

## When Good Savers Make Bad Investments

*Planners Help a Bachelor  
Fix His \$200,000 Nest Egg;  
Why 34 Funds Are Too Many*

By JEFF D. OPDYKE

**T**HERE ARE TWO SIDES to Curtis Hensyl's portfolio. The 30-year-old Savannah, Ga., bachelor does all the right things when it comes to saving. But he is doing many of the wrong things when it comes to his investments.

Unlike many young people, Mr. Hensyl has already stashed away an impressive amount for his retirement—more than \$200,000—even though he's just five years out of graduate school.

### CAN THIS PORTFOLIO



### BE SAVED?

He is debt-free and lives relatively frugally on a \$55,000 salary. He even contributes a huge slug of his paycheck to a 401(k) plan, contrary to the media perception of his generation as slackers.

Mr. Hensyl's portfolio offers a lesson that a surprising number of disciplined investors overlook: It isn't just how much you save that matters, it's what you do with it. That is the theme of this installment of Can This Portfolio Be Saved? In this occasional series, we engage three different financial-planning firms to deconstruct and rebuild a reader's portfolio.

In Mr. Hensyl's case, the planners uniformly agree that despite all that he is doing right, his portfolio needs a serious makeover. It is littered with mediocre mutual funds, most of which impose ongoing fees that sap returns, and he has too much of his employer's stock. He owns North Carolina municipal bonds that provide no benefit to a resident of Georgia. And he has relied on questionable—if not outright bad—advice. One example: Mr. Hensyl bought a variable annuity, a product usually marketed to near-retirees, from a broker when he was just 26 years old.

Now he needs to clean house by questioning everything he owns, rebuilding his portfolio with a stronger, leaner selection of funds, reducing his bond exposure



Stephen Montroy/Film Magic

**Curtis Hensyl of Savannah, Ga., hopes to retire in his mid-50s.**

and axing investments that make no sense to his plan. And he should fulfill as soon as he can one of his overriding dreams: home ownership—one of the best investments young savers can make because of the annual tax advantages and the benefits of leveraging a relatively small down payment into tax-free profits upon selling.

Mr. Hensyl's financial journey began with a lawnmower. He started cutting yards as a kid and in high school mowed 15 acres of grass over 16 to 18 hours every weekend at a small farm near his home in Towson, Md. He saved so religiously that he was able to afford his own Ford Bronco in high school. During college at Virginia Tech—where he earned bachelor's and master's degrees in forestry management—he worked summers for an electric company and left school with between \$20,000 and \$30,000 for his efforts.

Today, Mr. Hensyl—who hopes someday to have a family—coordinates land transactions for the forest-resources division of International Paper Co. His living costs are unusually low because he is house-sitting for a friend who is crewing a yacht. Because of that, Mr. Hensyl's housing costs, for now, are just \$400 a month; he is paying part of the mortgage and all the utilities. He owns his 1994 Ford Explorer outright, and the rest of his

monthly expenses total only \$350. He spends another \$300 on just "random stuff during the month," he says, like crewing racing sailboats. He also volunteers for the charity Habitat for Humanity.

Before he spends money on any of his expenses or hobbies, Mr. Hensyl does what so many people need to learn to do: He pays himself first. He is currently stuffing 16% of his paycheck—\$8,800 a year—into his 401(k) plan. International Paper matches 6% of the savings, paying its portion in a company-stock fund.

Every month, Mr. Hensyl—who hopes to retire in his mid-50s—also sweeps about \$1,400 of unspent salary into his investment accounts, and each year fully funds his Roth IRA. He has \$35,000 set aside specifically for the down payment on a house in the \$150,000 range.

Here are the portfolio changes the pros say Mr. Hensyl should consider:

■ **John P. Enright, private wealth adviser**  
*Sagemark Consulting/Wealth Management Services, Syracuse, N.Y.*

The first weakness Mr. Enright notes is that more than half of Mr. Hensyl's investments—all mutual funds picked by current and former brokers—are laggards in their peer groups.

The majority of those funds are so-

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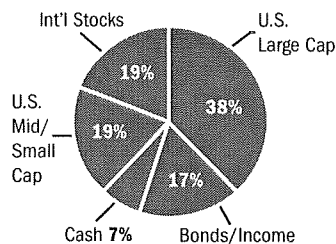
## Professional Advice

What three different financial-planning firms say Mr. Hensyl should do with his portfolio:

### Hefren-Tillotson

Pittsburgh, Pa.

#### ■ Asset Allocation



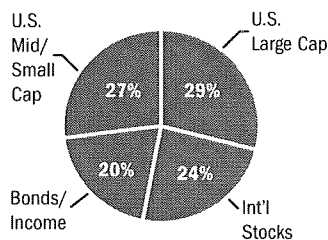
#### ■ Suggested Mutual Funds:

Longleaf Partners  
Growth Fund of America  
T. Rowe Price Mid Cap Value  
FPA Capital  
Capital World Growth & Income  
Julius Baer International Equity A  
American Funds New World

### The Monitor Group

McLean, Va.

