



The 2005 Investment Guide

## What's the Plan?

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### **You're seeking an advisor for your nest egg. Should you choose a huge finance house like Vanguard or the solo practitioner on Main Street?**

The financial industry has eased back its ad pitches about making you rich by next year with hot stocks. Now it is scaring up anxiety that you'll lack the gold to pay for your golden years. The new sales push is planning for old age.

By no coincidence America's biggest age cohort is at the doorstep of retirement. In 2005, 37 million will be in their 50s--prime candidates for 401(k)s and all kinds of advice.

The megarich, with their more complicated estates, have long had brokers and accountants dancing attendance on them. For those without a private banker at JPMorgan, there are always dubious tips available from an insurance agent, family friend or the Web. And planning software of marginal utility can be had for as little as \$60.

That's why a cottage industry of 115,000 individual financial planners has emerged in recent years to hold people's hands. These small-time guides often prefer to be called "wealth advisers." By whatever name, a solid, well-established planner can provide you with fairly customized, ongoing help for \$10,000 to \$15,000 a year in fees. You also can get a one-shot plan for \$600 or so, though a case can be made that you will need periodic tune-ups, which obviously must cost far more.

Lately, however, the small planner shops are getting big-league competition. Backed by nationwide ad blitzes, huge money management houses are offering advice for one-fourth to one-third less than stand-alone planners. The stand-alones dismiss the institutional help as little more than a disguised sales come-on for in-house products, and it's true that the behemoths are heavy on their house brands. The small fry insist they offer more personalized service than the mass-market institutions.

What makes the most sense for you? For a comparison we took a composite family's portfolio to a well-recommended one-office outfit, Schultz Financial Group in Reno, Nev. Principal Vicki P. Schultz is a certified financial planner with an M.B.A. If you're a Reno-area resident, you get marvelous, personalized service from Schultz face to face.

For the institutional monolith, we had a large choice, including Fidelity Investments and Charles Schwab (see box, p. 184) with varying services and fees. We opted for Vanguard Group and asked that its Personal Financial Planning Services program review our test family's finances. The advice here came via e-mail or over the phone. We liked that Vanguard's value-oriented planners are on salary, not commission. And, yes, Vanguard pushes the in-house goods, particularly its signature index funds. At least its funds are well run and cheap. Each Vanguard fund and program pays its own freight, and costs aren't shifted around for marketing aims.

Schultz and Vanguard both went through the planning exercise for a hypothetical family with \$2.5 million in savings.

### **One-time plan.**

Vanguard will do a one-shot plan, on the basis of plenty of conversation and analytics, for \$500 for portfolios with at least \$250,000, or \$250 if yours is a \$1 million-plus portfolio. That's less freight than most small planners. (Schultz won't do one-timers.) And if you follow Vanguard's plan and put everything into its funds, the first-time plan is free. The Vanguard funds it picks may seem pretty general, even though Vanguard can show you its approach is a sophisticated way of diversifying over years of disparate economic circumstances.

## Ongoing advice

Vanguard also offers regular hand-holding, for \$12,000 yearly in our case, compared with \$15,000 for Schultz. But with Schultz you get a planner who will get to know you. Vanguard says it will try to keep you talking to the same person over time, yet there's no guarantee. And it likely will be on the phone. Unless you happen to live near one of Vanguard's three service hubs (in Valley Forge, Pa.; Charlotte, N.C.; and Phoenix, Ariz.), you're unlikely ever to see your adviser.

Nevertheless, do you even need continuing advice? You could plausibly implement Vanguard's plan and just keep your fund choices static for 20 years, saving the \$12,000 annual fee.

## Assessing finances

Both solo practitioner Schultz and vast Vanguard will give you a rounded assessment that covers investments including Roth or standard individual retirement accounts, and also insurance, college costs, trusts, mortgages, tax liability and long-term care policies. Or even your expected cosmetic surgery bills, if you want to volunteer information about them. These factors will be plotted out over decades. The plan preparation process usually takes a month or two.

## Plan structure

Schultz may point you to commodity plays or other hedges against rocky economic times. Not Vanguard, for whom good bear-market insurance is a generous fixed-income fund allocation. Your Vanguard funds will cost a lot less in management fees than Schultz's more exotic fare, which includes proprietary equity pools, known for higher fees. How the two plans will pan out over the years is anyone's guess.

## The Clients

Our hypothetical household, the Muchmores of New York's suburban Long Island, aims high. Donald, 49, wants to retire from his upper-management post by 60. His wife Clara, 46, a lawyer who has worked part-time while raising the couple's two children, is ready to increase her billable hours to boost the family income as she and Don begin the final push toward their goal: leaving the workaday world, still youthfully vigorous, to own and operate a bed-and-breakfast in the Berkshires, as well as a 1.7-acre spread for raising ostriches.

Like many Americans, the Muchmores think they can stay comfortable even as they put the kids through college, look out for Clara's needy parents (Don's are well-off) and dodge the taxes on their accelerating joint income. Don is relying on Clara for that earnings growth because his own salary in the tough logistics business is unlikely to increase much.

The Muchmores have a fifth of their net worth in equity in their residence and vacation home. Over time they've acquired a mixed bag of financial assets, including some once-hot tech stocks. Clara is sentimental about the Sara Lee shares her father, a longtime employee at the food company, gave her as a college graduation present. And the pair, like many Americans, have reached for yield in a junk bond fund. But they've also shown a more conservative side, loading up on municipal bonds out of recurrent tax worries.

Although the Muchmores report a combined gross income of \$300,000 and expect that to rise to \$350,000 with Clara's extra work, they are carrying an ambitious load, including \$20,000 a year of support for Clara's parents and a \$5,000 annual tennis camp for son Midas, with college ahead for both children.

