Five Easy Pieces of Investment Advice

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Here are Five Easy Pieces of Investment Advice that can stretch your investment dollars. The first 3 “Pieces of Advice” are connected. It’s a good practice to verify if your broker or advisor is following these tips or not (I’m always amazed to see how many money managers disregard these commonsense ideas and cost their clients more money):

1. **Location, Location, Location**

Different types of investments fit better in **taxable accounts** (funded with after-tax money) vs. **tax-deferred accounts** (e.g. IRAs, 401ks) vs. **accounts that never will be taxed** (Roth IRAs or Roth 401ks). While one investor may have most of her money in tax-deferred accounts (which can hold any type of investment), another investor may have most of his money in taxable accounts so he needs to be more tax-aware:

a) **Taxable accounts**: invest more of this money in stocks (individual shares, stock mutual funds or Exchange Traded Funds). Exchange Traded Funds (ETFs) are attractive in taxable accounts since they generate fewer capital gains. All types of stock holdings flourish in taxable accounts because gains are taxed at lower capital gains rates if sold after being held at least one year (and realized losses can offset gains). Real Estate Investment Trusts make tax-unfriendly distributions so these are best held in tax-deferred accounts. Regular taxable bonds are not a good fit in taxable accounts – go with municipal bonds and municipal bond funds because they’re exempt from federal taxation.

b) **Tax-deferred accounts**: invest more of this money in traditional bonds, Real Estate Investment Trusts and
commodities. If most or all of your investments are tax-deferred, then invest in a mix of stocks and bonds to make sure you are well-diversified.

c) Roth IRAs and Roth 401ks: these are ideal vehicles to hold stock investments since holdings grow tax-free forever.

2. Tax Managed and Tax-Advantaged Mutual Funds

Why invest in mutual funds instead of individual shares? Because they do a great job mitigating risk by investing in a large number of holdings. This valuable diversification – the investment equivalent of a “free lunch” is powerful. One drawback in taxable accounts is taxable capital gains distributions that mutual funds pass on to investors. You pay the capital gains tax – not the mutual fund – and there can be gains even if the mutual fund has declined in price over the past year. A better way is to invest in taxable accounts is to invest in tax-managed or tax-advantaged mutual funds. For example, Vanguard offers a “Balanced Tax-Managed Balanced Fund” designed for taxable accounts. Some other mutual fund companies offer tax-managed funds (note: I use www.dfaus.com Dimensional Fund Advisors funds, which provide a full suite of tax-managed mutual funds). If you don’t have access to tax-managed or tax-advantaged funds, investing in Exchange Traded Funds (ETFs) may trigger lower taxes than comparable mutual funds.

3. Low Cost Mutual Funds and Passive (= Low Cost) Exchange Traded Funds

In the great “passive” vs. “active” mutual funds debate, passive continue to attract more money from investors because they see the benefits of the low underlying expense ratios (note: data also show it’s hard to “do better than the market” on a consistent basis). Vanguard typifies this approach, charging rock bottom fees on the order of 1/10 of 1% vs. actively managed A, B and C share mutual funds that generate
commissions for your broker and can cost you **25x or more per year** (2.5% per year, including broker commission). Passive Exchange Traded Funds also can sport very low underlying expense ratios.

If you use these three strategies (Location, Tax-Management and Low Fees), you’ll stretch your investment dollars significantly.

In addition, here are 2 other strategies for stretching your money when helping your children with college or savings:

4. **529 Plans**

If your child is headed to college, invest in a “direct” (no advisor needed) 529 Plan. I send a lot of my clients to the State of Utah 529 Plan ([www.uesp.org](http://www.uesp.org)). Another good plan is the NY Direct 529 Plan ([www.nysaves.org](http://www.nysaves.org)). If you and/or your spouse work in NY (and you live outside NY State), you may benefit from deducting NY taxes from a portion of your contribution.

5. **Helping Your Children Get a Leg Up on Investments**

If your teenage or adult child has W-2 earned income, he/she should open a Roth IRA account and fund it each year. If he or she can’t afford to fund it, parents can step in and cover some or all of funding to help their children get a leg up on investing. You can defer up to $5,500 per year in a Roth IRA or match the amount of W-2 income if less was earned. Right now Roth IRA accounts remain tax-free and are a fantastic savings vehicle for young people.

*Put these “Five Easy Pieces” together and you’ll get far more out of your investment dollars.*