Goldilocks Strategy for Better Returns

RETIRING
DAVID A. LEVINE

Are you saving for retirement but worried about how to handle a sudden, unexpected expense? Or already retired and wondering how best to protect yourself against a stock market loss?

Many people with those fears keep large sums in their bank accounts or money market funds. This is a costly mistake.

You will need a lot of cash when you retire, or if you join the ranks of the long-term unemployed. Under those circumstances, however, you will need that money over a protracted period of time. There is no reason that the resources to finance this spending stream should take the form of low-interest bank deposits or money market funds.

Fixed-income investments should not be too long or too short.

Instead, you need a different strategy, one that produces a reliable, spendable cash flow and superior returns, minimizing the likelihood that the inflation-adjusted value of your portfolio will decline over time. The best way to achieve those goals is to avoid "perfectly safe" cashlike assets, relying on your savings account or money market funds only for a 30- to 60-day cushion to cover your day-to-day obligations, plus enough extra at times to satisfy those occasional outsize expenses due in the next few months.

After that, your primary goal is to build wealth. Not surprisingly, equities do best. That's why most of your money for your retirement should be invested in stocks.

But you may not have realized that intermediate-term bonds, over the long run, are superior not just to cash but to long-term bonds as well. So when thinking about where to invest your fixed-income assets, remember Goldilocks: The best place to be is not too long and not too short.

The return you expect to earn and the risk associated with bonds rise as maturity lengthens. But the rates at which they rise are neither uniform nor equal. At first, as you move out of cash into short-term bonds your expected return rises rapidly, but risk — if we define it as the chance that you will lose to inflation — actually diminishes. The shortest-maturity investments like money market mutual funds and Treasury bills are among the worst investments you can make.

As you then extend your maturity from short-term bonds to intermediate, the increase in return slows and risk begins increasing, but the trade-off between the two seems commensurate. Extend your maturity beyond intermediate, and the additional expected return that you gain seems inadequate compared with the amount of extra risk incurred. With long bonds you are at the mercy of the inflation gods: If inflation is low enough, you can win big; if it's high enough, you get buried.

The moral of the story: Don't put your money in long bonds, money market funds or bank accounts. Instead, the place to be is what is essentially a large "sweet spot" between short and intermediate. That's where the reward-risk trade-off is at its greatest.

But what about those of you who have been investing in long-term bonds, which have done well since the early 1980s? All I can say is: Fabulous market timing! As Morningstar reports, for the 34 years ending 2015, long Treasuries offered a compounded return of 10.1 percent per year, a pace that was better than intermediate Treasuries' 7.5 percent and not all that unfavorable compared with stocks' 11.5 percent.

But it's worth remembering that at the end of 1981 long Treasuries were yielding more than 13 percent and were about to begin a decades-long decline that produced hefty capital gains. With long-term Treasuries now yielding just 2.3 percent, you are all but certain to have inferior returns on long bonds unless we enter an extended period of deflation. I would not bet on that.

