

EARLY PLANNERS



A short-term portfolio for taxable accounts

- Spending Horizon: 5 Years or Less
- 20-40 percent Cash
- 40-60 percent Fidelity Limited Term Municipal Income (FSTFX)
- 20 percent Fidelity Intermediate Municipal Income (FLTMX)

This portfolio is geared toward taxable investors (that is, those investing outside of a retirement account) with time horizons of roughly five years. Thus, it's anchored in cash (certificates of deposit, money market accounts and so forth) and a short-term bond

fund. It also features an intermediate-term fund to help boost its yield. Morningstar analysts have long been impressed by Fidelity's careful and deliberate approach to the muni markets, and the funds that dominate this portfolio showcase what the firm does well.

A short-term portfolio for tax-deferred accounts

- Spending Horizon: 5 Years or Less
- 20-40 percent Cash
- 40-60 percent Fidelity Short-Term Bond (FSHBX)
- 20 percent: Dodge & Cox Income (DODIX)

This portfolio is geared toward investors with time horizons of roughly five years; it mirrors the structure of the taxable portfolio above but doesn't pay attention to tax efficiency. CDs, money market funds and money market accounts make up as much as 40 percent of the portfolio, with a high-quality

short-term bond fund composing another 40 percent. A smaller portion goes into an intermediate-term bond fund to boost the portfolio's yield. Here, I've used Dodge & Cox Income, whose managers' three-to-five-year time horizon for their holdings syncs up with the five-year time horizon of the portfolio.

An intermediate-term portfolio for taxable accounts

- Spending Horizon: 5-10 Years
- 20 percent Cash
- 20 percent Fidelity Limited Term Municipal Income (FSTFX)
- 40 percent Fidelity Intermediate Municipal Income (FLTMX)
- 20 percent Vanguard Total Stock Market Index (VTSMX)

Geared toward a taxable investor with a spending time horizon between five and 10 years, this portfolio includes cash and the same municipal-bond funds that appear in the portfolio above, albeit in slightly different allocations. It also includes a slice of

tax-efficient equity exposure. I've used a broad market traditional index fund, but investors could reasonably use a large-cap exchange-traded fund or a tax-managed equity fund such as Vanguard Tax-Managed Capital Appreciation (VTCLX).

An intermediate-term portfolio for tax-deferred accounts

- Spending Horizon: 5-10 Years
- 20 percent Cash
- 20 percent Fidelity Short-Term Bond (FSHBX)
- 40 percent Dodge & Cox Income (DODIX)
- 20 percent Vanguard Dividend Appreciation (VDADX)

This portfolio, geared toward investors in lower tax brackets or those investing in tax-deferred accounts, is stair-stepped by risk level, from cash to short-term bonds to intermediate-term bonds to stocks. I've mirrored the allo-

cations of the taxable intermediate-term portfolio above but have not factored tax efficiency into the investment selections. Vanguard Dividend Appreciation has historically had smaller bear-market losses than other core equity funds.

make investments in your own human capital — obtaining additional education or training to improve your earnings power over your lifetime. Of course, not every such investment pays off, and it's ideal if you can get your employer to shoulder at least some of the financing. But if you have considered an advanced degree or extra training of any kind, the earlier you get started, the higher your lifetime return on your outlay is apt to be.

Kick-start your retirement accounts

There are a lot of reasons that early accumulators put off saving for retirement. There's the not small fact that many people in their 20s and 30s are saddled with heavy student debt loads. Moreover, 20- and 30-somethings often have one or more shorter term goals competing for their hard-earned dollars alongside retirement savings: down payments for first homes, cars, weddings and children, for example.

Psychology also is in the mix: With retirement three or four decades into the future, people who are just embarking on their working careers in their 20s and 30s may be hard-pressed to feel a sense of urgency in saving for it.

Yet the youngest investors have the longest time to benefit from compounding, and that benefit accrues even if they're only able to save fairly small sums and the market gods serve up "meh" returns over their time horizons. The 22-year-old who starts saving \$200 a month and earns a 5 percent return per year will have more than \$362,000 at age 65. Meanwhile, an investor who waits until 35 to start investing yet socks away \$300 a month and earns a 6 percent return will have a little more than \$300,000 at age 65. Those first 10 years of missed compounding swamp both higher returns and higher contributions later on, underscoring the virtue of getting started on retirement saving as soon as you can, even if it means starting small.

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4 steps to setting up an EMERGENCY FUND

BY CHRISTINE BENZ

A few years ago, I met a lovely couple in their mid-20s who were struggling with more than \$100,000 in student loan debt. Though their salaries covered their regular payments and expenses (such as mortgage, utility bills, etc.), there was no room for error. As a result, they began charging unexpected expenses like car repairs and veterinary care on their credit cards, incurring exorbitant interest fees along the way.

