

Forbes

September 22, 2008

Cruise Control

For hands-off retirement investors, managed accounts may be a better choice than target date funds.

BY MATTHEW CRAFT

NURSES, PHYSICIANS AND PAPER PUSHERS at the Beaumont Hospitals in the Detroit area used to ask John Peetz for tips on investing the money in their retirement savings accounts. That put the genial Peetz, associate director in the hospital's treasury department, in an awkward position. "I didn't feel comfortable giving financial advice," he says. "I'd tell them, 'If I were you, I'd be well-diversified, but, you know, it's up to you.'"

Happily for Peetz, those questions have tapered off since the hospital moved most of the 7,000 participants in its workplace savings plan into "managed accounts" this past Jan. 1. Unless workers opt out—and 1,900 have—Financial Engines, a Palo Alto, Calif. firm founded by Nobel Prize-winning economist William F. Sharpe, determines which mutual funds they should buy and shifts their investments over time.

Never heard of managed accounts? They're a recent offering for 401(k) and 403(b) plans (the savings plan used by nonprofits, including Beaumont Hospitals). Just like target date funds, they're getting a boost from a 2006 pension law rewrite that encourages employers to enroll workers in retirement savings plans without their permission. Workers in plans with automatic enrollment have to make the decision to opt out of the plan, instead of making the effort to join. That puts inertia and procrastination on the side of savings.

But how should the money of such workers be

invested? Last year the Department of Labor issued regulations providing employers legal protection from workers claiming their money had been mismanaged if they used one of three "safe harbor" options as their default investment: balanced funds, target date funds or managed accounts. Moreover, if a company matches employees' savings by contributing its own stock, instead of cash, managed accounts are the only safe harbor.

With target date funds, every investor of the same age gets the same asset mix. By contrast, Financial Engines creates a portfolio based not only on your age but also on how much you've saved, your investments outside your company's retirement account and other retirement resources you expect to have. "If you want to include your house we can do that," says Kenneth Fine, a vice president at Financial Engines. If your grandmother left you a pile of General Motors stock that you refuse to sell, the plan might diversify your lopsided portfolio with international and growth stocks and trim risk with safer bond funds.

For that service Financial Engines charges Beaumont Hospitals employees 0.35% of assets a year if their balances are \$5,000 to \$100,000; 0.25% for accounts between \$100,000 and \$250,000; and 0.15% for bigger balances. Those fees are on top of the expenses charged by the underlying mutual funds and run higher (up to 0.6% of assets for smaller accounts) if an employer doesn't make managed accounts the default option, as Beaumont Hos-

pitals did. "You can opt out at any time," Peetz says.

Morningstar and Guided Choice offer managed accounts, too, but Financial Engines dominates the fledgling business. So far 294 employers, including Alcoa, are offering its managed accounts, and 275,000 workers, with \$18 billion in assets, have signed up for the service. (Many more workers have access to Financial Engines' online do-it-yourself asset-allocation advice.)

Financial Engines has no funds of its own, so it can choose only from a lineup of mutual funds picked by the employer. "We're independent," Fine says. "We don't have any incentive to offer one plan over another. We don't get fees from T. Rowe [Price] or Fidelity." When employer stock is included in a savings plan, Financial Engines won't allow it to make up more than 20% of a worker's account.

Does it really make sense to burden your savings with another layer of fees? That depends on how much time you want to spend monitoring your investments and how well you would handle them otherwise. Beaumont Hospitals turned to managed accounts after Fidelity Investments, which administers its 403(b) plan, analyzed employees' allocations and found disturbing results. Some younger workers had their savings parked in low-yielding money market funds, while some nearing retirement had gambled heavily in volatile biotech stocks.

If you're looking to put your 401(k) on cruise control, a managed account may be a better option than a target date fund, particularly if there's anything special about your situation. Maybe you have other retirement accounts or own a lot of employer stock outside the 401(k) and want an asset allocation that is balanced against these other holdings.

Christopher Jones, Financial Engine's chief

A managed account could save you from **panicking** and selling stocks at a market **bottom**.

investment officer, says the firm tries to hold down an employee's investment costs by putting institutional funds, instead of retail mutual funds, into his account if his 401(k) offers them. The same manager may charge 0.2% to 0.3% annually for institutional funds and 0.8% for similar retail funds. Index funds are even cheaper.

Another part of Financial Engines' pitch is that its asset allocation methods are more sophisticated than what investors can do on their own. It uses Monte Carlo simulations, in which a model portfolio is subjected to thousands of different possible scenarios (with varying stock and bond returns, inflation rates, etc.) to gauge the probability of different results. (Again, you can get Monte Carlo simulations a lot cheaper with the firm's do-it-yourself software, but that takes more diligence.)

Financial Engines' portfolio models take a long-term point of view. So a managed account will save you from panicking and selling at the bottom, but it won't save your investments from falling along with the rest of the stock market, as Peetz has had to explain to some hospital employees who wondered why their professional managers couldn't avoid market losses. "I tell them, 'No, you're in this for the long haul,'" he says. "Markets will go up and markets will go down, but if you ride it out you'll benefit." **F**