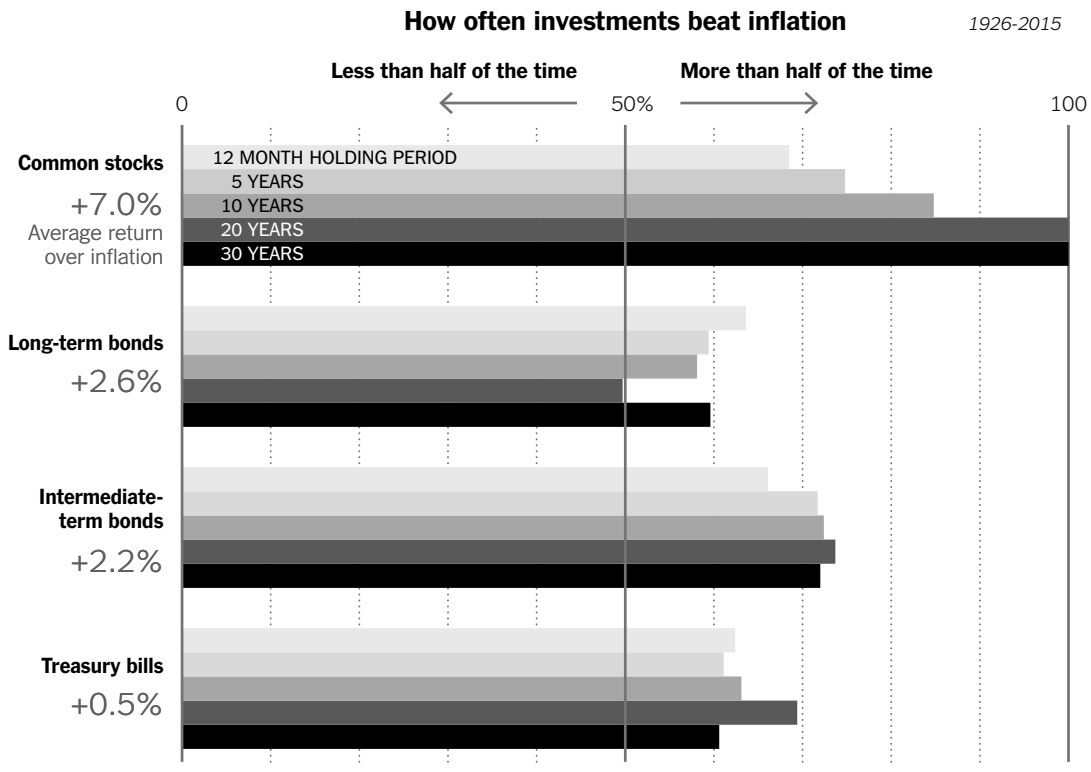
Fortunately, not many investors keep a large share of their funds in long bonds. More fall prey to the irrationally strong preference for perfect stability: Bank accounts and money market funds capture almost 30 percent of individual investors' liquid financial assets. That's a sucker's game, with no chance to earn the higher coupons routinely paid by bonds with modestly longer maturities. For the 90 years ended 2015, investors gave up 1.7 percent a year, compounded, if they stuck to Treasury bills instead of being willing to invest in intermediate Treasuries.

Obsessing over risk costs investors a great deal of money. And it's even better to avoid Treasury securities in favor of low-cost mutual funds that invest in either corporate or municipal bonds. The extra yield these bonds pay (after tax) swamps the tiny costs they incur on those rare occasions when bond issuers default.

Within the universe of fixed-income investments, intermediate maturities offer you the best odds of beating inflation.

The Real Risk in 'Risk-Free' Investments

Short-term Treasury bills, like bank accounts and money market funds, are sold as risk-free investments. But for anyone saving for the long term, the returns would barely keep up with inflation, and would be eroded even further after taxes. By contrast, stocks and intermediate-term bonds offer the greatest rewards compared to the risks that they will underperform over shorter periods.



Source: Morningstar Inc.

THE NEW YORK TIMES

A Different Kind Of Trust Fund

WEALTH
PAUL SULLIVAN

Parents should make emotional investments too, an author says.

What if parents thought about the capital — financial, but also emotional and intellectual — they were spending on their children as assets in an "emotional trust fund?"

That's the concept advanced by Jacalyn S. Burke, a former nanny and the author of "The Nanny Time Bomb: Navigating the Crisis in Child Care." The essential components of an emotional trust fund are analogous to those of a conventional one — cash, stocks, bonds and property. How investments in those assets are divided, though, is what matters.

Nannies and child care workers are the stocks in the emotional trust fund. Their influence on children is a bet on the future. Like stocks, some nannies do well from the start. Others pay dividends over time. And then there are those that disappoint.

Parents need to do their due diligence. "For someone who you're employing for the majority of the time when you're out of the home, you should go back and see how that stock has performed in the past," she said.

Ms. Burke recommends detailed background checks but also visiting the nanny at home or where she was last working, to gauge her interaction with that family.

Enrichment activities are the bonds in the portfolio. Just as analysts following the declining prices of municipal bonds knew Detroit was headed into trouble long before a crisis hit, parents can measure their children's responses to enrichment fairly quickly. "There's a consummate value in enriching your children but not overextending them," she said.

Community is the property component of the emotional trust fund. "A cloistered sense of the world does not do them well," Ms. Burke said. "At the weekends, walk the dog around the neighborhood, have pancakes, play ball in your neighborhood, get involved in your church or synagogue. It gives your kid a great grounding in life."

How parents spend time with their children is the cash in the emotional trust fund. It can be spent wisely to maximum benefits or it can be squandered.

Ms. Burke calls for parents to spend their emotional cash on experiences — not on more things. "Cash is switching your phone off and doing things with your children," she said. "What I hear from children is they just want down time with their parents."

Given the amount of time and money parents spend on their children, the emotional trust fund is an interesting concept. If nothing else, thinking in these terms might reframe how people spend time and money in their family.