## **Current Situation: Different Takes**

Schultz's view of the Muchmores' existing finances was upbeat, saying they would meet their retirement needs. Vanguard, though, gave a darker assessment. The Muchmores had a less-than-even chance of attaining their retirement goals, it figured.

For Schultz, the clients filled out a 36-page questionnaire, asking about everything from the Muchmores' insurance policies to their "three wishes if you found Aladdin's lamp." Then she personally interviewed the clients about parents' ailments and kids' camps, plus investment philosophies.

In return the family got from Schultz a 68-page report, partly canned investment advice but mostly specific to the Muchmores' situation. It spelled things out in balance-sheet, income-statement and cash-flow terms over a 42-year time span. Schultz recommended portfolio revampings, with justifications for them. The Schultz bottom line was comforting: "According to our projections, you will not have a deficit in retirement, and you have a 'cushion' available if you need it."

Vanguard had the Muchmores fill out a much shorter (16 pages) questionnaire and later delivered a much shorter (28 pages) briefing. Aside from a boilerplate section on Vanguard's philosophy, it showed striking historical performance data that said they had only a 43% likelihood of attaining their goals. The report warned they had to reduce "day-to-day core expenses." Initially vacations and entertaining, it said, then if need be the son's tennis camp and aid to Clara's parents.

Why the difference between Vanguard and Schultz? For one thing, it transpired that Vanguard figured a higher annual expense line using the figures we gave them. (Tip: Fill out the form carefully and pay attention to the calculations you get back.) Also, Schultz, like many planners, uses average expected returns to estimate a household's capabilities. But Vanguard's procedure is more complex. The fund company frames outcomes using a myriad 44 scenarios from most bullish to most bearish. In only 19 of the 44 would the Muchmores make it.

## **ASSET ALLOCATION: TWO VIEWS**

Vanguard would place the Muchmores firmly in its index funds, from the Short-Term Bond Index (charging 0.2% of assets per year) to the Total Stock Market Index (0.2%), a Wilshire 5000 tracker. Vanguard also offers nonindex vehicles aimed at market-beating (*see story, p. 190*). The fund house recommended actively managed Windsor II (0.43% in fees), a value warhorse that has outdistanced the S&P 500 by an annual 7.95 percentage points over the past five years.

Vanguard advocated getting rid of all the Muchmores' old stock and bond picks, even such venerable value funds as Weitz Value, which has bested the S&P by 9.2 points over five years. Weitz charges an un-Vanguardly 1.1% annually. Intriguingly, value-house Vanguard would leave the Muchmores with a bit more than Schultz in growth stocks--a good 15%.

Schultz Financial is no index fan. "No one's watching valuations" in an index, Vicki Schultz says, meaning an index can get overweighted in one popular area, like tech in the late 1990s. Schultz also thinks overreliance on growth stocks is foolish. She will accommodate your preferences, such as letting Clara stick with those lackluster Sara Lee shares from her dad.

The Muchmores walked in with 35% of their equity assets still in growth stocks, which they believe will recover. Schultz, after analyzing each of the individual securities, would sell virtually the whole taxable account (except for Sara Lee) and reconstitute the overall equity portfolio to only 10% growth.

Schultz directed the Muchmores to nine solid, albeit not cheap, mutual funds, such as First Eagle Gold Fund, which charges 1.41% of assets yearly and a maximum 5% upfront sales charge. She also suggested putting big blocks of money into "private" stock and bond pools. Stand-alone planners can get clients into these things, otherwise restricted to the very wealthy, by collecting clients in a mass. Schultz included "fund of funds" choices, including a long/short hedge vehicle, that can impose a couple of percentage points of fees, then slice 20% from profits.

Further, Schultz recommended that \$90,000 go to a "working interest" natural-gas pool, which charges investors 4% to 6% up front. Although such tax dodges have an unsavory reputation, Vicki Schultz says she has vetted this one along with the specialized fund offerings and can vouch for long-term returns after fees. "I'm very, very cognizant of those fees," she says.

All told, the Schultz portfolio revision would have 11% of the Muchmores' financial assets in gold, commodities or energy plays. Hard assets are in worldwide demand, she reasons. And \$50,000 would remain in an unhedged foreign bond fund to shield against dollar depreciation.

Vanguard doesn't recommend to financial-planning clients a global bond fund or exchange-traded funds that could mimic a commodities strategy. Wouldn't that leave clients naked should inflation kick up? If the client expresses that worry, the portfolio will be adjusted to reflect it, says Shawn P. Hoffman, a Vanguard senior investment manager.

## **Vetting A Planner**

In choosing a planner, ponder these questions:

- Do you need face time with your adviser? Forget it with a big house. But you get it with a stand-alone. Schultz believes an ongoing relationship is in your (and certainly her) best interests. That's why she doesn't do one-time plans.
- Do you and your planner share investment outlooks? If you want to skate out on the risk curve with go-go stocks, Schultz is not for you.
- Have you checked out your planner for hidden costs and conflicts? You don't want to be put into a garbage fund, with your planner taking a "consideration" (translation: kickback) from the stinker's manager. Schultz vows she takes no such gratuities and even has dropped from Schwab's planning referral list because the brokerage demands a fee split that would boost client costs. She does use Schwab for back-office support.
- How far ahead can you see? You need to tell your planner about possible factors off in the distance: big inheritances, onerous medical obligations, property liquidations, kids' graduate school bills. Midas Muchmore, 17, may go to med school.

Can't afford that? His parents might suggest his becoming a financial planner. It's a growing field.