

MID-CAREER PLANNERS

CASE STUDY:

An exclusive portfolio for moderate savers

BY CHRISTINE BENZ

How different should your portfolio look when you're in your 40s versus how it was positioned when you were just starting out?

Not all that different, it turns out. The portfolios here are for a slightly older investor, one who intends to retire near 2035. The moderate portfolios include more than 80 percent in stocks and a still-sizable allocation to foreign names.

As with other more aggressive portfolios, I've used Morningstar's Lifetime Allocation Indexes to help set the baseline asset allocations. In this case, I used the Moderate version of the 2035 Index.

To populate the portfolios – one composed exclusively of mutual funds and the other focusing on ETFs – I've employed funds that are highly rated by our analyst team. Most of the funds earn Gold ratings, but I used Silver- and Bronze-rated funds in cases where suitable Gold-rated funds were unavailable.

The Moderate Saver mutual portfolio consists of the following funds in the following allocations:

- The mutual fund portfolio**
- 15 percent: Primecap Odyssey Growth (POGRX)
  - 15 percent: Vanguard Dividend Appreciation (VDADX)
  - 15 percent: Oakmark Fund (OAKMX)
  - 10 percent: Vanguard Extended Market Index (VEXAX)
  - 21 percent: Vanguard Total International Stock Index (VTIAX)
  - 5 percent: Oakmark International Small Cap (OAKEX)
  - 19 percent: Metropolitan West Total Return Bond (MWTRX)

- The ETF portfolio**
- 47 percent: Vanguard Total Stock Market Index ETF (VTI)
  - 8 percent: Vanguard Small-Cap Value ETF (VBR)
  - 20 percent: Vanguard FTSE Developed Markets ETF (VEA)
  - 5 percent: Vanguard FTSE Emerging Markets ETF (VWO)
  - 20 percent iShares Core Total USD Bond Market ETF (IUSB)

I stuck with the same basic basket of funds that I would have used for an early planner portfolio, and the allocations aren't terribly different, either. Given that a person in his or her 40s has a 20-year time horizon until retirement, it's only reasonable that the bulk of the portfolio remains in stocks, which should enhance its return potential.

That said, there are a couple of noteworthy differences between an aggressive, early-planner portfolio and these moderate portfolios.

First, the moderate portfolio's equity allocation is a touch lower. Much of that differential owes to the moderate portfolios' lighter international equity allocations. However, 40-somethings with high risk tolerances—that is, those who didn't freak out and sell during the global financial crisis—could reasonably keep their all-in equity weightings as high as 90 percent.

The bond pieces of the moderate portfolios also are higher than those of a more aggressive portfolio. Note that Morningstar's Lifetime Allocation Index for 2035 retires with moderate time horizons contains tiny stakes in both Treasury Inflation-Protection Securities and foreign bonds. However, the allocations are so small that it's hard to see that their effect on performance would be significant enough to make initiating new positions worthwhile.

**How to use**

While I expect the portfolios to perform well over time, the key goal of all of my model portfolios is to depict sound asset-allocation and portfolio-management principles. Thus, mid-career individuals can use the moderate portfolios to help assess their own portfolios' positioning.

I developed the portfolios with open architecture in mind—that is, I assumed that an investor wouldn't mind buying holdings from separate firms. But because all of the holdings shown here are mainstream in their exposures, investors who would like to stick with a single provider or supermarket could likely find funds with similar characteristics at their own firms. (Here again, Morningstar analysts' Medalist funds can come in handy.)

I also developed the portfolios without consideration for tax efficiency—that is, I assumed they would be held inside of a tax-sheltered wrapper of some kind, such as an IRA. Investors who intend to hold their portfolios inside of a taxable account would want to put a greater emphasis on tax efficiency, emphasizing index funds and ETFs on the equity side, for example.

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MISTAKES THAT CAN BREAK YOUR RETIREMENT SAVINGS PLAN

Those who are saving for retirement often worry over the things they want to get right—finding an appropriate investment mix or buying the best mutual funds.

