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## 6 smart 401(k) moves for rough times

Novices usually do a few dumb things when the market tanks, but you don't have to if you know the alternatives.

By [Tim Middleton](#)

Whenever the stock market tumbles, novice investors begin to squeal. They forget the scuffed knees they got when they learned to ride a bike; they think every spill in this arena is a fatal crash.

The pain would be bad enough if investing didn't determine your personal bottom line. But, in today's pensionless world, it does. You're going to ride your 401(k) throughout your retirement. You've got to learn how.

Former President Franklin D. Roosevelt offered excellent advice to a nation gripped by far worse problems in 1933: "The only thing we have to fear is fear itself." Even bear markets of historic proportions end, and when they do, markets quickly come back. Those timid souls who gave up on the market in 2002 have given up profits of nearly 50% since -- and that's even after our current malaise.

What you're afraid of is the unknown. But bad markets are very well known. Generations of investors have endured them and learned from them. The dumbest investing mistakes are also the most common, and smart solutions to them are instantly available. Here are six of those mistakes and their antidotes.

### Keeping saving

**DUMB:** Stop contributing to your 401(k) plan because you're "losing money." In fact, notes Jill B. Boynton of Cornerstone Financial Planning in Newington, N.H., "you are adding to your investments at lower and lower prices, thus lowering your average cost basis."

Everything goes on sale. Stock sales are called corrections or bear markets, but what they are is sales. Markets always come back -- always. The price can be 20%, 30% or even 40% off, but it's still good merchandise.

**SMART:** Buy the ugliest stuff on the shelf. When any asset is getting beaten up, it will decline relative to others. Keep your portfolio in balance by shifting new money to categories that have fallen below the percentage gain called for in your long-term portfolio plan.

"The market changes all the time. Your long-term asset allocation and goals should not," says Frank C. Boucher, an investment adviser in Reston, Va.

Adam J. Leavitt, with Disciplined Investments in Tulsa, Okla., notes that many 401(k) Web sites have a "rebalance" button that will automate this process of restoring balance between expensive funds and cheap ones. Buying the seemingly worst possible choices "forces you to buy low," he says.

## Think long term

**DUMB:** Dumping your "disappointing" funds for those with better recent results. "This is the classic investor mistake of chasing returns," says Lori L. Embrey of Fairfield Investments and Wealth Management in Columbus, Ohio.

Lately the small-cap value style of investing has gotten walloped, even though over long periods it is among the best-performing styles. For months, commodities like petroleum and gold defied the bad market for stocks, but nothing lasts forever; recently, gold fell 10% in just a few days. Never sell anything simply because it declines in price.

**SMART:** Even great mutual funds can be expected to underperform in as many as three years of every 10. Assuming the same management team is running the fund in the same way it was when you became attracted to the fund in the first place, stick with it. What Wall Street calls "reversion to the mean" predicts that hot asset classes will cool and cool ones will heat up again.

## Look for new opportunities

**DUMB:** Rejecting investing because today's returns are less than they were in the 1990s. Instead of the double-digit gains back then, the stock market has been delivering annualized returns of about 3.5% in this decade.

Brian Pon, an adviser with San Francisco-based Financial Connections Group, turns that argument on its head. "If you're expecting lower rates of return going forward, you should be increasing your savings," he advises.

And you should be looking in new places for future returns.

**SMART:** Look ahead for investment opportunities, not behind. For example, U.S. bonds are unsteady, but others overseas are not. "Look for a nice global bond fund," suggests David E. Zumbusch of Sportsmen Dream Financial in Buffalo, Minn. Until very recently, foreign bonds were hard for U.S. investors to own, but now there's even an exchange-traded fund, **SPDR Lehman International Treasury Bond** ([BWX](#), [news](#), [msgs](#)). And while stocks are down in double digits this year, that ETF is up 5.4% as of March 24.

## Escape a 401(k) the right way

**DUMB:** Shunning the 401(k) plan because you're afraid of Wall Street "tricks." If you have an employer match, you're being paid to learn how to avoid them. "If your bank was offering you a dollar for every dollar you contributed, would you think that was a good deal? Of course you would. Yet some people think the 401(k) match is different," says Peter A. North, a planner in Orange Park, Fla.

