

How to Create a Portfolio You Don't Have to Babysit

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“No Babysitter Required” Portfolios: A Road Map

- What are the essential ingredients of low maintenance portfolios?
- What are the steps to take when building yours?
- What do successful “no babysitter” portfolios look like?

Successful Low-Maintenance Portfolios Have These Essential Ingredients

- Employ a long-term stock/bond/cash allocation.
- Use broadly diversified mutual funds rather than more specialized investment types.
- Are set up to reduce the drag of expenses, sales charges, and taxes.
- Help you resist your urge to buy and sell at inopportune times.

Five Simple Steps to “No Babysitter Required” Portfolios

Step 1: Find your portfolio’s true north..

Step 2: Identify low-cost, well-diversified building blocks.

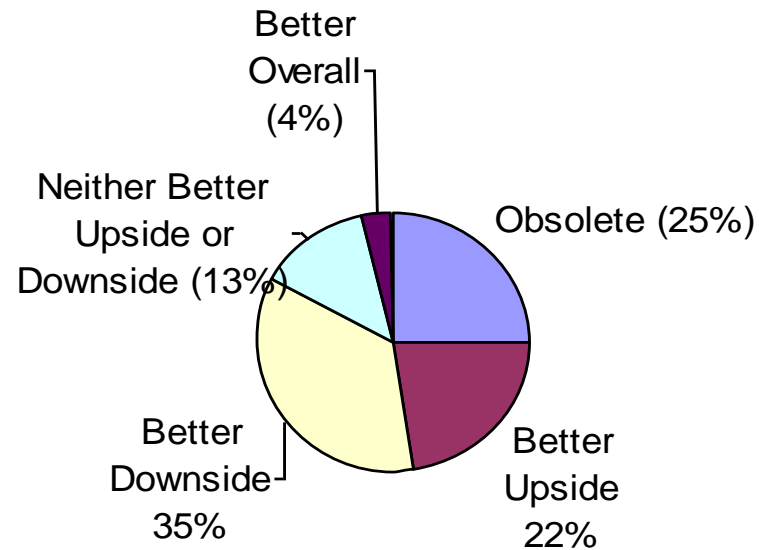
Step 3: Pay attention to tax efficiency.

Step 4: Schedule regular checkups; know when to make changes.

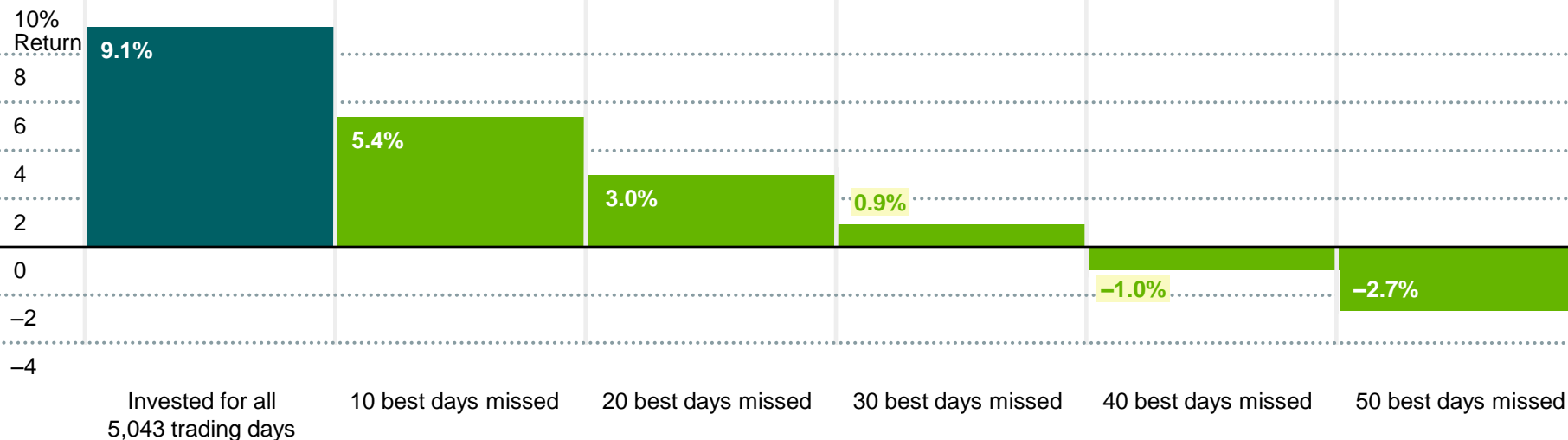
Step 1: Find your portfolio's true north.

