

Thank You, *PracticalFinance* Readers

Dear *PracticalFinance* readers,

This is the last issue of *PracticalFinance* in its current incarnation. I'll be transitioning to a new position at Morningstar.com over the next month, where I'll be writing personal-finance articles and developing tools for users of Morningstar's website. Given the demands of my new position, we've decided to suspend publication of the newsletter.

However, I'm confident that you're in good hands. Instead of *PracticalFinance*, subscribers will be able to receive the Morningstar newsletter of their choice for the duration of their *PracticalFinance* subscriptions. (By now you should have received a letter from us communicating what your options are.) If subscribers don't specify which newsletter they'd like to receive, they will automatically begin receiving my colleague Russ Kinnel's newsletter, *Morningstar FundInvestor*. Russ is a savvy investor with whom I've worked—and learned from—for many years. Every issue of his 48-page newsletter is chock-full of research, data, and investment picks to help you build a successful portfolio and monitor it to ensure it's on the right track. If you'd like to receive *FundInvestor*, you don't need to take any action. But if you'd like to receive one of our other newsletters for the duration of your *PracticalFinance* subscription, please call 1-866-910-1145 by Feb. 22 to let our product team know your preference.

In addition, former *PracticalFinance* subscribers will be able to keep up with my latest personal-finance advice via Improving Your Finances, a free monthly PDF newsletter that we'll begin publishing in March. Each issue of this free report will focus on a specific planning-related theme, such as estate-planning or taxes, and will include articles that I've previously published on Morningstar.com. As with *PracticalFinance*, I hope you'll find the new publication to be a helpful resource as you manage your household's finances.

I'd also like to take a moment to thank each and every one of you for being loyal subscribers to *PracticalFinance*. I feel passionately about providing straightforward, commonsense personal-finance guidance, and have truly enjoyed the opportunity to explore many important topics with you over the past two years. I've also appreciated hearing what's on your mind, and thank those of you who have written me with questions and comments. Your feedback has been invaluable. I'd also like to extend a special thanks to those of you who have volunteered your portfolios for inclusion in *PracticalFinance*'s "Portfolio Makeover" feature. I have loved having the opportunity to get to know each of you better, and *PracticalFinance* subscribers have told me that they've benefited from seeing real-life portfolios in action.

Best wishes to all of you in the months and years ahead. And stay in touch via e-mail:
christine_benz@morningstar.com.

Thank you,
Christine



Christine Benz,
Director of Personal Finance

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What's Next for Bonds?

Investment Insights | Christine Benz

Reporters often ask me for my take on the biggest mistake that investors make—so often, in fact, that I can practically answer that question in my sleep. The most common flub is what we at Morningstar call “driving with the rearview mirror,” or buying what has been hot in the recent past in the hope that its performance streak will continue. Such performance-chasing rarely works—last year’s hot asset class or category often lands in the doghouse just a few years later—but that doesn’t stop investors from falling into the same trap again and again.

Unfortunately, an examination of inflows into mutual funds shows that good old-fashioned performance-chasing was alive and well in 2009. While stocks staged a monster rally that began in early March, investors demonstrated a clear preference for bonds, a (relative) safe haven in 2008. Open-end bond mutual funds (both taxable and municipal funds) raked in \$357 billion in new investor assets during 2009. Flows into equity funds, by contrast, were roughly flat for both traditional mutual funds and ETFs in 2009. It’s hard to know for sure what’s in investors’ heads, but my hunch is that many have decided that a smaller but knowable gain beats the potential for higher returns, as well as the potential for greater losses, that stocks entail.

Buying bonds now isn’t likely to result in the kind of calamity that technology investors faced in early 2000 or that newly arrived commodity investors stepped into in mid-2008. Notwithstanding high-profile blowups at funds like **Schwab YieldPlus** SWYPX and the now-defunct Regions Morgan Keegan Select High Income Fund, bond-fund losses are usually substantially smaller than stock losses. Still, I’m afraid the outlook for bonds isn’t particularly bright right now.

Yields are low, as is painfully obvious to legions of seniors looking to their portfolios for current income. As of mid-January 2010, most intermediate-term bond funds were yielding less than 4%. Venturing into longer-term or lower-quality bonds doesn’t deliver an appreciably higher payout, either, particularly considering the additional risks. Through Jan. 15, **Vanguard Long-Term Bond Index** VBLTX had an SEC (30-day) yield of just 5.2%, while **Vanguard’s High-Yield Corporate** VWEHX bond fund was yielding a little more than 7%.

