MONEY MAKEOVER

The Boston Globe

Foundation is solid for geologist's fiscal future

By Lynn Asinof, Globe Correspondent | March 23, 2008

When he started his current job, geologist Rob Danckert bought a copy of the book "The Automatic Millionaire" to help guide him through the process of setting up his new 401(k) retirement plan.

That book turned out to be a great investment.

Using its advice as a blueprint, Danckert, a Waltham resident, set his contribution levels, chose an asset allocation, and selected specific investments. He ended up with a small-but-well-balanced portfolio of mutual funds and a contribution level that captured every penny of his employer's match.

Now 31, Danckert is facing the next round of financial questions with a bit more trepidation: Do I have enough money to buy a second condo, keeping the one I currently own as an investment? Can I afford to travel more? Does my portfolio make sense? Recognizing that he needed something more than that book, he applied for a Boston Globe Money Makeover to get specific answers to his questions.

"Overall, you are doing great," fee-only financial adviser Dana Levit of Paragon Financial Advisors told Danckert when they sat down in her Newton office. Not only was Danckert tucking 10 percent of his $50,000 a year salary into his 401(k) plan, but his employer's match was adding an additional $1,960 to his plan each year as well. He housed those funds to craft a well-diversified portfolio that was performing well. Levit awarded him an A+ on both counts.

Having built a good foundation, however, the geologist needed to position himself for the next phase of his financial growth, Levit said. Her prescription: Beef up the emergency accounts, add international and small-company investments to the portfolio, hold off on the condo, and stay the course.

The emergency accounts were an obvious problem. Analysis of Danckert's current balances showed that he had barely enough cash to cover one month's expenses if he should suddenly find himself without a job. Rather than recommending that he simply start stashing cash in his bank account, Levit told Danckert to divide his emergency funds into two parts so that he could take advantage of his retirement plan savings.

The first step, she said, was for Danckert to build up his regular savings account (the balance was just $700) until it equaled 10 percent of his gross income, or $5,000. And she recommended using a high-interest account to increase returns. Online banks such as ING Direct typically offer higher rates than brick-and-mortar banks' savings accounts, she said. The current rate is now about 3 percent.

Next, she said, Danckert should use his 401(k)'s stable-value fund, which works as a high-yield cash account, as another source of emergency money.

"That is a perfect fund for this purpose," Levit said, recommending that Danckert eventually have the equivalent of 20 percent of his gross income in that fund. That means boosting the current $1,700 balance to about $10,000. Although there is a 10 percent penalty on most early 401(K) withdrawals, this retirement-plan cash would only be used in case of a true emergency, she said. And since true emergencies are rare, the money would most likely continue to benefit from tax-deferred growth.

Although conventional wisdom is that young people should invest aggressively in equities, Levit says the current economy makes that risky. "Too often I see people who lose their jobs" and end up living off their credit cards, she said, noting people sometimes fail to factor such risks into their asset allocation calculations. "That is why I am more conservative for young people. Bad things have a way of spiraling."

To ensure that Danckert has an ample financial cushion, Levit recommended a portfolio that allocates only 55 percent to equities and 45 percent to fixed income. Noting the current volatility of the stock market, she said, "These times are a good example why you don't want to put everything into the market." While Danckert's existing portfolio was 84 percent in equities, Levit said that percentage would quickly adjust to her recommended level as he started building up his emergency funds.

Using advice from the book, Danckert had done a good job of diversifying his investments across most asset groups. International equities, however, had been largely ignored, accounting for just 1 percent of his portfolio. "You are also over-weighted in large-company stocks," Levit said, noting that more than half the portfolio was invested in large company mutual funds.

To correct these imbalances, Levit said Danckert should allocate all new 401(k) contributions between the stable value fund, an international mutual fund, and a couple of small-company funds. Once achieving the recommended balance, he could then put new money into whichever funds were under-weighted at the time.

Since Danckert won't hit retirement age for more than 30 years, Levit said a quick "back of the envelope" calculation was all that was needed right now. The calculations showed that Danckert now spends about $35,000 a year. Given a 7.5 percent annual return on investment, Danckert was right on track to retire at age 63 with a lifestyle comparable to the one he has today.

Because his financial life is so finely balanced, Danckert isn't in a position to make big lifestyle changes right now. Adding travel to his budget would require a reallocation of resources, Levit said. And a second condo could create serious financial stresses. "You wouldn't have a lot of wiggle room if something goes wrong," she said. "I can see a lot of potential disasters." ■