- The biggest determinant of how your portfolio behaves is how you've split your money among stocks, bonds, and cash.
- Two key strategies for asset allocation: tactical and strategic.
- Tactical: Hands-on; actively maneuvers among asset classes.
- Strategic: Hands-free; gradually grows more conservative as goal date draws near.

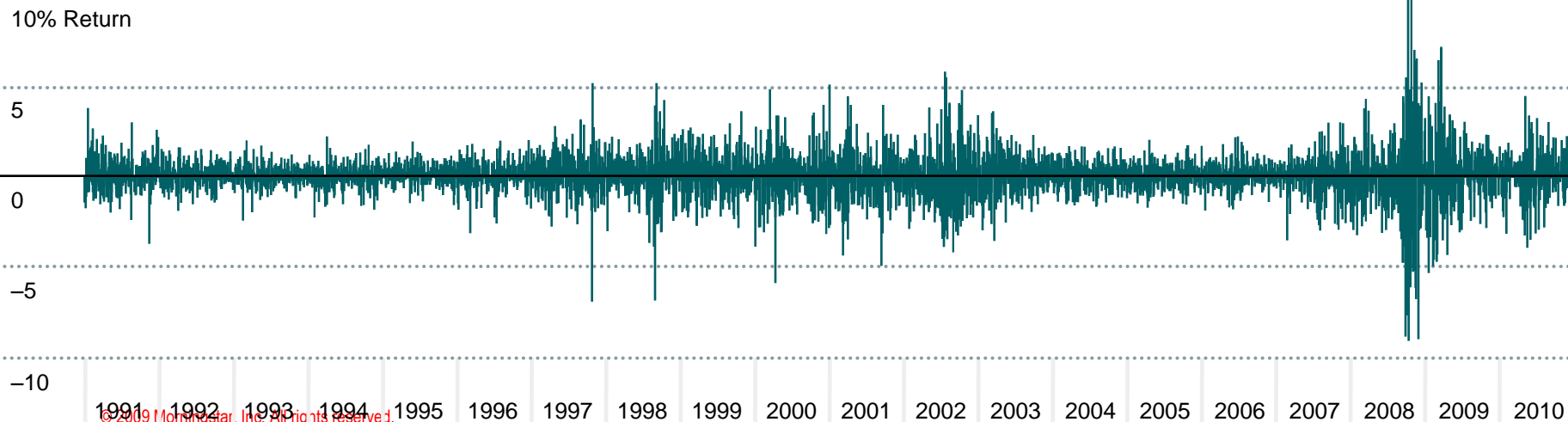
Performance of "Tactical" Mutual Funds Versus Vanguard Balanced Index (1992-present)



Risk of missing the best days in the market 1991–2010



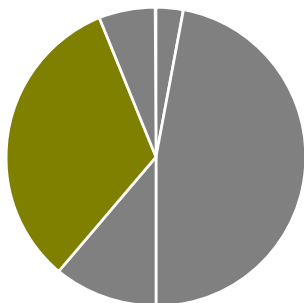
Daily returns for all 5,043 trading days



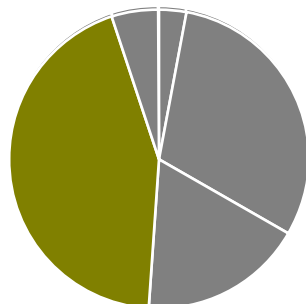
If the pros can't get it right consistently, how much of a shot does the average investor (or the average investment advisor) have?

For most investors, “buy, hold and rebalance” is the right mantra.

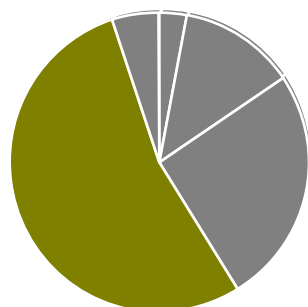
A Starting Point for Strategic Asset Allocation: Morningstar Lifetime Allocation Indexes



