PORTFOLIO STRATEGIES WORKSHOP

Young Couples: Developing a Coordinated Approach to Savings

By Maria Crawford Scott

Young couples in which both the wife and husband are working do not tend to focus on retirement issues. Yet both are likely contributing to employee-sponsored retirement plans. And, since no two individuals tend to think alike, they are likely to be investing their retirement contributions very differently, with different goals in mind.

However, the couple will eventually be living off of both retirement plans, and following two separate goals will result in neither goal being met. A more coordinated approach will result in a greater likelihood of achieving long-term financial goals.

What exactly is a coordinated approach? The following case study provides an example.

The Newlyweds

Lisa and Peter were recently married and just had their first big fight. The argument, not surprisingly (to anyone who is married), was over money—specifically, who has the better investment approach in their retirement account.

Both Lisa and Peter are young, and have a combined salary of about $70,000. Their retirement accounts represent the accumulated savings of the couple (see Table 1). They also have accumulated a small amount of taxable savings, which each have kept in their own interest-bearing savings accounts. However, the purpose of these savings for both of them is to provide a small amount of liquidity for emergencies, and to cover large bills and other cash flows that may not be covered by periodic salary payments.

Lisa's approach to investing her retirement money has been conservative. She feels she should be conservative with this money because she will eventually have to live off of it, and she doesn't want to take any risks losing the money she is saving. Lisa also is not familiar with investing, and she feels that it would be inappropriate for her to be invested in the stock market. For that reason, she has allocated half of her 401(k) money to a money market fund and half to a somewhat "riskier" investment—a bond fund—that pays a higher yield.

Peter, who is in marketing, has absolute confidence in the growth of the company at which he works. He thinks the products it markets are superb, that the firm has not yet reached its full potential in terms of market penetration, and that owning the company stock is a "sure thing." For that reason, he has invested his entire 401(k) money in the stock of his employer.

The Fight

The argument began as Lisa and Peter were discussing whether they should combine their checking/savings accounts into one. That led to a discussion of which account was the better deal, which led to a discussion of money management and, eventually, whose investment approach was more sound.

Needless to say, Lisa feels that Peter is far too aggressive, taking way too much risk with his retirement money and, in particular, putting all his eggs in one basket by investing only in his company's stock.

Peter, on the other hand, thinks Lisa is being far too conservative by placing her retirement assets in investment vehicles with no growth prospects. "No guts, no glory," he says.

The outcome of the argument was that both resolved to continue investing the way each felt was "right."

Lisa decided to call her mother and relate to her the argument and their resolution to keep their monies separate.

Her mother laughed. "It doesn't sound like you have really resolved your differences by going your separate ways with your retirement plans. When the two of you retire, you are going to have to live off of both of your retirement plans. So you're stuck with his approach whether you like it or not. It would make more sense if you act like a team and work out together what approach to take with your money.

"And neither of you have had much experience with money matters, so you both may want to take this opportunity to learn

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a little bit more before finalizing your opinions."

Lisa grudgingly recognized this as good advice, and told Peter what her mother had said. Peter conceded that they should reconsider their "separate" approaches, and he particularly liked the idea about learning more about investing.

Developing an Approach

Lisa and Peter plunged into several books that covered investing basics. Fortunately, each was able to say enough "I told you so's" to satisfy both.

Lisa realized that, by investing so heavily in fixed-income, she was actually taking on much more risk than she realized. While these investments protected the nominal amount she was putting into her account, inflation would gradually erode the purchasing power of her savings—in other words, her savings would not be able to purchase the same amount of goods in the future, and in real terms her savings would decline. She also learned that the risk she had been concerned about with stock investing—the possibility of large losses—significantly declines over longer time periods, although she would have to live with considerable short-term volatility.

Peter, the risk-taker, for his part realized that by not diversifying, he was taking on significant risks for which he may not be compensated. Although there was the potential for long-term growth, by concentrating in only one stock, he was also taking on the risk associated with that particular company, including the risk of failure. So, he was taking on all the risk of stock investing, yet the likelihood that he would participate in the long-term returns associated with a diversified portfolio of stocks was lowered. In addition, his livelihood was dependent on the company, and if something were to happen to the company and thus his job, it would only compound his financial problems to have all of his retirement assets decline at the same time.

Peter and Lisa also realized that their separate approaches produced a combined asset allocation that didn't even satisify their previous individual misconceptions, much less their new understanding.