If you're a novice, look for a fund option that owns both stocks and bonds, like a balanced or target-retirement fund. Own it while you're learning the ropes.

**SMART:** Getting out of a 401(k) when you leave the company. You can roll it into a self-directed IRA with unlimited investment options at a discount broker. And even good 401(k) plans can have bad rules.

Carolyn T. Walder, president of Lifetime Wealth Planning and Management of Alexandria, Va., says her clients have included beneficiaries of plans that automatically cash out plans upon death and withhold 20% of the proceeds for federal tax (the federal Thrift Savings Plan, notably).

"Get out when you can," she warns. "The beneficiary has no say in how or when they get to take the money out, and this can have a tremendous impact on their tax planning." Self-directed rollover IRAs can be inherited without a huge, immediate tax bill.

## **Don't owe money -- even to yourself**

**DUMB: Borrowing from your 401(k) because "you're paying interest to yourself." Don Martin, president of Mayflower Capital in Los Altos, Calif., notes that you'll pay taxes on that interest, "yet no deduction is allowed for interest expense." Also, if you change jobs or get laid off, the whole loan could come due on the spot.**

**SMART: Pay back any loan as fast as you can, because you'll earn far more on the stocks you can buy cheaply now than on those "interest" payments.**

## **Sell company stock the right way**

DUMB: Selling highly appreciated company stock if you're near retirement. "The tax break on net unrealized appreciation will be lost forever," warns Jeremy E. Portnoff, a financial adviser in Westfield, N.J.

This little-known tax dodge works like this: The IRS will allow you to withdraw company stock in-kind (that is, you don't have to sell it first) from a 401(k) or other deferred-compensation plan at retirement and deposit it directly into a brokerage account. The tax "basis" in the stock becomes the value when it is transferred, not when it was originally purchased, when it was presumably worth much less.

Proceeds from retirement accounts are taxed like ordinary income, at rates approaching 40%. With this move, you pay the capital gains rate of 15% or less.

SMART: Selling excess company stock, such as the sort used for the annual match, as soon as you can. Since your income is already tied up in your job, tying your nest egg to the company as well exposes you to extra risk, says Lauren G. Lindsay of Personal Financial Advisors in Covington, La.

"Make sure it's not a substantial chunk of your overall portfolio," she says. "Most advisors like to keep it below 20%, or even 10%."

You don't need a perfect investment portfolio to retire well. But you do need a portfolio. Today's 401(k) plans are loaded with incentives. Take advantage of them. Don't look back from the future in sorrow.

<http://articles.moneycentral.msn.com/Investing/MutualFunds/6Smart401kMovesForRoughTimes.aspx?page=1>

Mutual Funds 5/20/2008 12:01 AM ET

## The best funds for your 401(k)

Part 2: Fidelity is the retirement-plan giant, but its style puts a premium on individual fund managers. Keep a close eye on who's running yours.

By [Tim Middleton](#)

*This is part two of an occasional series on the best offerings from the fund families that hold most retirement plans. To read Part 1, on Vanguard, [click here](#).*

Fidelity Investments is the largest operator of corporate 401(k) retirement plans. And it's a good one, offering an excellent array of funds.

But it can be the most daunting fund company with which to invest. Its funds are only as good as their managers, meaning you've got to do much more research than with other fund families to identify the funds you want to own.

"Fidelity is a place, more than anywhere else, where you buy the manager," warns John Bonnanzio, the group editor of the Fidelity Insight investment letter. "You have to like Harry Lange" to buy **Fidelity Magellan** ([FMAGX](#)) despite that fund's famous name.

Although it's big, Fidelity remains a gunslinger among investment managers. Its corporate culture is as unlike Vanguard, which I wrote about recently in [Part 1](#), as it is possible to be.

Where Vanguard is buttoned down and thrifty, Fidelity is a cowboy who aims to shoot out the lights. And this cowboy demands to be paid a premium for his marksmanship, whether he shoots straight or not. That puts a premium on managers' skills.

I've developed a list of Fidelity funds whose managers are first rate and whose funds would be excellent candidates for your 401(k). Just bear in mind that if a manager changes tomorrow, the opinion expires. And because the average Fidelity manager has a tenure of only 2.8 years, it could expire quickly.