Retired in 2010: 50% bond, 11% foreign stock, 33% U.S. stock, 6% commodities

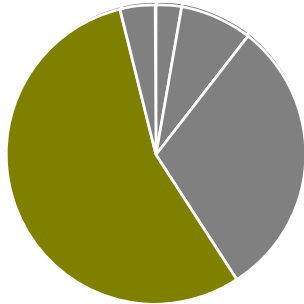


Retiring in 2020: 32% bond, 18% foreign stock, 45% U.S. stock, 5% commodities

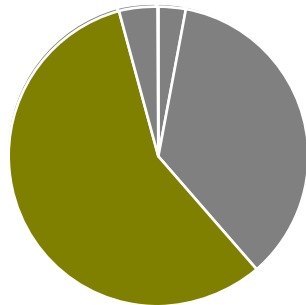


Retiring in 2030: 14% bond, 26% foreign stock, 55% U.S. stock, 5% commodities

A Starting Point for Strategic Asset Allocation: Morningstar Lifetime Allocation Indexes



Retiring in 2040: 8% bond, 31% foreign stock, 57% U.S. stock, 4% commodities



Retiring in 2050: 7% bond, 34% foreign stock, 55% U.S. stock, 4% commodities

Tailor your stock/bond/cash mix to suit your personal circumstances. Factor in:

- Your own human capital (Are you a stock or a bond?)
- Longevity: Does it run in your family? (If so, more stocks)
- Other assets/sources of income during retirement, such as a pension (if so, more stocks)
- How much you've saved (if the answer is “not much,” consider adding more stocks, but don't go overboard)
- Risk capacity (if low, fewer stocks)
- Desire to leave something for children/grandchildren (if so, more stocks)

Step 2: Identify low-cost, broadly diversified building blocks.

- Don't assume fancy/complicated strategies are better than more straightforward ones.
- Fewer, well-diversified investments can get the job done just as well.
- You'll also have fewer moving parts to oversee on an ongoing basis.
- Broad-market "index" funds and exchange-traded funds make good starting (and ending) points.
- All-in-one target-date and balanced funds can also be very effective, especially for hands-off investors.
- Focusing on low-cost investments helps you pocket more of your return.

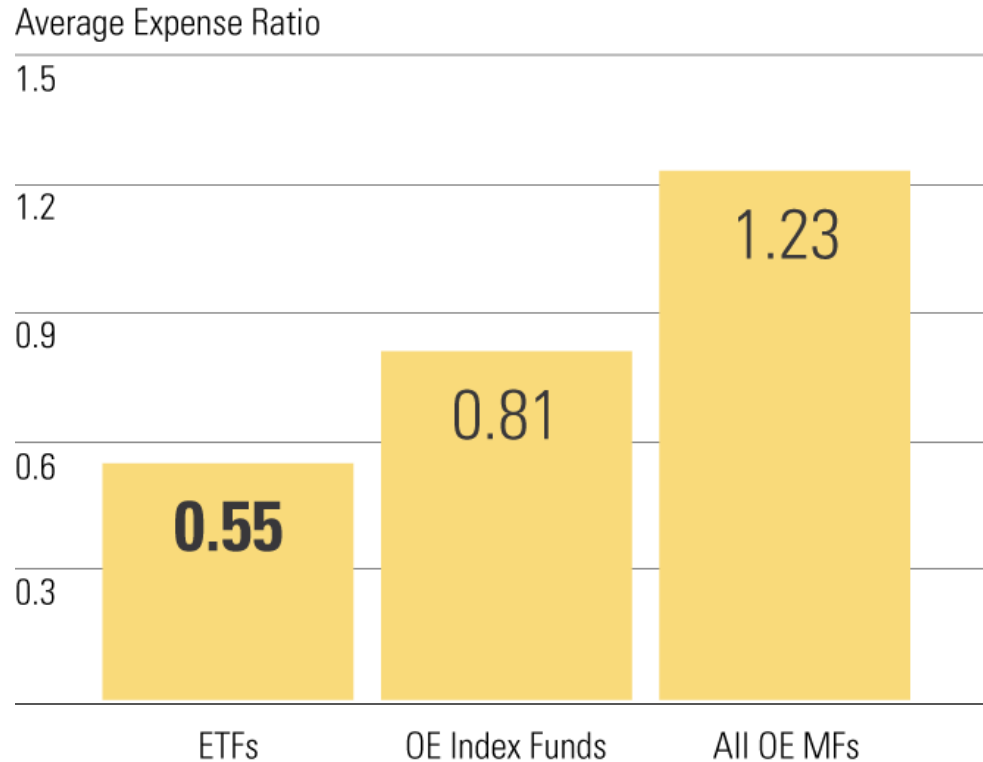
What is an ETF?