Looking forward, bond investors face a few different possibilities, none of them especially appealing. If the economy continues to recover, as it has been doing in fits and starts for the past few months, inflation could rear its head and interest rates could head up in a hurry. Under that scenario, bonds, particularly longer-term ones, will see their prices get depressed. A useful rule of thumb is that with each percentage-point increase in interest rates, a bond fund will lose an amount roughly equal to its duration, a measure of interest-rate sensitivity. So if a fund has a 12-year duration, as Vanguard Long-Term Bond Index had as of mid-January, it could shed 12% of its value if rates jumped up by just 1 percentage point. Intermediate-term and certainly short-term bonds wouldn’t suffer as much, but nor would they be bulletproof. **Vanguard Total Bond Market Index** VBTFX, for example, has a 4.5-year duration currently, which would translate into a roughly 4.5% loss with each percentage-point increase in rates. Those rising rates would eventually translate into higher bond yields, but the process would be painful for current bond-fund holders. If the economy picks up and the Fed doesn’t act to keep a lid on inflation, higher prices for goods and services could gobble up every bit of yield that investors are able to earn. As it is right now, bond investors are barely outearning today’s meager inflation rates.

Finally, it’s possible that both inflation and interest rates could remain low for the foreseeable future—a likely outcome if the economy fails to mount a lasting and convincing rebound. Bonds wouldn’t get hurt under that scenario and may in fact be a safe haven if market participants decide that stock prices reflect overly rosy expectations. That scenario isn’t out of the

question. But if you're making the bet that bonds will be appealing in the future, it's important to understand what a gloomy wager you're making.

Take-Cover Strategies for Bond Investors

So now that you're thoroughly depressed, what should you do with this information? I'm always preaching about the merits of long-term, buy-and-hold investing: finding an appropriate stock/bond mix for you, and then making very few changes except to make your asset mix more conservative as you grow older. And there's certainly nothing wrong with building a fixed-income portfolio that's in line with your target allocation, battening down the hatches, and not worrying about modest fluctuations to your principal value. If you employ such a hands-off approach, you can take comfort in the fact that higher interest rates will eventually translate into higher take-home yields, even if the process causes some disruption along the way.

But what if you want to take a more active approach to shield your portfolio from the bond market's vagaries? I'll explore the various options available to you, as well as their pros and cons and my own bottom line for each approach.

Strategy 1

Seek cover in cash and short-term bonds.

Pros: Retreating to cash or even short-term bonds with a portion of your bond portfolio will help insulate it from interest-rate changes.

Cons: Yields on short-term bonds are about as low as they can go. And if you move a big share of your fixed-income portfolio to cash or short-term bonds, you may have trouble figuring out when is an opportune time to get back into the bond market.

Bottom Line: I get nervous when investors start talking about downplaying a core asset class like bonds in favor of another one—that smacks of market-timing. And staking a lot in ultrasafe investments also has an opportunity cost, as interest rates on cash and short-term bonds are meager. The SEC yield of **Vanguard Short-Term Bond Index** VBISX was just 1.5% as of mid-January, a pitiful percentage for those looking to their portfolios for current income. But the bond portion of your investments is there to provide safety and stability more than it is for return potential. And if you're concerned about the effect that rising rates could have on your

Best Bets for Bonds

Name	Category	Star Rating	Expense Ratio (%)	Comment
Dodge & Cox Income DODIX	CI	★★★★★	0.43	Sturdy, opportunistic fund has big corporate-bond stake.
Fidelity Total Bond FTBFX	CI	★★★★	0.45	Flexible fund focuses on corporates; surged in 2009.
Fidelity Short-Intermediate Muni Inc FSTFX	MS	★★★★	0.38	We like all of Fidelity's muni funds for their low costs, sound strategies.
Harbor Bond HABDX	CI	★★★★★	0.55	PIMCO-subadvised offering showcases flexibility, top-quality management.
Harbor Real Return HARRX	IP	★★★★	0.57	Fund focuses on TIPS, but often includes stake in short-term corporates.
iShares Barclays TIPS Bond TIP	IP	★★★★	0.20	Plain-vanilla TIPS ETF offers inexpensive exposure.
Loomis Sayles Bond LSBRX	MU	★★★★	0.94	Aggressive, opportunistic fund holds junk bonds, emerging markets.
Metropolitan West Total Return Bond MWTRX	CI	★★★★★	0.65	Flexible core fund features seasoned management.
SPDR DB Intl Govt Infl-Protected Bond WIP	IB	N/A	0.50	ETF focuses on inflation-protected foreign bonds, mainly sovereign debt.
T. Rowe Price International Bond RPIBX	IB	★★★	0.81	Fund provides high-quality nondollar exposure.
T. Rowe Price Short-Term Bond PRWBX	CS	★★★★	0.55	Fund takes on more credit risk than some peers, but still conservative.
T. Rowe Price Spectrum Income RPSIX	MU	★★★	0.70	Fund composed primarily of bonds, but also includes an equity sleeve.
Vanguard Inflation-Protected Securities VIPSX	IP	★★★	0.20	Another straightforward TIPS offering with very low costs.
Vanguard Intermediate-Term Inv-Grade VFICX	CI	★★★★	0.21	Don't expect a repeat of '09, but an attractive pick for the long haul.
Vanguard Short-Term Inv-Grade VFSTX	CS	★★★★	0.21	Durable fund focuses on corporate, asset-backed bonds.

