

Savings plan lacking focus

Money Manager/by Karin Price Mueller

Sunday, December 30, 2001

PROBLEM

Lots of people make a hobby out of following the stock market, tracking their savings plans and investigating new investment opportunities.

Jim and Torie don't fall into that category. They aren't wild about money matters, and would rather put their finances on autopilot so they can spend their spare time doing things they enjoy.

Jim and Torie - not their real names - came to the Herald to assess how they're doing so far in reaching their goal of retiring in about 10 years. (Retirement, to Jim and Torie, means leaving their full-time jobs and working two or three days a week to fill some of their newfound spare time.)

"We just keep putting money away," Jim says. "Trying to plan so far ahead of time kind of confuses me."

Confusion or not, the Hub couple has been socking away 10 percent of their income from their jobs at a mail-delivery company in their 401(k) plans. They also receive an employer match of 50 percent on their first 3 percent of contributions. And with Jim's annual salary of \$38,566 and Torie's \$40,884, their accounts are growing nicely.

Jim, 47, has a balance of \$100,738 in his plan. The account is split as follows: \$33,340 is in a government securities fund, \$5,310 in a fixed income fund and \$62,088 in a large-cap U.S. stock fund.

Torie, 45, has \$50,315 in her account. \$50,106 is in the common stock choice and \$209 is in the government securities option.

In addition to their 401(k)s the couple also has a few IRAs. Torie has a Roth IRA worth \$5,919, invested in American Express Equity Value. Jim's Roth IRA is worth \$2,706, invested in the American Express Global Growth Fund.

Through an account with American Express Financial, the couple adds \$433 a month to a mutual fund account. That account, worth \$44,760, is invested in a diversified group of funds.

They also own some individual stocks: \$899 worth of Lucent Technologies, \$12,484 of Verizon, \$11,537 of BellSouth and \$2,997 of AT&T.

Jim and Torie also have about \$2,000 and \$16,000 in money market accounts.

Though they have saved quite a bit to date, Jim is concerned about saving too much.

"I don't want to put all my money away for the future and not enjoy life now," he says.

"My wife worries about the future and that we should put more away, but I say we might not be alive in five years."

As they ponder their savings strategy, Jim and Torie have a pretty good handle on some other parts of their financial lives. They have no credit card debt and they pay their bills in full each month.

"It kills me to pay interest," Jim says. "About 15 years ago I had maxed out two or three cards, and I had to go to court to make the payments. I said I'd never do that again so if we can't afford to get it, we just don't get it."

Jim dislikes debt so much that he and Torie used to prepay their mortgage, until they refinanced a few months ago.

He decided he could better use the cash today that he had been spending in extra mortgage payments.

He doesn't believe they'll stay in the house forever, though.

"The house is big for us," he says. "I figure the profit we could make on the house - in retirement we could live off some of that."

SOLUTION: Professional advice would maximize couple's returns

Jim and Torie almost have the brass ring in hand.

As good savers who live well within their budget and without bad debt, the couple is on their way to a secure retirement - on their timetable.

But still, the couple needs to do some investment planning to make the most of their money, says David Bross, a certified financial planner and founder of Leominster's DS Bross Financial Advisory. He sees some potential pitfalls.

"One of the biggest dangers is they don't really understand what they own," says Bross, a member of the Financial Planning Association of Massachusetts.

Because the couple has other interests they'd rather spend their time on, Bross recommends they work with a financial adviser on a regular basis to make sure their strategy is on the right track.

To get them started, Bross says the couple has to look carefully at their asset allocation.

They currently have 77 percent of their savings in large-cap U.S. stocks, 1 percent in foreign large-cap stocks and the remaining 22 percent in interest-earning investments, both short- and long-term. The heavy weighting in large caps is too risky, Bross says.

"We will not forever repeat the late '90s, which was the time when large-cap growth stocks were the best-performing asset class," says Bross.

Overall, he recommends the couple put 60 percent of their total portfolio in equities and 40 percent in interest-earning investments. Of the equity portion of the portfolio, he suggests 50 percent should be in U.S. large caps, 20 percent in U.S. small caps, and 30 percent in international stocks. For fixed income, he recommends 50 percent should be in short-term instruments (with maturities of 18 months or less) and 50 percent should be in intermediate-term instruments (with maturities of 18 months to 10 years).

One thing in Jim and Torie's current portfolio that Bross wasn't crazy about: annuity contracts. He says they should stop contributing to those investments and instead fully fund Roth IRAs using low-cost, no-load mutual funds.

"The annuities are inferior to a Roth because although both plans are contributed to with after-tax dollars and they both accumulate on a tax-deferred basis, the Roth will distribute all the earnings tax-free in the end," Bross says. "With the annuity the gains will always be subject to taxes."

Another problem with the annuities is that they're a more expensive way to invest than just plain old mutual funds. In addition to the expenses of a mutual fund, the annuity has another layer of expenses that eats into earnings - in Jim and Torie's case: an additional 1.25 percent in expenses.

In other areas, Bross suggests the couple add another \$3,000 to their cash accounts to complete their emergency fund. He says that one-third of the funds should remain in their money market account, and the remainder should be in something that's tax sheltered, such as U.S. series EE series I bonds.

"I like to see the equivalent of 10 percent of their wages in a readily accessible account like the money market," Bross explains. "The likelihood of them having to tap into the rest of the money is small so its better they get the tax deferral on that money."

He also recommends some insurance changes for the couple. Torie is currently paying \$1,000 a year for \$58,000 of variable universal life insurance. Bross says she should surrender this policy and invest the cash value of \$8,000.

"Her life insurance need will be met more appropriately by buying an extra two times worth her salary in group term life through her employer," he says, mentioning a 10-year, level-term policy as the best.

Bross also recommends similar coverage for Jim, to protect Torie should something happen to him.

Disability insurance should be the next consideration. Bross says they can probably buy policies through their employer. They should look for policies that would replace 60 percent of their income should they be unable to work.

"Generally speaking it's cheaper to buy disability insurance through work because insurance companies underwrite a very large number of people that way," he says. "Economies of scale enable an individual to purchase the coverage cheaper through a group plan."

Finally, for further protection, Jim and Torie should buy umbrella liability insurance worth \$1 million.

"It's really important for them to protect their liability exposure - they have a pool at their home," he says. "They can get it for probably \$300 a year."