As they discussed their situation, they agreed that they would need a larger commitment to the stock market, but that it should be primarily in a diversified pool of stocks, although a small commitment to Peter's company would be acceptable. Since they have no short-term needs, they settled on an 80% commitment to common stocks. And to satisfy Lisa's concern with volatility—she felt she could not stand to see *all* of their retirement assets drop in value even with the knowledge that it would probably bounce back—they decided to allocate 20% of their

Table 1.
Accumulated Retirement Accounts

	Accumulated Retirement Plan Assets				Periodic Contributions	
	Before		After		Before	After
Lisa's Plan						
Growth Fund	$ —		—			
Growth & Income Fund	$ —	0%	$ 12,000	100%	—	$ 5,000
Bond Fund	$ 6,000	50%	—		$ 1,250	—
Money Market Fund	$ 6,000	50%	—		$ 1,250	—
Total	$ 12,000		$ 12,000		$ 2,500	$ 5,000
Peter's Plan						
Company Stock	$ 18,000	100%	$ 12,000	67%	$ 2,500	—
GIC	$ —		$ 6,000	33%	—	—
Money Market Fund	$ —		—		—	—
Total	$ 18,000		$ 18,000		$ 2,500	$ 0
Plans Combined:	**$ 30,000**		**$ 30,000**		**$ 5,000**	**$ 5,000**

	Retirement Savings Asset Allocation			
	Before		After	
Stocks	$ 18,000	60%	$ 24,000	80%
Bonds	$ 6,000	20%	$ 6,000	20%
Cash	$ 6,000	20%	$ —	0%
Total	$ 30,000	100%	$ 30,000	100%

retirement portfolio to fixed-income assets.

Coordinating the Investments

As they looked over their individual retirement plans, Peter and Lisa realized it would be difficult to implement their new approach separately within each plan. Peter's retirement plan only offers three options: the company stock, a GIC (a fixed-income investment sold by an insurance company), investment, and a money market fund. Lisa's retirement plan, on the other hand, offers a broader range of options, including a growth fund, a growth and income fund, a bond fund, and a money market fund. Of the two, Lisa's plan clearly offers the better stock investment choices.

The couple realized that they only way they could meet their overall allocation would be to coordinate the allocations of their individual plans. The couple would like to shift most of Peter's money out of his company stock, but there is no other stock alternative. The remaining alternatives are fixed-income investments—cash and the GIC. So they decide to use these investments for their entire fixed-income allocation—$6,000, which is 20% of their $30,000 in total retirement assets. That means that Peter's retirement plan would be 67% invested in company stock and 33% invested in the GIC.

The only way to shift more out of Peter's company stock would be to increase their overall fixed-income allocation, and Peter and Lisa decide not to do this at the moment. Peter is still fairly confident in his company, and they will not add to this investment in the future. They agree that a small investment in the company—not more than 10% of their overall stock commitment—would be their ultimate goal.

Because the entire fixed-income allocation is satisfied within Peter's retirement plan, Lisa's retirement assets will be reallocated so that they are 100% in stocks. And since the stock portion in Peter's retirement plan is extremely aggressive, they decide to invest Lisa's assets in the growth and income fund, the more conservative of the two stock funds offered.

Future Investments

After coordinating their existing retirement plan investments, Peter and Lisa realize they have to think about future contributions.

Currently, both Lisa and Peter contribute about $2,500 each annually to their plans—a total of $5,000—and neither contributes the maximum allowed. While they don't have any specific spending plans at the moment, they eventually would like to purchase a house, which means that they will have to start to build some savings outside of their retirement accounts. Thus, it is unlikely that they will be able to increase their contributions to their retirement savings. On the other hand, they hope to keep their current contribution levels, and use additional savings and salary increases to help finance their house purchase and any other purchases they will make for the house.

If the couple wants to maintain their new asset allocation, and they want to continue to invest $5,000 annually to their retirement plans *and* at the same time not make any additional investments in Peter's company, their individual contributions are going to have to change: Lisa will have to increase her contributions, and Peter will have to decrease his.

Fortunately, Lisa earns a somewhat higher salary than Peter, and finds (by double-checking with her employee benefits department) that she could increase her contributions to the full $5,000 level that they want to invest annually. If all future contributions are invested in one of the stock portfolios in Lisa's retirement plan, Peter could gradually shift more of his retirement plan assets out of his company stock and into the fixed-income investments, maintaining the 80/20 stock/fixed-income asset allocation balance that they are seeking.

Satisfied with their new approach and teamwork, Lisa and Peter go out to celebrate. And they live happily ever after.

Final Thoughts

Retirement may seem too far off in the distance for young couples to worry about. However, contributions to retirement plans are not distant assets but rather current assets that require current decisions. Working as a financial team to reach those decisions may or may not lead to a happy marriage, but it will be more financially rewarding.

Here are some items for young couples to keep in mind when coordinating retirement plan assets:

- The first step is to develop an asset allocation strategy for your savings, taking into consideration all the risks you will face, including long-term risks such as purchasing power loss, and the significant risks of being too heavily concentrated in one sector, industry or stock.
- Once you have worked out an asset allocation strategy, allocate the investment of your existing retirement assets by taking full advantage of the choices within the best plan. For most retirement plans, the biggest limitations are the stock investment choices.
- For future contributions, if you cannot contribute the full amount to each plan, maximize contributions to the plan with the best investment options and use the other plan for remaining amounts that you can afford to contribute.