CI Intermediate Bond

CS Short-Term Bond

IB World Bond

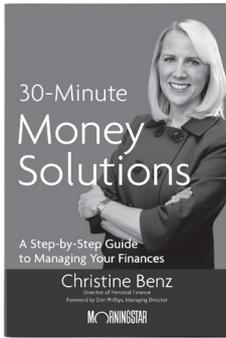
IP Inflation-Protected Bond

MS Muni Short

MU Multisector Bond

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portfolio, particularly the portion of it that you expect to draw upon within the next five years, limiting its interest-rate sensitivity is a worthwhile precaution. One fund I particularly like, if you decide to go this route, is **T. Rowe Price Short-Term Bond PRWBX**.

Strategy 2

Buy individual bonds and hold them to maturity.

Pros: Interest rates may go up, but if you buy a bond at its par value and hold it until maturity, you'll receive your principal back eventually, assuming the issuer is able to fulfill its obligations to debtholders. Nor will you have to pay the mutual fund expense ratio, though you will have to pay commissions to buy and sell individual bonds.

Cons: Owning individual bonds means you give up the valuable diversification and professional bond selection you can get via a bond mutual fund. And unless you ladder your bond portfolio (more on this in a moment), you'll have locked in today's low rates, even if available rates trend up before your bond matures.

Bottom Line: At times like this, the idea of holding individual bonds to maturity carries a lot of appeal because it provides a certainty of return that just isn't there for bond mutual funds. However, you need to have a lot of money to build an adequately diversified portfolio composed of individual bonds. You'll also be foregoing professional research and management, which is one reason that I'm hesitant to recommend the individual-bond route unless you're buying Treasury or GNMA bonds, which carry U.S. government backing. (Unfortunately, yields on government bonds are ultrashrimpy right now.) No matter what, don't venture into lower-quality individual bonds: The company-specific risks are simply too great. Also consider laddering your portfolio of individual bonds—that is, buying bonds of staggered maturity dates to avoid locking your portfolio into today's ultralow rates. So when your shortest-term bond matures in a year, for example, you may be able to reinvest that money in a bond that earns a higher rate at the time.

Strategy 3

Delegate to a talented active manager.

Pros: A truly active manager can seek shelter in bonds of varying types if interest rates go up.

Cons: Even great bond-fund managers have posted losses in sustained periods of rising interest rates.

Bottom Line: There's a reason we recommend flexible, go-anywhere intermediate-term bond funds like **Harbor Bond HABDX**, a clone of **PIMCO Total Return PTRAX**; **Dodge & Cox Income DODIX**; and **Metro-politan West Total Return Bond MWTRX** for the core of investors' fixed-income portfolios. Their managers can graze across all of the major bond-market sectors, and they can also give their portfolios a more defensive cast if they deem it appropriate. The funds certainly wouldn't be immune in a sustained period of rising interest rates—all three lost money in rising-rate years like 1994 and 1999, for example. But they would at least be able to avail themselves of wide-open tool kits and deep and seasoned teams of analysts. Making sure you have a fund such as the above-mentioned offerings is a minimally invasive way to tweak your fixed-income portfolio.

Delegators might also consider devoting a small sleeve of their bond portfolios to a multisector bond fund. These funds often court a fair amount of risk—many invest in emerging markets and junk bonds, for example—but their flexibility is attractive. The team at **Loomis Sayles Bond LSBRX**, one of our multi-sector bond Fund Analyst Picks, recently took home our Fixed-Income Fund Manager of the Year award.

Strategy 4

Don't gorge on "safe" investments.

Pros: Reducing your portfolio's exposure to the most interest-rate-sensitive bonds will reduce its vulnerability to interest-rate shocks.

Cons: Government bonds tend to be the most rate-sensitive, but they also offer good diversification versus stocks.