- It's like a mutual fund...
 - Regulated just like a mutual fund
 - Has a manager
 - A structured package of assets
- ▶ ... that trades like a stock.
 - ▶ Listed on an **Exchange** like a stock or closed-end fund
 - ▶ **Traded** intraday
 - ▶ Allows for stock-like strategies such as shorting and margin investing but this flexibility entails complexity

Advantages of Index Funds and ETFs

- Tax Advantage
 - Low turnover of index funds
 - In-kind creation and redemption process for ETFs
- Cost Advantage
 - Less overhead at fund provider
 - Pass on economies of scale
- Return Advantage
 - Guaranteed not to underperform the market
 - For every dollar outperforming the market, there is a dollar underperforming

Passive, Long-Term Investing: Lowest Cost Wins



ETFs versus Mutual Funds: What Type of Investor Are you?

- This can be a key determinant in deciding which vehicle is better suited for you.
 - ETFs appeal most to two types of investors: those who prefer a passive index-based approach and those who like to actively manage their own portfolios through such strategies as market-timing.
 - Mutual funds are better suited for investors who are looking for active management and for those who are looking to make regular frequent contributions (dollar-cost averaging).

10 Largest ETFs

Name	Ticker	Total Assets USD Mil
SPDR S&P 500	SPY	89,204
SPDR Gold Shares	GLD	59,429
Vanguard MSCI Emerging Markets ETF	VWO	45,864
iShares MSCI Emerging Markets Index	EEM	41,243
iShares MSCI EAFE Index	EFA	37,615
iShares S&P 500 Index	IVV	23,784
PowerShares QQQ	QQQ	23,769
iShares Barclays TIPS Bond	TIP	20,436
Vanguard Total Stock Market ETF	VTI	19,199
iShares Russell 2000 Index	IWM	14,624

Asset Allocation plan for someone retiring in 2050

			2050
US Stocks	Vanguard Total Stock Market ETF	VTI	55%
Non US Stocks	Vanguard Total International Stock	VXUS	34%
US Bonds	iShares Barclays Aggregate Bond	AGG	5%
Non US Bonds	SPDR Barclays Capital Intl Treasury Bond	BWX	2%
Commodities	iShares Gold Trust	IAU	4%
Inflation Protected	iShares Barclays TIPS Bond	TIPS	0%
Cash			0%
			100%

Asset Allocation plan for someone retiring in 2030

			2030
US Stocks	Vanguard Total Stock Market ETF	VTI	54%
Non US Stocks	Vanguard Total International Stock	VXUS	25%
US Bonds	iShares Barclays Aggregate Bond	AGG	12%
Non US Bonds	SPDR Barclays Capital Intl Treasury Bond	BWX	3%
Commodities	iShares Gold Trust	IAU	5%
Inflation Protected	iShares Barclays TIPS Bond	TIPS	1%
Cash			0%
			100%

Asset Allocation plan for someone who retired in 2010

			2010
US Stocks	Vanguard Total Stock Market ETF	VTI	32%
Non US Stocks	Vanguard Total International Stock	VXUS	11%
US Bonds	iShares Barclays Aggregate Bond	AGG	32%
Non US Bonds	SPDR Barclays Capital Intl Treasury Bond	BWX	5%
Commodities	iShares Gold Trust	IAU	6%
Inflation Protected	iShares Barclays TIPS Bond	TIPS	11%
Cash*			3%
			100%

*Cash amount in the portfolio is separate from a cash reserve one might keep for emergencies. A good rule of thumb is 6 months of living expenses.

Step 3: Pay attention to tax efficiency.

- Controlling tax costs is one of the best ways to exert control over your portfolio.
- A few simple rules of thumb:
 - Take maximum advantage of tax-sheltered wrappers—IRAs, 401(k)s, etc.
 - Store tax-unfriendly investments like bonds in tax-sheltered accounts.
 - Hold stocks in taxable accounts.
 - Manage taxable accounts for tax efficiency: Index funds and ETFs, municipal bonds, tax-managed funds.

Step 4: Schedule regular checkups; know when to make changes.

- Quarterly (or even less frequent) checkups are sufficient for most investors.
- Don't focus exclusively on performance.
- Instead, ask the following questions:
 - Has your portfolio's asset allocation changed versus targets? (Rebalance when asset class exposures diverge by 5 or 10 percentage points relative to targets.)
 - Has anything fundamentally changed with your investments (expense ratio went up, manager left, etc.)?
 - Are you getting closer to hitting your financial goals?

Questions? (or you'd like a copy of the presentation)

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