skills and responses to stress to lower levels of substance abuse and likelihood of obesity.

How a 401(k) Is Like a Marshmallow

Here's a scary finding: In a recent E*trade survey, 40 percent of investors said they'd rather spend the money today than save it. That number jumped to 58 percent for investors under age 34—and, the study found, 47 percent of those folks have already made early withdrawals from their 401(k). Ouch! This flies in the face of the accepted wisdom that maxing out your contributions to your company's 401(k), especially if your employer matches a certain percent of that money, is one of the smartest investments you can make. In fact, Fidelity Investments reports that among its myriad investors, 72,379 are now "401(k) millionaires." Granted, most of these "tycoons" are, on average, 59 years old, have been with their company at least 30 years and contributed more than the average worker (14 percent, with their companies' matching another 5 percent). But we're not talking about top executives: Most make less than $150,000 a year, thus proving that over time, the market is the best investment and that the secret to success— compounded interest—is no secret.

Make the Most of Your 401(k)

Fidelity's 401(k) millionaires, consciously or otherwise, followed three rules: Start saving early, contribute as much as you can afford, and leave the money alone. But on top of that, there are some specific things you can do to keep your money working as hard for you as you do to earn it.

1.Max out on contributions. Okay, that's a big duh, but so many of us have perfectly reasonable excuses for why we can't. Yet experts agree: It's a good strategy to tighten your belt now and think of these austerity measures as investing in your own future. At the very least, contribute whatever percent your employer matches. Not doing that is, in effect, throwing away free money.

2.Increase your contributions. Follow the "1 Percent" rule. If you can't max out your contributions from the get-go, increase it 1 percent each year until you hit the ceiling.

3.Play catch-up after 50. Once you reach this age, you're allowed to contribute an additional $5,500 each year (on top of the $18,000 annual limit).

4.Keep your hands off! A 401(k) is not a saving account—or a lottery payout. Even if you suffer financial reversals or get slammed with unexpected expenses, remember: This money has been earmarked to provide you the annual income you'll need for the rest of your life. Early withdrawal means that not only will you whittle away at that important nest egg, but that you'll get hit by significant taxes and penalties. Prevent temptation by starting an emergency fund—a separate account with no tax consequences. Open it with as much as you can spare, and then add to it regularly.

5.Mix it up. The same advice that applies to your brokerage account applies here. Work with an adviser to select a smart (and dynamic) mix of investments, including mutual funds. Make sure you're not overweighted with company stock. "Familiarity bias," or too much confidence in company stock, means you might not be able to diversify quickly enough should there be a negative change.

6.Hoard that bonus! Fidelity found that just 28 percent of annual bonuses are saved. Buck that trend and get further ahead every year by saving three quarters of it. This may require that you don't "pre-spend" it on luxury items.

7.Don't watch the clock. Or your monthly statement. Do, however, check in on a regular basis—every quarter, half-year or year—making adjustments as warranted. Remind yourself that this is a marathon, not a sprint, and that your reward will be twice as many marshmallows.