Bottom Line: Safety may not be all that safe. In fact, arguably the most overheated pockets of the bond market are securities backed by the full faith and

credit of the U.S. government: Treasury bonds, GNMA mortgages, and five-year Treasury Inflation-Protected Securities. Yields are scant due to a variety of factors, offering a limited cushion against losses, and these bonds also tend to be highly interest-rate-sensitive. That doesn't mean you need to scrub your portfolio of all traces of these securities, but it is an argument for thinking twice before layering on dedicated exposure to any of these asset classes. It's also one reason that our analysts are currently lukewarm on total bond market index funds, which tend to be heavy on Treasury and U.S. government-agency-backed bonds.

Strategy 5

Steer a portion of your fixed-income portfolio to high-yielding stocks.

Pros: Stocks have better capital-appreciation potential than bonds. Also, dividends are currently taxed at a more favorable rate than bonds.

Cons: Stocks have much higher volatility than bonds.

Bottom Line: Some pundits, including PIMCO's Bill Gross, have argued that investors may be better off allocating at least a portion of their fixed-income portfolios to dividend-paying stocks. (Gross' specific recommendations were utilities and telecom stocks.) That's not completely unreasonable: Stock dividend yields, in some cases, are competitive with what you'd earn on a bond fund, the stocks have more appreciation potential, and the tax treatment is certainly better. (Dividends are taxed at capital gains rates, at least through this year, whereas bond income is taxed as ordinary income.)

But the risk level of dividend-paying stocks is appreciably higher than it is for bonds. For example, the three-year standard deviation of the typical intermediate-term bond fund is 6, versus 21 for dividend-paying large-cap value funds. Clearly, the asset classes aren't interchangeable. If you peel off a portion of your bond allocation to put it in a dividend-paying stock fund, do so on a very limited basis—say, 5 percentage points of your fixed-income portfolio.

Strategy 6

Move some of your fixed-income weighting to higher-yielding hybrid alternatives, such as preferred securities.

Pros: Yields on securities like preferreds can be lush—7% or even higher. Preferred dividends also receive favorable tax treatment currently, just 15% for most investors.

Cons: Risks can be substantial. Preferreds don't have maturity dates, so there's no guarantee you'll receive the price you paid when it comes time to sell. Preferred issuance tends to be concentrated in the financials sector.

Bottom Line: Hybrid securities like preferreds may give income-focused investors the yield they seek without having to draw heavily on the principal in their portfolios: Many preferreds have dividend yields of 8% or 9%. But those rich payouts may also provide an illusory sense of security, delivering high yields while eroding principal. In contrast with bonds, many preferreds don't carry maturity dates, and those that do may mature in 30 years or more. That means that when you invest in a preferred, you won't necessarily receive a promise that you're entitled to a certain amount of money back on a certain date. And while a company that issues debt is obligated to pay interest to its bondholders, companies issuing preferred stock—like companies issuing common stock—aren't obligated to make payouts.

When it comes to interest-rate sensitivity, preferreds have an unattractive "heads they win, tails you lose" quality. Many preferreds are callable. That means that if interest rates go down and your preferred carries a high interest rate, the issuer can call it in by paying you back and leaving you to invest the proceeds in a lower-rate environment. And if rates head up—a more likely scenario in the coming years—you could get stuck with a low interest rate that doesn't keep up with prevailing market rates, which has the effect of lowering the value of the security. Given all of those risks, preferreds should take up a very small share of a portfolio, at most. ■■■

Blazing an Independent Trail

Expert Q&A | Christine Benz

Sheryl Garrett, founder of the Garrett Planning Network, started her company in 2000 with an eye toward providing individuals with financial-planning advice on an hourly, as-needed basis. The idea took off, and now Garrett has more than 300 member-advisors across the United States and overseas. I recently sat down with Garrett to discuss her unique approach to financial planning, as well as why she believes all advisors should be fiduciaries.

Christine Benz: Let's start with the genesis of your firm. What prompted you to start Garrett Planning Network?

Sheryl Garrett: I started my financial-planning practice doing hourly as-needed fee-only advice in 1998, after leaving a wealth-management partnership. My former firm was a comprehensive financial-planning firm, including portfolio management. We had one service, take it or leave it. My business partner and I found that we were attracting a lot of prospective clients but our model didn't really fit most of them. It was overkill, at a minimum. Sometimes it was grossly overkill.

So were you charging clients as a percentage of assets at that point?

