Self Directed Retirement Accounts Give Investors More Control in Uncertain Economic Times

by Steven D. Cox, CPA

Turning passion into profit, SDRAs allow investors to diversify tax-advantaged retirement savings by investing in something they know and understand.

Self Directed Retirement Accounts - SDRAs - are providing a growing number of people with what they are looking for in these uncertain times – more control over their retirement nest egg. And companies that offer them to their employees are doing them a service as self directed investing also offers an opportunity for true diversification and the option to create wealth outside traditional stocks, bonds and mutual funds.

What is self directed investing?

Since 1974, investors have been able to invest their retirement savings in whatever they know best – whether it's real estate, domain names, a business or even show horses. Add to that the advantages of an IRA or 401(k) – namely, tax-advantaged growth – and you have an investment strategy that is a hedge against market volatility.

For example, if an investor understands real estate, the restaurant business, farm animals, golf courses, RV parks, even show horses, they can use that knowledge or passion to invest in those assets within an SDRA. The non-traditional investment opportunities are virtually endless, with a few exceptions per the Internal Revenue Code (IRC).

Many businesses are growing and looking for different ways raise to capital even in this period of a down economy and tight credit. Just look around your community for those businesses that are thriving, such as auto repair, real estate investments, and dozens more. Once you know how, you can invest your IRA or even your 401(k) (if your employer allows) in local businesses and other nontraditional assets.

Non-traditional investing through SDRAs requires knowledge of the rules, regulations and guidelines set forth within the IRC. An experienced professional can help manage risk and help an investor navigate within the rules and regulations. The professional also can help those interested in self directed investing who may not have a firm idea or interest, by providing a range of non-traditional options that protect the investor by meeting high standards and complying with all guidelines and regulations.

But finding a professional with non-traditional investing experience is not as easy as it may sound. American investors have been able to legally invest in almost any asset ever since the Individual Retirement Account (IRA) was created in 1974. Even so, few professionals have taken on the challenge to truly understand this concept and help make it work for their clients.

And as a result, people saving for their retirement have been typically steered toward traditional stocks, bonds and mutual funds to the point that most believe Wall Street is the only option for their retirement accounts. Recent market volatility – and the prospect of more frequent fluctuations – has prompted savvy investors to look for additional ways to diversify, sparking interest in self directed investing.

How does it work?

An SDRA is set up with a qualified custodian (usually a bank or a trust company) that allows for non-traditional investments, funded either through new retirement savings or by rolling over all or a portion of an existing retirement account, which could be an IRA (traditional and Roth), a 401(k) or pension plan, a Simplified Employee Pension Plan (SEP), a Savings Incentive Match Plan for Employees (SIMPLE), a Health Savings Accounts (HSA), or a Coverdell Education Savings Account (CESA).

Once created, funds in the SDRA can be used to purchase a virtually endless range of assets, per the IRC, excluding life insurance and collectibles.

Real estate is one of the most popular choices for non-traditional investing with an SDRA. Most of us who have owned a home understand how real estate and mortgages work. Real estate is also a physical asset investors can see and touch, and in some cases exercise some control over. With prices having dropped, there may be some good opportunities to invest. And with real estate it is unlikely that the value of a given property will decline to zero due to the intrinsic value of the land itself -- even with the housing fluctuations we have seen across the country.

An example of a more "outside the box" investment choice that lends itself to an SDRA is horses. One investor with a passion for horses knows the ins and outs of buying, training and selling horses and how to create wealth with this asset. Working closely with his team of advisors, trainers, farm hands, and others, the investor was able to capitalize on his passion within his retirement account.

No matter what your passion or knowledge base happens to be, there is bound to be a non-traditional investment available that can generate retirement wealth. Using investments where the investor has the proper knowledge and understanding, along with proper allocation and risk management, SDRAs may provide the diversification needed to hedge against the ups and downs of Wall Street and secure a comfortable retirement.

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