It's the manager, not the fund, at Fidelity.

### Magellan's old magic

Magellan was once Fidelity's flagship and the largest actively managed mutual fund. Today, after shriveling in half to \$41 billion in assets, it is back on track to greatness.

Since taking control in October 2005, Lange has channeled about a quarter of the fund's assets into foreign stocks and domestic winners such as **Google** ([GOOG](#), [news](#), [msgs](#)) and **Monsanto** ([MON](#), [news](#), [msgs](#)). Last year he delivered returns to his shareholders of 18.8%, more than triple the market's gain.

Before Magellan, Lange managed **Fidelity Capital Appreciation** ([FDCAX](#)), another big-cap growth fund, for more than a decade. He racked up an outstanding record and just in time for Fidelity, because Magellan badly needed his attention. Magellan had become not only bad in the 1990s and early years of this decade - it had virtually become an index fund.

Lange has overhauled the fund, and today the portfolio's R-squared, or similarity to the **S&P 500 Index** ([SINX](#)), is 79. A 100 would make it mirror the index, and that's where it was before Lange took over.

(Magellan's gain has been Capital Appreciation's loss. Morningstar notes that last year that fund tumbled into the bottom 25% of funds of its type -- badly lagging, among other Fidelity funds, Magellan.)

## And a nod to Contrafund

Jack Bowers, the editor of the Fidelity Monitor newsletter, says, "Magellan and Contrafund have strong managers and are in lots of plans, and I rate both of them a buy."

**Fidelity Contrafund** ([FCNTX](#)), which is closed to investors except when bought through employer retirement plans, has been managed for nearly 18 years by Will Danoff, one of the best managers Fidelity has ever had. He has guided Contrafund into the top 5% of large-growth mutual funds, or better, for 15 years.

Danoff, a Morningstar manager of the year in 2007, has often supercharged Contrafund's performance with small and midsize companies, albeit with difficulty. The fund has assets of \$75 billion, and it's difficult to put an appreciable portion of that large a portfolio to work in small companies.

Lately, though, he's zeroed in on megacaps, which have been lagging the market.

Over the three years ending May 13, Contrafund delivered annualized returns of 15.3%, 6.5 percentage points more than the market.

## Hot emerging-markets manager

**The hottest equity category in recent years has been emerging markets, but until four years ago Fidelity Emerging Markets ([FEMKX](#)) was a dud. Then Robert von Rekowsky took the helm and turned around the portfolio, from ranking among the worst of its type to one of the best. Morningstar says it has beaten all but 3% of its rivals for the past three years.**

**Don Martin, the owner of Mayflower Capital in Los Altos, Calif., says this is one of the best emerging-markets funds open to retail (as opposed to institutional) investors, and he recommends it highly. "It has reasonable fees for an emerging markets fund, and it has a best-fit alpha of 1.7."**

"Alpha" is market jargon for manager excellence. An index would have an alpha of 1.0. Managers can boost returns by taking additional risk, but alpha takes risk into consideration. Von Rekowsky's score indicates he delivers returns 70% greater than would be expected based on the risks he takes. Over the past three years, those returns have averaged 38.2% annually.

## Boost your bonds

For investors looking for income, **Fidelity New Markets Income** ([FNMIX](#)) is a time-tested way to supplement the meager returns of domestic bonds with those of emerging nations such as Russia, Venezuela and Mexico. Manager John Carlson has been at the helm for 12 years, meaning he's one of the

few of his peers who endured the Russian default of 1998. The average fund of this type lost 40% that year; this fund lost only 26.6%.

"We like overseas debt," says Kipley J. Lytel of Montecito Capital Management of Santa Barbara, Calif., noting the fund's yield is 6.1%. That's above the category average and 135 basis points higher than the current yield of a domestic intermediate-term bond fund, the most widely owned type.

Over the past five years, the fund's annualized return has been 10.4%. Carlson invests in dollar-denominated bonds, so there's no significant currency risk -- the danger of the bonds' return swinging simply based on exchange rates.