We had to make it as complicated as possible! Literally, it took a worksheet to fill out, and it was convoluted. It was trying to represent the complexity of the case, but I don't think any formula works very well for that, and that's why I don't favor them. The fees that we charged or quoted to clients were based on their assets that we managed for them as well as earned income. So to figure out what someone's charge was, sometimes the numbers came out really goofy. You might have a very high wage earner who hasn't accumulated much; they're just starting out in life and they have a very straightforward financial situation but they just happen to make a lot of money. So the fee could be \$15,000, but the amount of labor involved might really warrant \$1,500. And sometimes

the opposite would be the case, where the situation was very complex, maybe the individuals are selling a business or they're getting divorced. Those formulas don't fairly represent, in my view, the amount of labor and expertise needed, and potential liability the advisor is exposed to.

I'm all about everybody pays their fair share, and I think charging by the hour is the closest way I can get there. If they want gobs of my time, they would pay for it, and if they don't need me much they don't pay much. It's not that I think hiring advisors on retainer is philosophically flawed, it's that the majority of the end users doesn't need a retainer. Do you need an attorney on retainer? Let's hope not. But you do need an attorney periodically throughout your life. Sometimes it's for good things, like you're adopting a child, and sometimes it's because your neighbor's tree fell on your fence. But there are always times when you turn to an attorney or CPA or consultant of some sort. So I decided that why in the world, if the rest of the consultants in this country can charge by the hour or by the project or their time or advice, why can't financial advisors do that? And that was basically the beginning of my hourly practice and the network.

One of the most liberating things that accidentally happened was that clients started taking more responsibility. When I worked under retainer, clients occasionally would come in with boxes full of papers they hadn't even opened. They definitely hadn't filed

them, they weren't in any semblance of organization. And when I went on an hourly basis, a few people would actually bring in binders, and their stuff was under the right tabs. I found that clients started actually coming up with their own agendas. "Here's what we're thinking about, please give that some thought and let's plan to talk about it at our next meeting." So it was a really wonderful change.

“One of the most liberating things that accidentally happened was that clients started taking more responsibility... I found that clients actually started coming up with their own agendas.”

How did you get the word out about your business?

I had a few pieces—news stories—in various industry publications. And Bob Veres did a profile in his newsletter *Inside Information* entitled “Walk-In Planning.” That was one of the more significant introductions to how it was that I was working with clients. As I described my practice to him, he said, “It sounds like a dentist’s office—the way they pay on the way out and schedule the next appointment.” It’s not nearly as painful but the dental analogy actually works quite well. The dental industry has helped us maintain good dental health because they train us to not let an ache or a chip or something like that turn into a massive pain. And that’s kind of my approach to working with clients on an hourly as-needed basis. Once we get things organized, and if they’re helping to keep them that way, then maintaining it shouldn’t be all that complicated, unless they have a lot of significant changes in their lives. Checkup appointments, if you don’t have any pain going on, are pretty harmless in terms of the time and energy involved as well as cost. But it does help to maintain your good fiscal health, to make sure you’re not missing out on any good opportunities and you’re continuing to plug away as you should.

One question I have is about the economics of your business, whether the typical advisor in your group has to have more clients make this hourly model work for them. Is that the case?

Well, yes, but it requires a little explanation. When I was working with individual clients I had support staff, and we had worked together with about 400 client families. And I called them all clients even though I didn’t have any ongoing responsibilities to those clients at the same time. So it was very much like the dental practice. My calendar became the controlling factor of who I could see and when. So I could look out on my calendar and see that three weeks from now I’ve got an opening so I could take an appointment at that point, but this week I’m completely swamped.

But as you alluded to, yes, in this type of hourly practice, you are working with more people with less revenues per household, on average, than you typically would with any other compensation structure. And that’s one of those reasons why financial planners aren’t just falling over themselves to do this.

As I mentioned earlier, CPAs and other consultants work on an hourly basis. Frequently these professionals are members of a firm or have support staff, which allows them to serve more clients and make more money than solo practitioners. Leverage is an important consideration.

Let’s talk about how you vet the advisors in your group.

All the advisors are fee-only in our group. And as of January 1, 2007, we instituted a new rule that any member coming into our group had to either already be a Certified Financial Planner or be a CFP candidate at the time. They have up to five years to obtain their CFP designation. There are other great financial-planning designations out there. However, I also think that it’s in the client’s or the public’s best interest for our industry to embrace one for clarity purposes. And if we build upon one, it’s better than saying, “Well there are five designations that one could have, and any of these would be OK.” Over the years, the CFP designation has kind of bubbled to the top as being the premier designation.

Prospective members of our network also have to fill out an essay-type application that says why do you want to do this, why are you going to be good at it, what do you want to target, what resources do you have as you're ramping up, why are you attracted to this service model? Because it's a philosophical decision. My philosophy is pretty well known by our prospective members, and they also participate on a biweekly virtual tour of our network. That gives us an opportunity to answer questions and visit with people. They might have specific questions about their situation. And then one of my staff members speaks with all of the prospective members individually. And then they may or may not submit an application, and I review all of the applications. We verify licenses and designations, either now or in the past, and once they register as an investment advisor, we require copies of those documents, and then annually upon renewal, they have to re-submit those updated documents for review.

advisor, so we don't put together select lists. Secondly is the advisor needs to have the ability to do the due diligence, and asset selection, and they need to be able to do that on their own.