They clearly were troubled about having dug themselves into such a deep hole, and they were eager to do everything that they could to pay off both types of debt as soon as possible. We discussed various ideas for reducing their financing costs.

What I think surprised them, though, was that I didn't suggest that they put every extra penny toward paying down their debt. Rather, I urged them to simultaneously set up an emergency savings fund.

True, setting up an emergency fund would probably mean that it would take them longer to pay off all of their debt, but it also would guard against the prospect of taking on any more debt than they already had. Not only could they use their emergency fund to pay unexpected bills, but it also would provide a needed cushion should one of them lose their job.

In fact, creating a safety net in case of job loss is the key reason to set up an emergency fund. Conventional financial planning wisdom holds that you should have three to six months' worth of household living expenses tucked away in your emergency fund, with the thought being that it would take you that long to find a new job if you should lose yours. However, I would recommend building yourself an even more generous cushion if you can swing it, preferably nine months' to a year's worth of living expenses. That's particularly true if you're highly paid or work in a highly specialized field, because it's usually more difficult to replace such jobs. And of course, if you have any reason to believe that your job is in jeopardy — either because of problems in the economy at large or at your own company — you also should aim to build a larger emergency fund.

In addition to determining the right amount for your emergency fund, you also have to take care in selecting the investments that you put inside it. As a general rule of thumb, your emergency fund should consist of investments with maturities of less than one year, including checking and savings accounts, money market accounts and CDs. This is money that you could need to tap in a pinch, so you want to steer clear of higher-yielding investments that could be tough to sell or that you might have to sell at a loss if you needed to get out in a hurry. Instead, you need to stick with vehicles that ensure you'll be able to take out as much as you put in.

Here's an overview of the types of savings and investment vehicles that are acceptable for your emergency fund:

■ **Online savings accounts:** These vehicles often offer the most attractive yields for cash. They also typically offer at least a few transactions per month. Deposits of up to \$250,000 per institution will be covered by FDIC insurance.

■ **Checking and savings accounts:** Convenience is the big plus here, but rates may be rock-bottom. Deposits of up to \$250,000 per institution will be covered by FDIC insurance.

■ **Money market deposit accounts:**

These interest-bearing savings accounts typically offer a limited number of transactions per month, and deposits of as much as \$250,000 per institution are FDIC-insured.

■ **Certificates of deposit:** CDs are apt to have a higher yield than checking, savings, or money market accounts. They also carry FDIC insurance for deposits of as much as \$250,000 per institution. The big drawback to holding CDs in your emergency fund, however, is that you'll pay a penalty to withdraw money from a CD prematurely. So if you hold CDs as part of your emergency fund, you'll have to weigh the higher yield against the risk of having to pay a penalty to pull money out.

■ **Money market funds:** A money market mutual fund can be a good option for an emergency fund, and yields may be higher than what you'd earn on your checking, savings, or money market account. Because money funds buy very short-term bonds, they can readily swap into newer, higher-yielding securities when interest rates edge up. The big downside relative to the checking and savings accounts, CDs, and money market accounts is that money market fund assets are not FDIC-insured.

Here are the key steps to take when setting up your emergency fund.

Step 1: Determine your monthly living expenses. Don't include nonessential items that you could live without in a pinch, such as a dog walker and discretionary clothing purchases. Multiply that number by three months. This is your absolute minimum savings target for your emergency fund.

Step 2: Add up the aggregate investments that you hold in your checking and savings accounts, money market accounts and funds, and CDs. Exclude any assets that you have earmarked for other purposes, such as money that you're saving for a car down payment or college tuition; also exclude any cash holdings in your stock or bond mutual funds. This is your current emergency fund.

Step 3: Subtract the figure from Step 2 (your current emergency fund) from the figure in Step 1 (your target emergency fund). This is how much you need to save at a bare minimum — it should be double this level or more. Setting money aside to hit this savings target should be your main savings priority in the months ahead. (If you're also paying off high-interest credit card debt, you should try to build up your emergency fund at the same time.)

Step 4: To home in on the best investments for your emergency fund, start by looking at the yields for your current investments. Then go to www.bankrate.com to find current yields for CDs, money market deposit accounts, and money market mutual funds; compare them with what you're earning currently. Bearing in mind the above guidelines about FDIC insurance and liquidity, also remember that it's fine to use a combination of these vehicles rather than holding your entire emergency fund in one place. For example, you may choose to keep two months' worth of living expenses in your checking account and the rest of your emergency fund in a higher-yielding CD or money market fund.

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