

■ **EARLY PLANNERS**



COMMENTARY  
by *Christine Benz*

# Fresh start to retiring

Staging your future can get you on the right track

**H**ave you ever stopped to think about all of the different tasks your brain is processing when you drive a car? Figuring out how to pilot the vehicle from point A to point B is the overarching job, but you're also completing scores of little tasks in very short bursts of time — merging into traffic, minding the street signs and speed limit and watching out for pedestrians and bicyclists, to name just a few. Is it any wonder it's illegal to text and drive at the same time?

Though we may not give it much thought, most of us are multitasking throughout our financial lives, too. Even though retirement may be your long-range goal, it's a good bet you're knocking off scores of smaller financial jobs along the way — paying off student loans and home mortgages and socking away funds for college for the kids, to name some of the biggies. You also are practicing the equivalent of defensive driving — building an emergency fund to defray the periodic large car repair or vet bill, for example, and purchasing various insurance products.

We designed this guide to address the fact that financial multitasking is a way of life for people at all life stages, and to help you do it even better.

Because the financial priorities and jobs of a new college grad are vastly different from a 62-year-old who's trying to figure out if he's on track to retirement, we've organized the information in the next pages by life stage. We've crafted sections for early-career accumulators (20- and 30-somethings), mid-career accumulators (40- and 50-year-olds), pre-retirees, and retirees. For each age band, we highlighted the most important financial "jobs" to have on your radar — along with advice about how to get them done.

Because Morningstar is first and foremost an investment-research firm, the guide includes plenty of concrete guidance on making smart investment decisions. In addition to discussing which investment types are appropriate at each life stage, we've also provided model portfolios to depict how all the pieces come together and showcase sensible security-selection techniques. In keeping with Morningstar's long-standing emphasis on the virtues limiting investment costs and spreading your money across investments with disparate characteristics, the portfolios are anchored by broadly diversified low-cost mutual funds and exchange-traded funds.

The guide also includes deep dive articles that tackle some of the most nettlesome tasks that can arise at various life stages. For those starting out in their investing careers, for example, we've taken a closer look at topics such as right-sizing an emergency fund (**next page**) and avoiding the big traps when saving inside of a 401(k) plan (**pages 20-21**). For more seasoned investors, the guide features articles about tax matters (**pages 22-23**) and in-retirement portfolio withdrawals (**page 13**), among other topics.

No matter your life stage, we're confident that you'll be able to pull a few tips — or maybe even more — to help you get where you need to go, avoid the big roadblocks, and enjoy the trip. And isn't that what it's all about?

Many happy returns!

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# Investing FOR SHORT- AND INTERMEDIATE-TERM GOALS

BY **CHRISTINE BENZ**

**J**ust as putting and chipping look deceptively simple to beginning golfers, so can the process of investing for short-term investors. It looks so easy, but it can be difficult to get right.

For example, investors may confuse their risk capacity with risk tolerance, thereby venturing out on the risk spectrum and incurring losses just before they need to tap their portfolios. Or they might assume that just because stocks have delivered returns that have bested other asset classes' in the past five years, they'll do it again during the next five.

At the opposite, conservative extreme, investors might assume that the best way to meet short- and intermediate-term goals is to stick exclusively with guaranteed products such as CDs or money market accounts. That's not an unreasonable idea given how small the current differential is between cash and products that do not promise stability of principal; for very near-term expenditures, cash is best. But if the investor's time horizon is longer than a couple of years, the bite of inflation means that guaranteed products will be a losing proposition.