#### ■ Asset Allocation



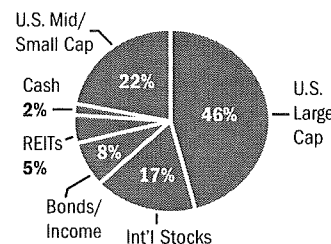
#### ■ Suggested Mutual Funds:

Pimco Low Duration  
Vanguard Intermediate Term Corporate Bond  
Templeton Global Bond  
Constellation Clover Small Cap Value  
Dreyfus Small Cap Stock Index  
T. Rowe Price Value  
Vanguard 500 Index  
Glenmeade International  
T. Rowe Price International Stock

### Sagemark Consulting

Syracuse, N.Y.

#### ■ Asset Allocation



#### ■ Suggested Mutual Funds:

Thompson Plumb Growth  
Hartford Capital Appreciation A  
Julius Baer International Equity A  
Jensen J  
Independence Small Cap  
Vanguard REIT Index  
Calvert Income A  
iShares Lehman TIPS Bond exchange-traded fund

called C shares that carry recurring high fees, meaning he'll incur tens of thousands of dollars in extra costs that he wouldn't have with no-load funds.

Moreover, the funds in one of Mr. Hensyl's accounts are automatically rebalanced every quarter, a strategy that Mr. Enright says "exposes you to short-term capital gains and, therefore, a greater tax burden." That ultimately reduces the long-term returns. Instead, a portfolio should be rebalanced annually.

While he is dumping his underperforming funds, Mr. Hensyl should also jettison the lackluster variable annuity he bought four years ago. Such an investment isn't suitable for someone his age or his 25% tax bracket. Moreover, annuities carry sizable penalties if money is withdrawn before age 59½, and even then the profits are taxed at much higher ordinary income rates instead of lower capital-gains rates.

The roughly \$10,000 annuity has about \$1,000 in losses, allowing him to sell without suffering IRS penalties. He can apply those losses to capital gains elsewhere.

Finally, the planner counsels Mr. Hensyl to exit a North Carolina municipal-bond fund, where he parked the proceeds from the sale of a house he owned when he lived in that state. He should reallocate that money, and the proceeds from the annuity, across a variety of highly rated equity mutual funds such as **Thompson Plumb Growth**, **Julius Baer International Equity** and **Independence Small Cap**. Those are the same types of funds, the planner says, that Mr. Hensyl should plow his additional monthly savings into.

### ■ Don Belt, chief investment officer Hefren-Tillotson, Pittsburgh, Pa.

Mr. Belt says Mr. Hensyl's holdings of 34 mutual funds and annuity sub-accounts have two problems: There are too many of them, and they are overly allocated in health care while skimping on other necessary asset classes.

The planner agrees that the North Carolina muni bonds should go, as well as an underperforming Morgan Stanley U.S. government-bond fund. The proceeds, he says, should go into individual Georgia munis, particularly intermediate-maturity issues that can be called in fairly soon. The benefit: A far bigger after-tax yield and no ongoing management fees to sap returns. Plus, if the bonds are called early, "he'll be able to reinvest in higher-yielding bonds if rates move higher."

Once that is done, and once Mr. Hensyl sets aside the cash needed for the house down payment and a car purchase he expects to make, Mr. Belt recommends the remainder of the portfolio be scrapped and rebuilt—largely because the funds Mr. Hensyl owns are expensive underperformers. Moreover, he encourages Mr. Hensyl to revise his asset allocation, reducing his exposure to bonds and increasing his exposure to stocks, particularly foreign shares, an underrepresented class in his current portfolio. That is because high-quality stocks tend to substantially outperform bonds over the long term.

Mr. Hensyl should also sell off his International Paper stock. As Enron and other corporate implosions have shown, having a paycheck and a slug of your

retirement plan vested in your employer is risky double-dipping.

Finally, Mr. Belt says that Mr. Hensyl shouldn't worry that he is saving too much. At 55, Mr. Hensyl will need \$120,000 to live as he does on \$55,000 today—and his 401(k) savings alone will not get him there.

### ■ Cal Brown, vice president, planning The Monitor Group, McLean, Va.

Based on Monte Carlo analysis—which measures the likelihood an investor will reach a specific goal—Mr. Brown calculates a 99% probability that the Georgia resident will have enough money to retire when he wants. Yet Mr. Hensyl needs to better harmonize what Mr. Brown calls a "hodgepodge of uncoordinated investments and strategies."

One of Mr. Hensyl's must-do chores: Buy the house he wants, and soon. "When you can sell an asset and pay no taxes on the first \$250,000 of profit, that is a very good thing," says Mr. Brown.

The planner also recommends Mr. Hensyl pare back his exposure to International Paper shares, now more than 11% of his 401(k) plan. And he should use the plan's so-called brokerage window to invest in a better selection of mutual funds.

Overall, Mr. Brown says, "anyone who spends less than they earn, invests wisely and continues to do this over a long period of time can reach their goals. It's a simple concept, but difficult for many people to execute." Mr. Hensyl, he says, "is displaying remarkable discipline" in this pursuit.