These decisions are undoubtedly important, but just as critical to retirement success may be the things you don't get wrong—the mistakes you avoid along the way, as you're building your nest egg. All too often, life gets in the way, and can put the best laid retirement plans at risk.

Morningstar.com's editor sat down with Christine Benz, Morningstar's director of personal finance, to discuss five common pitfalls that can trip up retirement savers.

**Question:** Christine, although it can be tempting when unexpected expenses come up, pitfall number one is raiding your company retirement account.

**Christine Benz:** Taking premature withdrawals from a company retirement plan can be very costly. You'll have to pay ordinary income taxes on that withdrawal, and you'll also have to pay a penalty if you're prior to retirement age.

**Q:** Some plans have the option for participants to take a loan from their retirement account. Is that a better option than taking the money out directly?

**Benz:** It is a better option, but it's still not perfect. The reason it's better is that you will have to pay that money back to yourself, and you'll have to pay interest on the amount that you've withdrawn.

The key reason that it's not a great idea, though, is that if you do lose your job prematurely, you'll have to pay that money back almost right away; you usually have 90 days to get the money back into the account to avoid taxes and/or penalties. If you've lost your job, that could be very difficult to do.

**Q:** Early withdrawals or loans from 401(k)s often happen during times of emergency. Pitfall number two is not having an emergency account that would essentially prevent you from having to do that.

**Benz:** You'll want to have some safe money set aside outside of

your company retirement plan to meet those emergency expenses as they occur. Whether it's a leaky roof or some car repair that you've got to pay for, you'll have that money set aside in your checking or savings account. It will be there in your time of need, and you won't be forced to raid your retirement fund.

**Q:** This money should essentially be invested or saved in something very safe.

**Benz:** Very safe—money market accounts, checking accounts, CDs. It's money that will not ever be at low ebb when you need to withdraw it.

Taking premature withdrawals from a company retirement plan can be very costly.

**Q:** How much should you have in an emergency account?

**Benz:** The standard rule of thumb is that you want to hold three to six months' worth of living expenses in your emergency fund. I think that's a good starting point. But certainly people who have more volatile earning streams, those in careers where there is a high probability of disruption in their job, or higher earners would want to have more like a year's worth of living expenses in their emergency fund.

**Q:** A lot of retirement savers don't just have retirement to save for; they have other things such as college education for their children. Pitfall number three is not prioritizing those savings correctly.

**Benz:** We're all multitasking for most of our earnings years. It's im-

portant to make sure that we have our priorities straight.

Certainly there is a strong emotional motivation to fund higher education for children, but you'll want to step back and think about the fact that retirement is a very big-ticket item. Retirement needs to be at the top of your priority list.

Also when it comes to weighing college funding versus retirement funding, think about the levers that your child will have if he or she gets to college age and maybe you haven't saved enough. There are loans that he or she could take. But you won't be able to take a loan to pay for your own retirement.

**Q:** Pitfall number four involves not bumping up your retirement savings contributions when you get a raise.

**Benz:** This is one of the most painless ways to increase your savings rate. If you do bump up your contributions along with your earnings, you will be putting money into the account without ever having seen it. So it's a very nice and painless way to increase your savings rate.

Also, if you don't bump up your contributions as your salary increases, your level of consumption, your standard of living, will be going up and up, and when you get to retirement you'll expect to continue with that standard of living. However, you won't necessarily be funding that retirement at an appropriate level if you don't step up your contributions along the way.

**Q:** Most folks have the message now that retirement can be an expensive proposition. Pitfall number five is not considering some of the other retirement savings vehicles that may be available to you.

**Benz:** It's hard to beat a company retirement plan for painless savings; your money automatically goes into that plan month in and month out. That's a great way to build the bulwark for your retirement savings plan.

But it is important to think about supplementing it with a vehicle such as an IRA or even a taxable investment account. The key reason is that you are setting aside additional funds for retirement, and you may also be able to invest in investment types that aren't available inside the confines or your 401(k) or company retirement plan.

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