

INVESTMENTS

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portion of your portfolio to an IRA. Morningstar’s Instant X-Ray tool (morningstar.com) can help you see where you’ve got holes in your existing asset mix.

You also can use your IRA to include asset types not commonly found in company retirement plans, including funds dedicated to real estate investment trusts, commodities or Treasury Inflation-Protected Securities. All of these investment types do a good job of diversifying a portfolio that’s composed primarily of conventional stocks and bonds. They also can be a headache when held outside of tax-sheltered accounts, because they generate a lot of taxable income. So, they’re ideal holdings for an IRA.

DAY 14: MANAGE YOUR PORTFOLIO FOR TAX EFFICIENCY

Degree of difficulty: Moderate

Although utilizing tax-sheltered vehicles like IRAs and 401(k)s can help you dodge the tax collector, at least temporarily, there are occasions when you’ll need to save in your taxable accounts. Perhaps you’re socking money away for a goal that’s close at hand, for example, or maybe you’ve maxed out your contributions to the tax-sheltered vehicles available to you.

If that’s the case, there still are some steps you can take to reduce the tax effects on these investments.

One of the key steps you can take is to limit your own trading activity, thereby reducing the taxable capital gains you’ll owe from year to year. I’m also a big fan of actively pruning your taxable portfolio’s losers, which helps you offset capital gains from your winners. Single taxpayers with incomes below \$38,600 and married couples filing jointly with incomes below \$77,200 can do the opposite, pre-emptively selling their long-term gainers and immediately re-buying them. The advantage of that strategy is that it’s tax-free, as investors below those income thresholds pay a 0 percent rate on long-term capital gains, and it also increases the investor’s cost basis in her holdings.

Finally, it pays to be careful about what types of investments you hold in your taxable accounts. High-turnover stock funds, whose short-term capital gains are taxed as ordinary income, are a definite “don’t,” as are high-income-producing investments such as REITs and junk-bond funds.

On the “buy” list for taxable investors are low-turnover exchange-traded funds and index funds, municipal-bond funds, individual stocks and tax-managed funds.

DAY 15: CONDUCT A “QUICK, DIRTY” PORTFOLIO CHECKUP

Degree of difficulty: Easy to Moderate

A good starting point for a portfolio checkup is to take a snapshot of where your total portfolio is right now, with an eye toward flagging any notable trouble spots. The best tool for the job is Morningstar’s Instant X-Ray tool, which you can find at morningstar.com. Simply plug in tickers for each of your holdings (use CASH\$ for cash), then hit “Show Instant X-Ray” for a look at your portfolio’s stock/bond/cash mix and breakdown by investment style, sector, and geography.

That’s a lot of information, and it may not be valuable without some context. To help make sense of what you’re looking at, click on the “Interpreter” tab under “Edit Holdings.” As you do so, run through the following checklist and take notes as you go along:

1. Is your stock/bond/cash mix in line with your targets? Take note if your allocation to any one asset class is more than five or 10 percentage points higher or lower than your targets. If it is, it’s time to rebalance.
2. Are you making big, inadvertent sector bets? Compare your weightings to the S&P 500’s (provided in X-Ray). Again, look for big bets of five or 10 percentage points or more.
3. How about investment-style bets? To help provide a reference point, the Dow Jones Wilshire 5000 Index, a measure of the broad market, recently had the following breakdown in the Morningstar style box: 25 percent in each of the large-cap boxes, 6 percent in each of the mid-cap boxes, 3 percent in small value, 3 percent in small blend and 2 percent in small growth.
4. Is a big share of your portfolio in a single stock? To see, click on the Intersection tab. Positions amounting to 5 percent or more of your total portfolio can ramp up its risk level.
5. Do you have an adequate emergency fund? Make sure you have a bare minimum of three months’ worth of living expenses in a cash or cashlike vehicle. (Don’t use X-Ray to gauge your cash holdings because it is likely to overstate them by including cash holdings that appear in long-term mutual funds; you couldn’t access that cash without selling the whole fund, so that money isn’t really liquid.)

