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YOUR MONEY

Why Panic? A Couple's Nest Egg Better Left Alone

By TARA SIEGEL BERNARD MARCH 21, 2012

IMAGINE for a moment that your fairy godmother had appeared on Jan. 1, 2000. She told you that, over the coming decade, there would be two recessions, high unemployment and a major financial crisis that reverberated around the globe.

With that guidance, would you have done anything differently with your retirement savings?

Many retirees or those close to retiring would have probably dumped their money into cash and then waited for the markets to stabilize. But would that have been the right decision?

This is a situation that Mark Gochnour, a vice president at the mutual fund managers Dimensional Fund Advisors, sketches out as part of a presentation he has made to nearly 1,000 financial professionals over the last year. And he makes a strong case that it would have paid to remain invested in a well-diversified portfolio — and he uses his own retired parents as an example.

After all, his parents, Bryce and Luanne Gochnour of Boise, Idaho, a former orthodontist and homemaker, have already endured two recessions — including the Great One — since Mr. Gochnour stopped working in 1997. Their portfolio’s peaks and valleys are traced in the big chart at right, which their son likes to contrast with the more volatile course of the Standard & Poor’s 500-stock index.

Their portfolio, which is evenly divided between stock and bond funds, has certainly had its share of rough patches, particularly during the market plunge in 2008 and 2009, which caused their savings to dwindle about 25 percent from the market peak. But it has come back since then, and things could have turned out much worse had they not followed their son’s investment mantra: Focus on the things you can control.

“It is really the simple things that I call the blocking and tackling of investing,” the younger Mr. Gochnour said. “And you have to stay disciplined and stick with your plan, not only in good times but in more challenging times as well.”

You have heard this refrain before. It includes building a well-balanced portfolio, while keeping investment costs and taxes to a minimum. It also means giving up efforts to pick the next Apple or the next hotshot money manager and not trying to get out of the stock market before it crashes again. It also helps to turn off the television.

And that’s precisely what his parents — his father is 75, his mother is 72 — have continued to do. Their portfolio is invested in a collection of 15 mutual funds from D.F.A., which are sold through a select group of financial advisers. (D.F.A.’s approach, a twist on index investing, also tends to include heavier helpings of smaller-cap and value stocks, based on research showing that they tend to outperform the broader market over time.) Taken together, the funds, which represent more than 11,000 securities from 44 countries, have fees that cost 0.30 percent of assets each year.

That does not include the annual fee the couple pays to their financial planner, which typically costs an additional 1 percent. But Mr. Gochnour is adamant that it is well worth the price because of the invaluable hand-holding you will need during your darkest hours of doubt.

With a nest egg of about $1 million, the Gochnours entered retirement with more money than the typical American retiree. But a smaller portfolio with an identical investment mix would have had the same track record. From January 1995 through February 2012, the portfolio has delivered an annualized return of 7.85 percent, before inflation, compared with the S.& P.'s 8.55 percent. (For clarity's sake, the chart does not reflect any withdrawals.)

In exchange for a less volatile ride that resulted from their not being 100 percent in stocks, the Gochnours had to give up nearly a percentage point of return, which seems like a worthwhile trade. "A well-diversified portfolio is a much smoother experience," the younger Mr. Gochnour said.

And during the "Lost Decade," the nickname for the decade ending in 2010 that relates to the stock market's paltry returns during the period, the portfolio earned a respectable annualized return of 5.9 percent.

Anyone who doesn't have a financial planner or simply can't stomach paying for one could have achieved similar results over the same time period, with a smaller collection of funds that are accessible to all investors. A portfolio recommended by Vanguard that was also evenly split between stocks and bonds — using only three index funds — delivered an annualized return of 7.59 percent return over the 1995 to 2012 period. Meanwhile, a portfolio that comes as close as possible to replicating the Gochnours' investments using only Vanguard mutual funds had a return of 7.61 percent.

These results look good now, from the rearview mirror. But during the scarier moments, particularly as the market struggled to find a bottom in 2009, Mr. Gochnour's mother began to worry. So she called him one evening and told him they were thinking about selling their two-bedroom home in

Palm Springs, which they bought after retirement and where they live for half the year. "I asked her, 'What changed?' And she said, 'Well, I don't know if we can afford it anymore.' "

After all, the stock market had lost about 50 percent of its value from its peak and she was under the impression that they, too, had lost half of their money. But her son pointed out that only half of their money was invested in stocks, with the other half safely sitting in high-quality bond funds.

In fact, they had enough money in those funds alone to cover 15 more years of their annual spending, which means they had at least that long to let their stock funds recover. He suggested that his parents call their adviser, which they did. And after running some numbers, they realized they were still on track to meet their goals.

The elder Gochnours' success is largely because of their disciplined savings habits. Even though they had enough money to live a comfortable lifestyle, they did not spend lavishly. Their one big expense was their large family home — they paid $186,000 in 1975 — which sat on five acres on the Boise River in Idaho. As Mark remembers it, family vacations were not spent at fancy hotels but at smaller hotels off the Interstate. "And we'd always pack a cooler with milk, cereal and fruit and we'd lug it into the hotel," he said.

The couple, who moved to a Boise town house after selling their home, is also comfortable with the way their portfolio is invested. They have had their nervous moments, but they have not reached a point where they felt the need to sell any of their stocks at an inopportune time. Retirees who go on a selling spree as the stock market is plunging can do a lot of damage because they are essentially locking in their losses — whether it's out of fear, or because they're too heavily invested in stocks and need the money to live on.

That's why investors need to think seriously about whether they can handle the volatility associated with their own portfolio. "If you don't think you can stick with it, you need to rethink your plan," their son said. That might involve dialing down your stock exposure. "And there is nothing wrong with that."

Lowering your allocation to stocks may translate into a lower return, which means you may have to save some more, work a bit longer or make some other adjustments.

In fact, Mr. Gochnour had to work a few years more than he would have liked to make up for a real estate investment gone awry much earlier in his career.

"There is nothing wrong in doing some of those things, as long as you can afford your investment to go to zero," the younger Mr. Gochnour said. "Just be sure you understand that's speculation, not investing."

Trying to sell a bunch of stocks in 2009 or buy them in 2007 would have been speculation, too. But that kind of bet could have been even more damaging.

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