Newsletter editor Bonnanzio notes that there is one exception to the monitor-the-manager rule at Fidelity Funds, in his words, a fund "whose investment universe will never go out of style." He recommends **Fidelity Select Consumer Staples** ([FDFAX](#)), which owns companies such as **Procter & Gamble** ([PG](#), [news](#), [msgs](#)), **Coca-Cola** ([KO](#), [news](#), [msgs](#)) and **Altria** ([MO](#), [news](#), [msgs](#)). It ranks among the top 5% of large-cap core mutual funds for the past five and 10 years, and is down 3% this year, less than the market.

Fidelity has many fine funds with outstanding managers, and it should be possible in almost any Fidelity-managed 401(k) to put together an outstanding retirement portfolio. If your company plan doesn't include all these specific funds, ask your company's investment committee to add them.

Just remember to keep an eye on the manager. When a good one walks out the door, you should always consider following.

*At the time of publication, Tim Middleton did not own or control shares of any company or fund mentioned in this column.*

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## **Is the dollar's comeback for real?**

**The greenback's weakness sent foreign stocks soaring over the past few years, and many investors cashed in. Be careful now, because the tables are turning.**

**By [Tim Middleton](#)**

**Commodity investors are taking a whipping as prices plunge for everything from oil to gold. The folks who really ought to be scared, though, are shareholders in foreign-stock mutual funds.**

**Since the end of 2001, foreign stocks have outperformed their U.S. competitors entirely because of the dollar's weakness. The commodity-price rout is both a symptom and a cause of the greenback's sudden resurgence, and a strong dollar spells penury for U.S. investors in foreign developed-market equities.**

**In short, if you made money in global markets over the past few years, you made it because of the weak dollar. Bail out now, or the greenback will come back to bite you.**

That's assuming, of course, the dollar's comeback is real. I think it is, and what we're seeing is the start of a multiyear trend that changes the equation for global markets -- and likely for your portfolio or 401(k).

## All about the buck

"If you're going to invest in foreign companies, just be sure you realize that currencies seem to be at least as important as what's going on on an individual-company basis," says famed value investor Ronald H. Muhlenkamp, the manager of the eponymous mutual fund ([MUHLX](#)).

Conventional investment wisdom holds that foreign equities play a valuable role in any portfolio, providing excellent returns as well as diversification away from the risks unique to the United States. As is so often true, the conventional view is wrong. Foreign equities actually underperform the U.S. market when measured in terms of their own currencies. And the benefits of diversifying your portfolio disappears when markets head south. Beta -- which measures how closely markets are correlated, with 1 being perfect alignment -- "approaches 1 in a down market, so the protection through diversification you were counting on isn't there," says Georgia Bruggeman of Meridian Financial Advisors in Holliston, Mass.

If you own a bundle of foreign-stock funds, you are likely sitting on a lot of profits despite the recent bear market. Now is a good time to move money out of them and lock in some of those gains.

## Sinking dollar, rising returns

What kind of profits might you have racked up? Between 2001, when the dollar's value most recently peaked against other currencies, and the end of 2007, the MSCI EAFE Index, the standard measure of developed foreign stock markets, surged 223%. The **Standard & Poor's 500 Index** ([\\$INX](#)), by contrast, managed a gain of 42.4%.

That bonanza, however, flowed only to U.S. investors. In local-currency terms, the EAFE advanced just 36.1% in those six years, less than the S&P.

Why the difference? The value of the dollar shriveled. On a trade-weighted basis, according to the Federal Reserve, it tumbled 18.2% in those years. More particularly, it shrank 39.8% against the euro and 14.3% against the Japanese yen, the two currencies that dominate the EAFE.

Barry James of the James Advantage Fund shares a few of his favorite US stock picks.

One euro was worth 89 U.S. cents at the beginning of 2002. Early this year, a euro bought \$1.60. A buck that could buy 132 yen six years ago fetched only 101 at the dollar's low point this year.

Since the dollar's low in April, it has rebounded 6.3% against the euro, as of Aug. 15, and 8.5% against the yen.

These currency swings are nothing new. Muhlenkamp's book "[Ron's Road to Wealth](#)" was originally published in 1994, when foreign equities were enjoying just such a currency kick. In the latter half of that decade, however, the dollar rallied, and foreign gains evaporated.