I know you feel strongly that all financial advisors should be fiduciaries.

It may be partly because of my Midwestern, middle class naivete, but I just expect that when somebody has a position of trust and confidence with you, that you will give them your best guidance. When I go to the doctor, and they say "Sheryl, this is what you need to do," I take it for granted that that is their professional judgment—that it is truly the best thing for me to do at this time based on the information they have.

Well, in real life, I've also found that clients of financial advisors presume the same thing. But here's the danger: The rules don't work that way! We have this presumption that we can rely on this advisor, but no we can't. It's caveat emptor with a broker or registered rep, for the most part. When it comes to the fiduciary standard, it all comes back to, what does the client expect? What do they think they're getting, what kind of a relationship? When you spill your guts and all of your nitty gritty details to someone who holds himself out as a financial counselor, or retirement specialist, or who knows what they call themselves—you might expect that person is a fiduciary.

But the real standard that a broker works under is the standard of suitability. And in my research trying to define what suitability means, all's I can come up with is the word reasonable, or some variation of the world reasonable. Here in fiduciary land, you have to do what's best. In suitability land, you have to do something that's reasonable. And to me that's a big difference. The other big, huge difference is that with a suitability rule, the responsibility of proving whether or not the recommendation was suitable lies with the investor. But with a fiduciary, the responsibility that you did the right thing as the advisor stays with the fiduciary. The fiduciary is obligated to prove that they did what was in the client's best interest. Wouldn't you rather have that as the customer?

“When it comes to the fiduciary standard, it all comes back to, what does the client expect? What do they think they're getting?”

So the screening process is designed to help us end up with those people who are philosophically aligned with our mission and what we stand for. That weeds out darn near anybody who is after things that are either unreasonable or against our ethics. So the unreasonable would be, "I want to be up and running at full capacity in six months." Well, you need to get reasonable—it will take longer than that. And against our ethics would be, "Oh, and by the way, I run a hedge fund on the side that I'm going to put all of my clients in, or a mutual fund." Well, no, that's not being objective.

So in terms of the investments that an advisor might choose, do you have a list of recommended investments, or is it up to the advisor's discretion?

It's the latter, for a couple of reasons. One is that the organization is not a registered investment

How should one go about finding an advisor?

When I'm talking about interviewing advisors, I equate it to online dating. Do some checking out of a potential date online. Chat with them online. Then schedule a telephone call, and if you're still intrigued by this person, you might send some additional questions, or set up a time to meet with them, and interview them even more. I think that works really well for advisors, or online dating. I have experience with both! I'm a big advocate of doing your initial investigation in stealth mode. Why expose yourself to somebody until you're ready and you've narrowed it down to someone you think is going to be potentially a good fit?

“Here in fiduciary land, you have to do what's best. In suitability land, you have to do something that's reasonable.”

I have two acid test questions on how to find an advisor. One of them is, “Are you a fiduciary?” If the advisor can't glowingly say yes, or write down yes, then there's your answer. Because their employer very likely won't allow them to say yes to that question unless it's true. If they hedge, “Yes, but,” or “Well, it depends on the circumstance,” I'm sorry but that's not good enough.

The second question is how and how much are you compensated. For the majority of advisors, the rules are that we must tell you how we're compensated, but there's no rule that says you must tell how much you're compensated. That's for the majority of advisors. Fiduciary advisors do have to tell you the expenses, not just our compensation but all the expenses that are known or can be reasonably obtained. Brokers only have to tell you that they earn a commission, or that they get paid fees and commissions. Well, how can you compare apples to apples unless you know what you're going to get for a price that you're willing to pay? So I need a dollar amount. It's not really that there are evils in the compensation structure. It's that they're not clear and we don't really know if we're paying our fair share or a heck of a lot more than that. So my major complaint with compensation structures is lack of fairness and transparency. ■■■

Sheryl Garrett's Dos and Don'ts for Finding the Right Planner for You

Do:

- ▶ Work only with a fiduciary. You deserve nothing less.
- ▶ Read up on the advisor using online sources, then call him or her with additional questions before scheduling an appointment.