If you have extra time, click the individual security names at the bottom of the main X-Ray page to see data and analyses for the stocks, mutual funds, and ETFs in your portfolio.

DAY 16: LOOK FOR OPPORTUNITIES TO STREAMLINE

Degree of difficulty: Moderate

Today’s task is one that’s relevant to investors of all ages and of all life stages: combating portfolio sprawl.

Diversification is a good thing, of

course, but you can also overdo it. It requires time and research to keep track of important developments at stocks and funds, and that task is compounded when you have many different accounts. And the more investments you have, the greater the likelihood that your portfolio will behave like the market. There’s nothing inherently wrong with market-like performance, but you don’t want to have to pay active management fees when an index fund would have done the job just as well.

So what are some strategies for beating back the sprawl? Index mutual funds and exchange-traded funds that track a broad market segment are a good place to start if you’re trying to streamline your financial life; Morningstar’s fund pick lists include plenty of topnotch core index options.

Alternatively, you could take advantage of all-in-one options, either by using a target-date fund or a stock/bond hybrid fund. And if you’re managing multiple accounts geared toward a single goal — for example, you and your spouse each have IRAs and 401(k)s, as well as taxable assets earmarked for retirement — think of them as a single entity rather than running each account as a well-diversified whole. Doing so gives you the freedom to pack a significant share of your assets into the best investments available to you within each account. Use Morningstar’s Instant X-Ray tool to make sure the whole portfolio is diversified and that the asset allocation is in line with your target.

DAY 17: SEE IF YOU’RE ON TRACK FOR RETIREMENT SAVINGS

Degree of difficulty: Moderate

Most of the tasks in my 21-day financial fitness regimen have centered on helping you get your investment program up and running. But once you do, it’s essential that you periodically check in to make sure that your portfolio and your savings rate put you on track to help you meet your goals.

One way to gauge whether your retirement plan is on track comes courtesy of Fidelity Investments. The firm recommends that investors in their 30s have retirement savings equal to their current salaries, those in their 40s have saved three times their current salaries, those in their 50s have saved six times, and those in their 60s have saved eight times their current salaries.

For investors who are closing in on retirement and want to gauge their portfolio’s viability to supply their in-retirement income needs, they can simply multiply their current balances by 0.04. If that amount, plus any predictable income they’ll be able to rely on through Social Security and/or a pension, is sufficient to live on, they’re likely on the right track. (Retirement researchers have found that withdrawing 4 percent of a retirement portfolio’s balance in year 1 of retirement, then inflation-adjusting that dollar amount in subsequent years, gives a balanced portfolio a good shot of lasting for 25-30 years.)

Those are just rules of thumb, though. A financial adviser can provide a more precise read on the viability of your investment program, and can help you tweak it based on your own situation. Alternatively — or perhaps in addition to customized financial advice — you can turn to online tools to gauge the sufficiency of your retirement assets. T. Rowe

Price’s free Retirement Income Calculator (troweprice.com) is one of the most comprehensive. You’ll be prompted to enter some information about yourself — your birth date, your expected retirement date, your current asset level and allocation, and your desired level of income in retirement. (You won’t be asked to provide any personally identifying information, such as your name or Social Security number, though, so don’t worry about anyone contacting you with a sales pitch.) The calculator will then give you a gauge of whether your portfolio in its current incarnation will support your desired level of income.

The bottom line with all of these tools is that they help you assess whether your portfolio can realistically support your goals. And the sooner you make that determination, the better positioned you will be to make changes so you don’t fall short.

DAY 18: GET A PLAN FOR YOUR PORTFOLIO AS YOU NEAR RETIREMENT

Degree of difficulty: Moderate

Amassing enough assets to retire is the heaviest lifting that any of us will do in our investing lives. But even after you’ve cleared that hurdle, it’s still important to have a plan for managing your assets during retirement.

Because encountering a bear market early in your retirement years can have a devastating impact on portfolios that are too aggressively positioned, it’s a sensible idea to start moving a portion of your portfolio to safer securities like cash and bonds as retirement draws close.