Today, Muhlenkamp, whose fund can own foreign stocks, owns only two: **Cemex** ([CX](#), [news](#), [msgs](#)), a Mexican basic-materials producer, and **BHP Billiton** ([BHP](#), [news](#), [msgs](#)), an Australian natural-resources company. Currencies weren't a factor in his thinking, he says -- only the theme of global demand for resources.

But that boom in commodities has turned into a bust in recent weeks as oil has retreated from more than \$140 a barrel to little more than \$110 and gold from more than \$1,000 an ounce to just above \$800.

By no coincidence, both commodities, and most of the others, are priced in dollars wherever they trade in the world. Prices go up when the dollar falls, and a strong dollar brings them down.

## **The dollar bottoms out**

The dollar is bouncing off lows it has reached twice before in modern financial history, and it's finding a bottom about where it did both of those times. And it's looking up.

Currency traders are reckoning that the U.S. is more likely to raise interest rates in the coming year than Europe, where they are already much higher. Equity traders -- and U.S. stocks are purchased in dollars -- are reckoning that the U.S. economy, which turned south before the rest of the world's, will turn north before the others as well.

All these trends suggest the dollar, which moves in multiyear cycles, will keep moving up. This is a new cycle that will erase the advantage of foreign stocks.

In fact, this year, as of Aug. 12, core U.S. stock funds -- the Morningstar large-blend category -- are down an average of 11.3%. The corresponding foreign-stock funds are down 17%. This is a case in which diversification hasn't helped.

Muhlenkamp points out that, increasingly, the people buying stocks around the world are the same as those buying in the U.S., from individuals to institutions like pension and hedge funds. "If the owners act the same, the stocks act the same, even if they're in different countries," he notes.

## **You can't fight the cycle**

Advocates of long-term portfolio planning point out that market cycles recur, and the simplest investment strategy -- to diversify broadly, from large to small, domestic to foreign, growth to value -- is also the one that produces the most reliable long-term results. That would argue for standing pat in global funds.

Scott A. Leonard, a financial adviser in Redondo Beach, Calif., says a diversified portfolio is intended to capture outsize results wherever they occur, because predicting where they will occur, and when, is beyond most investors' ability. "If you feel that you can make these calls, then you don't care about diversification," he says. He argues that making such calls amounts to market timing, and he acknowledges that it can deliver superior results at times -- but not consistently enough for most investors to remain on board.

"To market-time, being right two-thirds of the time is probably doing pretty good," Leonard says. The third of the time you're wrong, however, will shake your confidence, especially if "you" are his client or my reader.

I shade this argument a bit differently. I view market timing as making a decision to be in the market or out of it, with no gray areas. My approach, in contrast, involves adjusting a portfolio moderately to align it with the winds you expect to blow in coming months and years.

Currency valuations are extremely volatile over days and months, but over years they tend to follow strong trends. These cycles are multiyear. The dollar's weakness has lasted more than six years; a multiyear period of strength in the years to come would be routine.

## **Overseas is still OK**

**Still, in my own portfolio, I'm not selling foreign stocks out to the bare walls. Foreign small-company stocks and emerging-market stocks have very different characteristics than the S&P 500, and I think each will remain attractive for years, if not decades.**

**But I plan to cut back selectively on my exposure to large developed-market stocks, which are the staple of international mutual funds. Cut back, not sell out. Even if they don't deliver home runs as they have in the recent past, foreign companies are not just like our own.**

**"A foreign corporation may be more warmly welcomed in an anti-American Third World country and may be more uninhibited about operating there," says Don Martin, the president of Mayflower Capital in Los Altos, Calif. "French oil companies can drill offshore in Cuba."**

**There are benefits to foreign investing I don't want to forsake. But tremendous outperformance is a benefit they are not capable of delivering when the dollar is getting stronger. In that regime, investment dollars will be more productive here at home.**

*At the time of publication, Tim Middleton didn't own or control shares of any company or fund mentioned in this article.*

<http://articles.moneycentral.msn.com/Investing/MutualFunds/IsTheDollarsComebackForReal.aspx?page=all>