Don't:

- ▶ Be shy about inquiring about compensation. Ask how the advisor gets paid, as well as for an estimate of how much he or she is apt to earn from your engagement.
- ▶ Pay for more service than you need. If you need advice on a specific subject or only need advice periodically, paying an advisor an hourly fee may save you money. If you have a complicated financial situation and need regular ongoing advice, paying a flat fee or retainer may make sense.

Helping the Kids Without Cracking the Nest Egg

Portfolio Makeover | Christine Benz

Jim and Esther Gilman (not their real names) felt like they were in pretty good financial shape when Jim retired from his position as a medical sales rep in 2005. The couple, now 73 and 71, respectively, had amassed a \$1.2 million portfolio in a variety of investment vehicles and their home was paid off. With fairly modest living expenses, they were looking forward to traveling in their RV and spending time with their grandchildren, most of them in their teens and 20s, and three grown children.

Five years, one bear market, and one Great Recession later, this couple is having serious doubts about their portfolio's ability to last throughout their retirement. While their equity assets have enjoyed a solid rebound over the past year, their overall portfolio is down to \$680,000. Investment losses took a toll. But an equally large factor behind their eroding nest egg is that the couple has been lending financial support to their children. On an ongoing basis, they've been helping one of their sons, who has been unemployed since losing his job at a large technology firm in 2008. They've also been helping a newly divorced daughter establish a life on her own. They gave her a \$35,000 down payment on a condominium last year, and also lend her financial support on an as-needed basis.

Jim and Esther say that helping their children financially is important to them. But they're also concerned that their spending rate is currently far above what they projected it to be when they retired. They're currently spending \$4,000 per month, in addition to what Social Security provides. That's fully twice what they had expected to spend, in large part because of the financial assistance they have been lending to their kids.

I agree that the Gilmans' current spending level of roughly 7% is unsustainable, particularly given that these young retirees could have 20 more years in

retirement. So they need to take action to address the problem, and the sooner the better.

From where I sit, this couple could explore one of three options, or perhaps some combination. One is to rein in their personal spending to the extent that they can. Esther and Jim aren't big spenders, but they admit that their home is larger than what they need, and their property taxes are also high at roughly \$9,000 per year. So downsizing is one idea. The couple think that they could buy a townhome for roughly half the price that their existing residence could fetch if they sold it, and the real estate taxes would also be substantially lower.

Another idea would be to improve the total-return potential of their portfolio, and that's why the Gilmans wrote to me. They currently have roughly a third of their portfolio in bonds, 15% in cash, and the remainder in stocks. I do think Jim and Esther could make some adjustments around the margins of their portfolio, as the "After" portfolio on the adjacent page reflects. In particular, their fixed-income portfolio should include a measure of inflation protection in the form of Treasury Inflation-Protected Securities. And given the prospect for higher interest rates in the future, they might also consider tilting their portfolio away from government bonds, which tend to be particularly interest-rate-sensitive. I'd also like to see their international stake emphasize developed markets over developing. But I wouldn't make major adjustments to their overall asset allocation, given that their equity position is already appropriate for their ages and life stage.

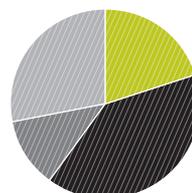
Finally, Jim and Esther should consider leveling with their children about their financial situation. This isn't an easy discussion for parents to have with their kids, obviously, but it's an important one. If the Gilmans decide to move to a smaller home—and they're leaning in that direction—that would provide a natural segue to discussing the fact that their financial resources aren't unlimited. And Jim and Esther also agree that leveling with their children about their finances now is far preferable to becoming a financial burden on their children later in life. ■■■

Jim and Esther's Portfolio: Before

Fund Name	Star Rating	Category/ Industry	Holding Value (\$)	Expense Ratio (%)
Fidelity Government Income FGOVX	★★★★	GI	73,245	0.45
Fidelity Short-Term Bond FSHBX	★★★	CS	55,669	0.45
Fidelity US Bond Index FBIDX	★★★★	CI	85,422	0.32
Fidelity Contrafund FCNTX	★★★★★	LG	122,348	0.94
Powershares QQQ QQQQ	★★	LG	43,524	0.20
iShares MSCI Emerging Markets Index EEM	★★★★	EM	42,275	0.72
Fairholme FAIRX	★★★★★	LB	71,262	1.01
Fidelity Overseas FOSFX	★★★	FB	8,002	0.48
Buffalo Small Cap BUF SX	★★★★	SG	21,176	0.48
Oakmark Fund OAKMX	★★★★★	LB	83,232	0.81
Cash	N/A	N/A	75,000	
Total			681,155	

Super Sector Weighting (%)		Top Three Sectors (%)	
Information	29.36	Healthcare	15.10
Service	48.85	Financial Svs	14.70
Manufacturing	21.78	Hardware	13.78