## Running the numbers

Investing for short- and intermediate-term goals is, in many ways, a game of probabilities. While the S&P

500 posted a positive return in 86 percent of rolling 10-year periods in the past 25 years, stocks have been much less of a sure thing for shorter time horizons. Over rolling one- and three-year periods from Feb. 1, 1993, through Jan. 31, 2018, the S&P has posted a loss roughly 19 percent and 22 percent of the time, respectively, and some of those short-term losses were punishing, especially in one-year windows. Meanwhile, bonds have a much higher probability of holding their ground over shorter time periods. During the same 25-year period, which was admittedly strong for bonds, the Bloomberg Barclays U.S. Aggregate Bond Index had a positive return in every rolling three-year time period and in 91 percent of rolling 12-month periods. Of course, past is not prologue. In a sustained period of rising interest rates, bond losses could be higher and more frequent than they have been in the recent past.

## What's a well-meaning short- or intermediate-term investor to do?

Well, even if bond returns aren't a sure thing to make money going forward, that doesn't automatically make stocks the better bet for short- or even intermediate-term time horizons. Historical returns suggest that if your time horizon is less than 10 years, stocks' returns have been too unreliable for them to

be a worthy receptacle for the whole of your money. Stocks might be a component of a portfolio if the time horizon is close to 10 years, but they shouldn't be the whole kitty. Investors have even more reason to check their near-term expectations for stocks as they've been on an extended tear for several years and that valuations, while not at skyscraper levels, aren't especially low right now.

The answer is that if you're saving for a goal that's close at hand, whether a home down payment, remodeling or a special family trip in five years, you need to take some risk but not too much. You also need to recognize the role your savings rate plays in all of this: If returns from reasonably safe asset classes are apt to be muted during your holding period — and current bond yields suggest they will be — you may need to step up your savings rate to achieve your goal rather than relying on portfolio returns to do the heavy lifting.

The portfolios on the next page are geared toward investors who expect to need their money within 5-10 years. Investors with very short time horizons of just a few years should stick with cash. Because many investors save for short- and intermediate-term goals outside of their retirement accounts, I've created portfolios for both taxable and tax-deferred accounts.

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# ■ **EARLY PLANNERS:** Road Map

**B**ecause they're just starting out, early career accumulators — loosely defined as people in their 20s and 30s — don't typically have much in the way of financial capital (unless they're technology savants or supermodels, that is). Not only are their earnings often low relative to where they'll be in the future, but new college grads also may be digesting college debt.

But early career accumulators have other assets that their older counterparts can look upon with envy. With a whole lifetime of earnings stretching before them, early career people are long on what investment researchers call human capital: Their ability to earn a living is their greatest asset by a mile.

Investors in their 20s and 30s have a valuable asset when it comes to investing, too: With a very long time horizon until they'll need to begin withdrawing their money (for retirement, at least), early career investors can better harness the power of compound interest. They also can tolerate higher volatility investments that,

over long periods of time, are apt to generate higher returns than safer investments.

If you're just embarking on your investment journey, it's hard to go too far wrong with the mantra of investing as much as you can on a regular basis and sticking with very basic, well-diversified investments. But it also pays to think of your "investments" in a broad sense, steering your hard-earned dollars to those opportunities that promise the highest return on your investment over your time horizon.

For most people, that will require a bit of multitasking: Rather than wait until all of your student loans are paid off to begin investing in the market or saving for a down payment for a home, for example, you may want to earmark a portion of each paycheck for all three "investments."

Here are some tips for investing well and yes, multitasking, in your 20s and 30s.

## Put debt in its place

One of the earliest forks in the road

that many early accumulators face once they begin earning a paycheck is whether to steer a portion of that paycheck to service debt or to invest in the market. If it's high interest-rate credit card or student loan debt that features a particularly high rate, it's worthwhile to earmark the bulk of one's extra cash for those "investments." The reason is that it's impossible to earn a high guaranteed return from any portfolio investment today, whereas retiring debt delivers a guaranteed payoff that's equal to your interest rate. As a general rule of thumb, investors carrying debt with an interest rate of 5 percent or more would do well to focus on paying down those loans (or possibly refinancing into more favorable terms) before moving full steam into investing in the market. One exception: building an emergency fund (more on this at right).

## Make the investment in human capital

While we're on the topic of "investments" in the broadest sense, the 20s and 30s also are the ideal life stage to