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Your portfolio got you down?

As the economy worsens, many investors with cracking nest eggs are bucking conventional wisdom and pulling out of stock funds - looking for lower-risk, lower-yield investments

By Ross Kerber, Globe Staff | April 6, 2008

It's gut-check time for investors.

Conventional financial planning takes a long-term view of holdings meant to pay for goals like retirement or college tuition. Advisers say to buy a diversified portfolio of stocks, bonds, and cash to avoid the worst hits when a particular sector tanks. And investors should stick with their basic strategies to ride out downturns, they say.

Now that advice is being tested. The average diversified US equity fund lost 11 percent of its value during the first three months of the year, according to research firm Morningstar Inc. And some of the most popular sectors were hammered even worse: Asian stock funds excluding Japanese companies fell 20 percent, and specialty technology funds fell 16 percent.

Planners say declines happen, and they represent buying opportunities for people who add a bit every week or month to retirement savings accounts like 401(k)s. Most planners are advising their clients to stick with their investment strategies during this downturn.

They are betting that markets will recover, starting by the summer, and that the US economy isn't entering a long period of stagnant stock prices such as in the 1970s.

But many investors have already run for the exits, putting more assets into low-risk vehicles that are much less volatile but historically have paid lower returns.

Data compiled by Financial Research Corp. of Boston show money market funds taking in $232 billion during the first two months of 2008 - the most recent data available - more than a third of what they attracted during all of 2007 and more than in all of 2006. And exchange-traded funds that invest in bonds maturing in two to 10 years took in $1.3 billion in the first two months of the year, up from $380 million in the same period a year ago, according to data from Morningstar of Chicago.

The same data show dramatic fall-offs from areas that were hot in the past. Most dramatically, investors in January and February pulled $9.6 billion out of large-cap value funds that invest in big, underpriced companies such as financial services firms, compared with the same period in

2007 when such funds drew in $8.7 billion.

Mid-cap blend funds, which invest in a mix of companies worth between $1 billion and $5 billion, also saw flight. That category saw $4.8 billion withdrawn in the first two months of this year after taking in $2.3 billion a year earlier.

"It appears investors aren't heeding the advice of the experts, which is to be adding in a time of market turmoil, not lightening up," said Christine Benz, Morningstar's director of personal finance.

Benz also noted that many funds focused on foreign stocks have seen big outflows lately, swinging from big intakes they had in previous years when foreign markets were hot - more evidence of people piling into the area because of its past performance rather than long-term goals. Even though Asia funds excluding Japan returned 48 percent in 2007, for instance, planners have long warned the area was volatile. Sure enough, when these funds lost 20 percent of their value in the first quarter, investors lost patience: $1.2 billion washed out of them in the first two months of 2008, compared with the $1.6 billion they took in a year ago.

"It looks like a lot of those assets are leaving as fast as they came in," Benz said.

There's a specific explanation for each sector's shifts, but the overall driver was a grim market. The Dow Jones industrial average, a measure of 30 blue-chip stocks, fell 8 percent during the first quarter to close at 12,216.40, its worst performance since 2002. The index rose a bit last week to close at 12,609.42, but still below its finish Dec. 31 of 13,264.82.

It's an anxious situation for many individual investors, many of whom also have lost equity in their homes as prices decline. Among the edgiest are clients with new money to invest from a bonus or the sale of real estate, said Beth Gamel, executive vice president for Pillar Financial Advisors in Waltham. "People are unhappy," she said. "They're saying, I don't know about the market. Do I really want to put this new money to work in it?"

Gamel's answer is the same as other planners: figure out a long-term plan and stay with it. Rather than buying or selling whenever there's a dip in the market, she usually rebalances client holdings in the fall to keep their mix of stocks, bonds, and cash at set proportions depending on their age and appetite for risk. This often means selling stocks after they have posted big gains, which can be painful for some people.

"You have to swallow that there will be times when you're excited about how parts of your portfolio are doing, and you have to sell it," she said.

In Burlington, Ted Yoos, president of Cornerstone Financial Management, said he also hears from many people who at one point in the winter saw their portfolios fall. "They were worried, they're asking what's going on." But he said he'd already sold many from the riskiest holdings starting in the fall, and has made few changes this winter.

"What I try to do is give them a perspective. If they're down 3 percent in their fund, and the broad market is down 5 to 10 percent, then even if the fund had a poor return they didn't lose as much as they could have," Yoos said.

Suggested asset mixes vary by an investors' age, goals, and tolerance for risk. A typical adviser might suggest putting at least half of the portfolio into stocks, and perhaps as much as 80 percent for an investor in their 20s, with the rest in bond funds and cash accounts. Bonds should become a greater share of the mix as an investor approaches retirement.

Some advisers are more conservative. In Newton, Dana Levit of Paragon Financial Advisors suggests an even split between stocks and bonds for a typical 30-year-old couple unless their net worth is at least three times their annual income. "I think people's risk tolerance is tested in times like these. So we start with a more conservative portfolio so they can sleep at night regardless of what the market is doing," she said.

Another concern is that returns in money market funds are also declining following a series of interest rate cuts by the Federal Reserve. The top retail money market funds are yielding around 3 percent, according to cranedata.com, down from more than 4 percent in the fall. Though many investors use these funds to park their money, they're not getting the long-term returns they would if they used the same funds to buy equities.

Still, many older clients who are 50 or older prefer to stay out of the markets until the dust settles, said Garrett Nagle Jr., who oversees asset allocation for his family's Boston financial firm. "The typical retail investor is keeping the cash rather than reinvesting it," he said.

Some fund companies say they're hearing the same concerns. Fidelity Investments help centers are getting a boom in calls from customers worried about market volatility, said John Ragnoni, senior vice president for the Boston mutual fund giant, and money is flowing into its money market and bond funds. "There's no question that new funds coming in are being invested conservatively," he said.

But money invested through the 401(k) retirement savings plans Fidelity administers hasn't followed this pattern, Ragnoni said, suggesting that investors have heeded the firm's advice to create a plan and stick with it.

"It's generally that the more the investor reacts to the market, the worse the retirement plan will be" in terms of performance, he said.

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