Asset Allocation (%)



- Cash 20.00
- U.S. Stock 40.00
- Foreign Stock 12.00
- Bonds 28.00
- Other 0.00

Equity Style (%)

Value	Blend	Growth	
19	19	34	Large
6	6	12	Medium
1	1	3	Small

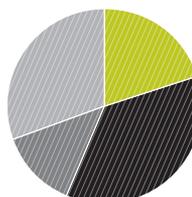
0-10 11-25 26-50 51-100

Jim and Esther's Portfolio: After

Fund Name	Star Rating	Category/ Industry	Holding Value (\$)	Expense Ratio (%)
Fidelity Intermediate Bond FTHR X	★★★	CI	100,000	0.44
Fidelity Short-Term Bond FSHBX	★★★	CS	55,000	0.45
Fidelity Inflation-Protected Bond FINPX	★★	IP	60,000	0.45
Fidelity Contrafund FCNTX	★★★★★	LG	75,000	0.94
Fidelity Spartan Total Market Index FSTMX	★★★	LB	50,000	0.20
Dodge & Cox International Stock DODFX	★★★	FV	75,000	0.64
Fairholme FAIRX	★★★★★	LB	60,000	1.01
Buffalo Small Cap BUF SX	★★★★	SG	21,155	0.48
Oakmark Fund OAKMX	★★★★★	LB	85,000	0.81
Cash	N/A	N/A	100,000	N/A
Total			681,155	

Super Sector Weighting (%)		Top Three Sectors (%)	
Information	24.84	Financial Svs	16.52
Service	48.65	Healthcare	15.42
Manufacturing	26.49	Consumer Goods	10.72

Asset Allocation (%)



- Cash 20.00
- U.S. Stock 36.00
- Foreign Stock 13.00
- Bonds 30.00
- Other 0.00

Equity Style (%)

Value	Blend	Growth	
21	25	26	Large
7	6	9	Medium
2	1	4	Small

0-10 11-25 26-50 51-100

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Categories

CI Intermediate Bond	GI Intermediate Government
CS Short-Term Bond	IP Inflation-Protected Bond
EM Diversified Emerging Markt	LB Large Blend
FB Foreign Large Blend	LG Large Growth
FV Foreign Large Value	SG Small Growth

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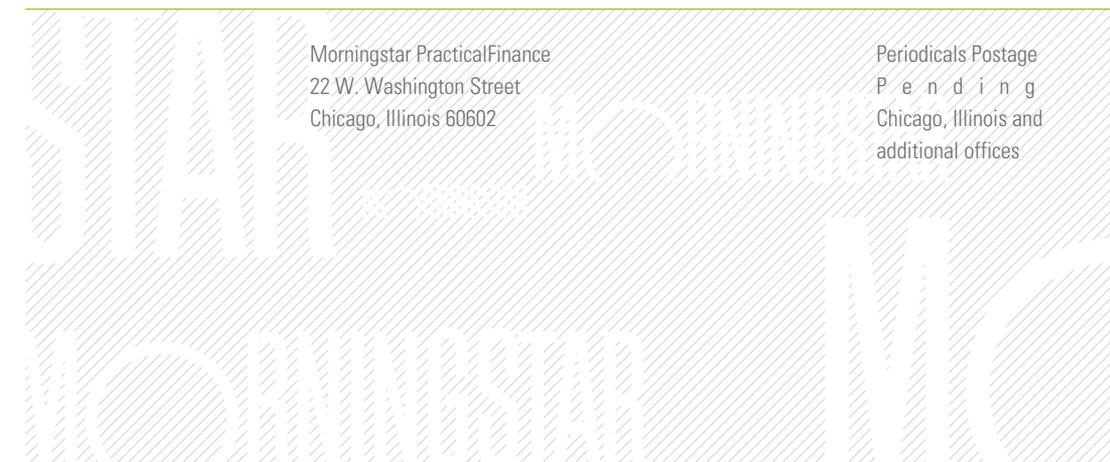
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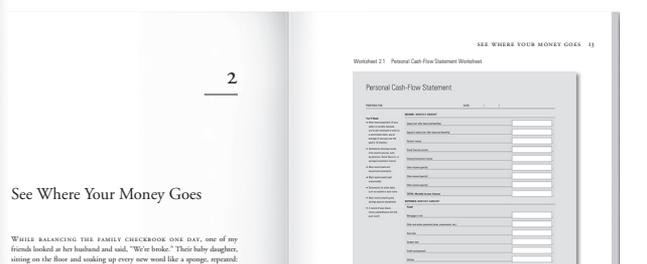
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