

## Two, Four, Six, Eight... Show Me How to Allocate

In athletics, it's "no pain, no gain;" in investing, it's "no risk, no gain." But when the going gets tough, investors have something going for them that's a lot less smelly than Ben Gay – asset allocation. Check out last month's article, "Don't Just Do Something, Stand There," for an overview of how asset allocation works and what it can do for you. You'll find it in the Budget Guy archives on the church website (in the Adult Ministry section).

So how does one actually do this asset allocation thing? With just two steps.

### Step 1: Choose Your Mix

First, keep in mind that we're talking about long term investment goals like retirement. Your short term savings for things like vacations, Christmas, emergencies – any money you might need in the next five years – should be safely tucked away in money market funds, CDs and the like.

With that done, choose your mix for your long-term savings by deciding how much you want in stocks and how much in bonds. You'll get the highest long-term return with stocks, but also the greatest fluctuations, including temporary losses, over the short term. But even if you are ultra, ultra conservative, you should still have 10% of your long-term portfolio in stocks. Why? Because over the long run you will not only get a higher return with 10% stocks/90% bonds than you will 0% stocks/100% bonds, you will also actually have less volatility – fewer losses over shorter periods of time. (Yes, Virginia, bonds can have losses, too.)

Studies have shown that the optimal asset allocation is somewhere around 60% stocks/40% bonds, and that's how most pension funds are allocated. Me? I'm 70% stocks/30% bonds. Scott Burns, a respected financial columnist for the Dallas Morning News, loves his 50% stocks/50% bonds "Couch Potato Portfolio" (see [www.dallasnews.com/business/scottburns](http://www.dallasnews.com/business/scottburns)).

How do you decide what's right for you? Vanguard, the mutual fund company, has an excellent set of model portfolio allocations at "flagship4.vanguard.com/VGApp/hnw/content/PlanEdu/General/PEdGPCreateTheRightMixContent.jsp" (ignore any hyphens and quotes). I also highly recommend *The Sound Mind Investing Handbook* by Austin Pryor. You'll find a link to it on the church website (look for "The Budget Guy" in the Adult Ministry section).

Keep in mind that there's no wrong answer. If you're not quite sure, choose an allocation that's on the conservative side. You can always sneak up on a more aggressive allocation as you go along by putting new investment money into stocks.

The most important thing is to start with an allocation that you believe will let you sleep at night. For example, the Vanguard website shows that from 1960 through 2004 a 50% stock/50% bond allocation earned an average annual return of 9.2%. But it lost money in eight of those years and had a year in which it lost 14%. This means that if you use that allocation and your portfolio drops, say, 12% in some year, you don't get scared and sell out. That's just the way a 50/50 allocation works, and in the long run you'll be fine.

### Step 2: Choose Your Funds

Once you've chosen your asset allocation, you're ready to choose stocks and bonds. But unless choosing individual stocks and bonds is your "thing," I recommend that you use mutual funds. That eliminates a number of variables and substantially reduces your risk.

You have three basic choices – balanced/asset allocation funds, target retirement funds and what I will call "regular" funds. Balanced or asset allocation funds are already invested in both stocks and bonds, so find one that is allocated the way you want and you're done. Two downsides, though. First,

#### Budget Guy Goofs!!

Yes, it's sad but true. I put the last two graphs in last month's article in the wrong order. A corrected version is in the Budget Guy archives on the church website. Sorry about that!

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these funds usually have broad allocation guidelines, so their allocations will vary over time. Second, if you want to change your allocation, you'll have to sell out and buy a new fund.

Target retirement funds also invest in both stocks and bonds, but choose a fund based in part on the year in which you expect to retire. As that year approaches, the fund gradually decreases the proportion invested in stocks and increases the proportion in bonds under the assumption that you want to be more conservative as you near your retirement year. Unfortunately, this changing allocation may or may not track what you'd like to do.

Personally, I prefer "regular" mutual funds, no-load funds in particular. (No-load funds do not take a commission off the top when you buy or sell them.) And if you're just starting out in investing or want to keep it as simple as possible, use index funds. Rather than choosing specific stocks or bonds to invest in, index funds track specific stock and bond indices like the S&P 500. They have very low fees and significantly reduce or even eliminate some of the risks that non-index funds have.

And these funds are easy to choose. If two index funds track the same index, buy the one with the lowest fees.

How many funds do you need? If you're using index funds, all you really need are two – a total stock market fund and a short- or intermediate-term bond fund (one that invests in bonds that will mature in no more than 10 years). That's all the Couch Potato Portfolio uses, for example. And these funds are easy to find – all of the major fund companies have them.

## Summary

The best way to maximize your return on your long term investments is with asset allocation – decide how to split your portfolio between stocks and bonds, buy a couple of index mutual funds, and then get back to doing what is most meaningful for you.

Is it really that simple? By and large, yes. I'll fill in a couple of details and talk about some variations next month... but you don't need to wait for that to get started.

Have questions? Is there an asset allocation or other investment issue you'd like to see me address? Just let me know (see box below) and I'll give it a shot!

Part of my job at SHPC is helping people get out of debt and manage their finances better. It's free and it's confidential. Just call the Budget Guy, Allen Gunter, at 292-4035 or send an email to [BudgetGuy@shpc.org](mailto:BudgetGuy@shpc.org). And check out the Crown Financial Ministries Small Study Groups – call Margaret Fetty at 288-9034 for more info.

Pastor, teacher, and conference speaker Randy Alcorn set out to discover what the Bible says about heaven. His biblical research resulted in *Heaven*. Alcorn seeks to answer questions such as, what will it mean to see God? What will our relationships with people be like? Will the New Earth be like Eden? Will there be animals on the New Earth? What will our bodies be like? His conclusions are thought-provoking.

Alcorn invites disagreement with his findings – as long as the disagreement is based on biblical grounds. He politely discounts "I've never heard this before," "I've always believed that..." and "Our denomination teaches..." as basis for

correction. The book is very thorough, but even just skimming it is an intriguing experience.



Other new books include:

***The Ragamuffin Gospel; Embracing the Unconditional Love of God***

231.6 COL

***The Parent's Handbook***

649.1 DIN

***God, Dreams, and Revelations*** by Morton Kelsey

248.2 KEL

***The Holy Spirit***, by Billy Graham 231.3 GRA

Check the library display in July for these titles.