Fixing a messed-up portfolio

Fixing a messed-up retirement portfolio

Our expert puts a readers mix of funds under the microscope.

By Walter Updegrave, Money Magazine senior editor October 16 2006: 6:00 PM EDT NEW YORK (Money) -- I'm 58 and plan to retire at 65. I have most of my 401(k) money in two target-date retirement funds - one with a target date of 2030, the other 2040 - plus some in a mid-cap stock fund. I've also got a relatively small Roth IRA that's invested in two bond funds. Given that I'm not a big risk taker but am willing to take a moderate amount of risk, do you think my retirement savings are invested in a reasonable way? - Vivian D., Baldwin Park Calif.

In a word, No. I think you're making this a lot more complicated than it needs to be.

Essentially, you've got to decide whether you want to manage your retirement savings on your own or put your money into a target-date retirement fund that will do it for you. At the moment, you're trying to take both approaches, which makes your portfolio a bit of a muddle.

The whole idea behind target-date retirement funds it that they give you a completely diversified portfolio of different types of stocks and bonds in proportions that make sense given when you plan to retire. These funds also gradually shift out of stocks and into bonds as you age, so your portfolio becomes less risky later in retirement. Choosing two target-date funds really makes no sense.

You end up with a lot of unnecessary overlap in funds and an overall mix of stocks and bonds in your portfolio that doesn't reflect either of the target-date funds. And throwing in other funds on the side also doesn't help. In fact, it hurts. All you're doing is interfering with what the target-fund is trying to do - namely, give you a mix of stocks and bonds appropriate for someone your age. It's as if you're ordering a prix-fixe dinner that comes with appetizer, entrée and dessert and then ordering additional dinners on the side. How to fix it

So the first thing you should ask yourself is whether you want to put together your own portfolio of mutual funds. If the answer is yes, then get out of the target funds and build your own portfolio. If you decide to go this route, you can find fund candidates by checking out our Money 65 list of recommended funds and get guidance on what sort of stocks-bonds mix is appropriate by going to our Asset Allocation tool or checking out A Plan For Every Stage, a story that gives suggested portfolio mixes for people of different ages. If you don't want to build your own portfolio, then pick one target-retirement fund and stick to it.

You can certainly do that in your 401(k). And if the company that offers the target fund in your 401(k) doesn't make one available for assets outside the plan, such as the money in your Roth IRA, you can invest in the target funds of another company. Just be sure to choose a fund that has a mix that's similar to your 401(k) target fund. So if you go the target-fund route, ideally you want to have virtually all your retirement savings in one or more target funds with similar asset mixes. This way, you've got all your retirement assets in a mix of stocks and bonds that makes sense today and that will continue to make sense as you age. Now, would it hurt if you don't have all your money in the target fund? Of course not.

You'll surely want to have a cash reserve for spending money and for emergencies. And you can keep that in a separate money-market fund. And if you have a little bit of money in mutual fund or two that you've owned a while or that for some reason you're really attached to, it won't mess things up too badly. One final point. You say you plan to retire in seven years - 2013 or so - yet the target funds you own are designed for people who plan to retire in 2030 and 2040. I have no problem with someone who wants to take a more aggressive stance.

But you're talking about funds with dates that are decades beyond when you plan to retire, which means they're quite heavy in stocks, more than 80 percent, in fact. That's pretty racy for someone pushing 60 who plans to retire at 65 and who describes herself as a moderate risk taker. Maybe you have enough money in the bond funds in your Roth IRA to offset the relatively high stock exposure in the target funds you currently own.

But if you decide to go with an all or nearly all target-fund approach along the lines I've suggested, I think you'll probably want to go with a fund closer to your actual planned retirement date, maybe something like a 2015 fund or at most 2020.