Another key task for retirees and pre-retirees is to determine a realistic portfolio withdrawal rate. How much can you take out without running the risk of outliving your assets? There aren’t any one-size-fits-all answers, but many planning experts agree that a 4 percent initial withdrawal rate, combined with ongoing adjustments to account for inflation, is sustainable with a 60 percent equity/40 percent bond portfolio over a 25-year retirement period. However, retirees with longer time horizons and/or more conservative equity allocations should take more modest withdrawals. It’s also a good idea to adjust your withdrawal rate downward if you encounter a weak market; that way, more of your portfolio is in place to recover when stocks do.

Finally, if you’ve saved for retirement in various accounts — and most of us have — your retirement portfolio strategy must also include a plan for tapping those assets. As a general rule of thumb, you’ll want to tap your taxable accounts first, deductible IRAs and company-retirement plan assets second, and Roth assets last. If you’re subject to required minimum distributions, fulfilling those distributions comes first.

DAY 19: USE A ‘BUCKETING’ SYSTEM WHEN CONSTRUCTING YOUR RETIREMENT PORTFOLIO

Degree of difficulty: Moderate to Difficult

One of the most daunting aspects of managing your finances is figuring out how to transition from accumulation mode into retirement, or “harvest” mode.

One intuitive way to construct a retirement portfolio is to create various buck-

ets of money based on when you expect to tap them for living expenses. Bucket number one contains living expenses for the next 1 to 2 years, and therefore should consist of highly liquid investments like CDs and money market funds. This is money you can’t afford to lose.

Bucket number two should be positioned for living expenses in years 3 through 10, and therefore you can afford to take on slightly more risk. Intermediate-term bond funds and even conservative stock funds or balanced fund are good choices for the intermediate sleeve of your retirement portfolio.

Those assets you don’t expect to tap for at least 10 more years can be stashed in stocks and stock mutual funds. Because you’ve established you have a fairly long time horizon for this money, you won’t be unduly upset if the stock market has periodic hiccups.

DAY 20: MAKE SURE YOUR RETIREMENT PORTFOLIO INCLUDES INFLATION PROTECTION

Degree of difficulty: Easy

If you’re already retired or getting ready to do so, one of the key risks that you’ll need to guard against is inflation. Social Security payments are adjusted for inflation (assuming the Consumer Price Index is going up), but the paychecks you’ll take from your retirement portfolio will grow smaller and smaller — in real terms — as the prices on the stuff you buy trend up. It’s therefore important to position your portfolio to address that threat.

Although investors often debate the best investments to guard against inflation, with some favoring so-called hard assets like commodities and gold, Treasury Inflation-Protected Securities (TIPS) provide the most direct way to do so. The principal values of TIPS adjust upward to keep up with inflation, as measured by the Consumer Price Index, giving investors a straightforward, low-cost way to ensure that their portfolios keep up with higher prices. I-Bonds, which can be purchased directly from the U.S. Treasury, have similar inflation-defending features. (In contrast with TIPS, however, I-Bonds receive an adjustment to their interest payments to account for inflation.)

DAY 21: SCHEDULE REGULAR CHECKUPS

Degree of difficulty: Moderate

Investors often make the mistake of checking up on their portfolios too frequently, or worse yet, only after big market moves, when they’re most inclined to make rash decisions. To help avoid that pitfall, schedule regular checkups in advance.

For most people, one comprehensive portfolio review per year is plenty, and much better than obsessing on a daily basis. Year-end — ideally around Thanksgiving, before the holidays gear up — is a good time to conduct your annual portfolio review, because you can still make adjustments to reduce your tax bill.

Morningstar.com’s Portfolio Manager makes it easy to monitor your portfolio on an ongoing basis. You can either enter your portfolio directly into the tool or via our Instant X-Ray tool. After you’ve viewed the X-Ray for your portfolio, simply click Save Instant X-Ray as a Portfolio.