ANDRE D. WAGNER FOR THE NEW YORK TIMES

BETTING ON THE FUTURE **Jacalyn Burke, an author and a former nanny, says parents need to evaluate the time they spend with their children and the people who provide care for them as they would a financial investment.**

New Cars Too Pricey For Many Families

YOUR MONEY
ANN CARRNS

As prices for new vehicles rise, the cost of an average new car may be a stretch for typical households.

An analysis from Bankrate.com found that a median-income household could not afford the average price of a new vehicle in any of the 50 largest cities, though cars are more affordable in others. "People are having to make tough decisions about financing," said Steve Pounds, a personal finance analyst for Bankrate.

The average price of a new car or light truck in 2016 is about $34,000, according to Kelley Blue Book. That's in part because new cars are loaded with helpful but expensive safety features like collision-avoidance systems.

Bankrate calculated an "affordable" purchase price for major cities, using median incomes from United States census data, and factoring in costs for sales taxes and insurance. In San Jose, Calif., the median income is about $84,000, and an "affordable" new car purchase price is about $33,000 — still below the average new car price.

In lower-income cities, however, affordable purchase prices for a typical family are far below the average cost of a new car. In Hartford, Conn., where the median income is about $29,000, an affordable purchase price is about $8,000 — about a quarter of the average new-car price.

That sort of squeeze helps explain why many people are borrowing more, for longer periods. Experian Automotive said that in the first quarter of this year, the proportion of new cars bought with financing rose to more than 86 percent and the average loan topped $30,000. The average term for a new-car loan is 68 months, and some loans stretch as long as seven years. The Consumer Financial Protection Bureau warns that borrowers who take out long-term loans end up paying more for the car and run a greater risk of owing more than the car is worth.

Bankrate noted that a traditional rule of thumb is the "20/4/10" rule: Car buyers should put down at least 20 percent in cash, take out a loan for no more than four years and keep the cost of principal, interest and insurance to 10 percent of household income.

"If you need to finance to five, six or seven years, you can't afford it," said Jeff Bartlett, deputy cars editor at Consumer Reports.

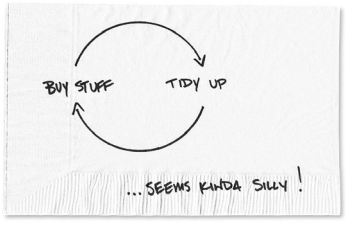
Q & A

¶ When is the best time to shop for a new car?
While car sales may abound on holiday weekends, shopping on a weekday may be preferable. There is less traffic to deal with when taking test drives, and sales representatives have more time to answer questions. "Buy when it's right for you," Mr. Bartlett said, not because dealers are promoting incentives.

¶ How can I make sure I'm choosing the right financing?
To help consumers comparison-shop, the Consumer Financial Protection Bureau has created a loan "shopping sheet" that can help you calculate the total cost of a car loan and compare offers.

¶ Should I buy a used car instead?
Used cars, particularly those two or three years old, often offer the best value, Mr. Bartlett said. Be sure to have a used car inspected by a mechanic before you buy it.

Quarantine Before You Buy



CARL RICHARDS

SKETCH GUY
CARL RICHARDS

My wife and I are setting up a customs screening station in our driveway. No, we're not starting an international airport. And it's not for solicitors or gift-bearing guests. It's for us and our stuff.

From now on, before anything new comes into the house, resident buyers will need to answer a series of questions: How much did it cost? Are you replacing something you already own? Why do you think it's amazing? And if it's food, are you sure you'll eat it?

We're doing this because stuff is taking over our home. And right now we're in the process of getting rid of things we never use. We're organizing, sorting and throwing things out. And it feels so good. But here's the catch: Throwing stuff away is only half the battle. You have to stop stuff from coming into the house in the first place.

I recommend a stuff quarantine of seven days, particularly if we're talking about anything that costs more than $50. Anything that you're considering ought to sit in your head for at least a week, and you should test it out on your fellow customs officers. I'm writing from experience, because as we've been getting rid of stuff, I've fallen in love with Lululemon's ABC pants for men. I bought a pair, and now I want them in another color. So I ran the idea by my wife.

"Are you kidding me?" she said. "You're going to buy pants that you'll wear two or three times, and then will just hang in the closet?"

It's hard to admit that there's a slight chance she's right. So the camo pants will go in the quarantine bin — for now.

Look, I know that buying things feels good. So does tossing out stuff you don't use. But wouldn't it feel so much better to spend that time and money on something you'll actually use or enjoy instead?

The answer is not to throw away the junk. The answer is the customs gate and the quarantine bin. Otherwise, if you're not careful, the stuff you buy today will be the junk you throw away tomorrow.