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ACT ONE
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 **DOW JONES REPRINTS**
**What to Do with \$2,500:
Advice for Young Investors**

After a few years in the workforce we may find ourselves with a little extra cash. Maybe it's a delightfully large tax refund or an apartment deposit you finally got back, but it's the first significant sum of money you've had that doesn't need to be spent paying back loans or furnishing an empty apartment. For the first time, you want to save or invest that money, instead of spoiling yourself with a spray-on-tan.

I spoke with five financial advisers about what a young investor should do with a small windfall: \$2,500. I created a profile of a twentysomething novice investor who doesn't have debts and is diligently paying into a 401(k). Investor X doesn't necessarily want to lock up this money until retirement. He or she may want to buy a house, fund a year off or have something socked away in case of a car crash or other emergency.

After each planner made a recommendation, I asked for numbers on the performance of their picks from the beginning of 2002 until this May.

QUICK TAKE: WHAT THE ADVISERS TOLD ME

Set up a Roth IRA: Charles Buck, a financial planner in Woodbury, Minn.

Put some money aside in a CD: Richard Rosso, Houston-based Charles Schwab financial consultant

Be Aggressive: Kathy Hankard, financial planner in Verona, Wis.

ETFs, ETFs, ETFs: Kim Arthur, San Francisco, investment adviser

Take the bond route: Christine Fahlund, senior financial planner at T. Rowe Price in Baltimore.

Set up a Roth IRA

Charles Buck, a financial planner in Woodbury, Minn., recommends that you set up a Roth IRA, as he did for his 27-year-old son. The nifty thing about the Roth is that we don't have to pay taxes when we finally withdraw the money after age 59 ½. We don't get a tax refund now on our contributions, but it's likely that we'll enter a

higher tax bracket by retirement and will thus save the difference in taxes. In special cases, like when buying a home for the first time, all of the money in a Roth IRA can be tapped pre-retirement without penalties. We can also withdraw our contributions -- but not returns -- early without penalties. Keep in mind Roths are only for singles who make less than \$110k or marrieds who make less than \$160k.

Mr. Buck advises that the twentysomething investor's Roth IRA include shares in a diversified mutual fund targeted for retirement withdrawal in 2045. "Target-date funds are good for young people," he says: "Pick a fund, forget about it and it takes care of itself." Mr. Buck's fund pick is the T. Rowe Price Retirement 2045 Fund. It charges a fee of 0.76%. T.Rowe Price has reported returns of 17.01% from the fund's inception on May 31, 2005 to April 30, 2007.

Put Something Aside First

Richard Rosso, a Charles Schwab financial planner in Houston, recommends setting your \$2,500 aside in an emergency reserve for six months of living expenses. "Keep \$1,000 in a CD that matures in 6 months, \$1,000 in another that matures in 12 months, and put \$500 in a savings account in case you need to change your tires or replace an air conditioner," he says. (For more info on CDs, see WSJ.com's savings center from Bankrate.com)

If you already have a reserve, Mr. Rosso says you should use the money for living expenses and increase your salary deferral to your 401(k) to benefit from employers' matching contributions.

"If all this is done," says Mr. Rosso, "I would contribute to the Roth IRA...invest in a way that's fully diversified." The mutual fund Mr. Rosso recommends is the Schwab Total Stock Market Index Fund, which contains a large amount of U.S. stocks and charges a fee of 0.53%. Schwab reports a five-year annualized return of 7.43% for the fund. Setting up a Roth or traditional IRA through the brokerage's Web site is free. The other large financial services firms I mention in this column also offer free Roth IRA enrollment.

ETFs, ETFs, ETFs

For the young person who is eager to learn about securities and actively manage his or her own portfolio, exchange-traded funds are an option. An ETF tracks an individual stock index such as the S&P 500 or a specific asset class such as real estate, currencies or gold. Unlike mutual funds, ETFs trade on a stock exchange or in an electronic market. Expenses tend to be lower, and ETFs that track a multitude of securities may not be as much of a gamble as an individual stock.

Kim Arthur, an investment adviser in San Francisco, doesn't invest on behalf of people with less than \$1 million dollars, but if he were your mom's best friend he might tell you, over lunch, that you should build a diversified ETF portfolio and rebalance it every year. His firm, Main Management, only manages ETF portfolios.

He likes their transparency, tax efficiency and low expenses. The goal: "10%-type returns with lower volatility than the stock market."

The blend Mr. Arthur recommends, and calls "all asset lite," contains five different ETFs weighted at different percentages. For stocks: 30% **Vanguard Total Market** and 30% **State Street Developed and Emerging Market**. For bonds: 20% **iShares 3-7 year Treasury**. For commodities and real estate: 10% **PowerShares DB G10 Currency Harvest Fund** and 10% **State Street International REIT**. "It's diversification at a low price," he says, "there are over 2,000 stocks in this blend." Though many of these ETFs didn't exist five years ago, Mr. Arthur calculates that based on their underlying indexes, an investment of \$2,500 would have returned an annual average of 12.91% between 2002 and now.

The expenses of an ETF are twofold: Those charged by the fund -- an average of 0.29% for all of Mr. Arthur's recommendations -- and broker trading fees. At TradeKing.com, for example, you will pay \$4.95 per trade. Re-balancing your portfolio back to the original asset weightings every year will cost \$25. Mr. Arthur says these ETFs have a lot of assets and thus won't suddenly shut down, as some ETFs with lower net assets have recently done.

Be Aggressive

If you expect to sell your shares ten years from now to purchase a house or pay a smidgen of your graduate-school tuition, financial planner Kathy Hankard says you want to be pretty aggressive and should invest in a mutual fund that is comprised mostly of stocks, with some short-term bonds. "You don't want to risk not making enough money and inflation eroding the value," says Ms. Hankard, whose firm is based in Verona, Wis.

She suggests the **Vanguard Star Fund**, for its low fees: 0.35%. It is the only fund that Vanguard offers for investors with less than \$3,000. Made up of 11 mutual funds, the "fund of funds" invests 62% in stocks, 25% in bonds, and 13% in short-term bonds. Vanguard's Fran Kinniry, a principal of investment counseling and research, says it's good for investors with a five-20 year horizon, and gives broad diversification. Vanguard lists the fund's annualized five-year return as 8.26%.

The risks of stocks are serious -- you can lose your money -- and should be considered whenever a mutual fund is heavily weighted in stocks. Intermediate government bonds, a more conservative option, will yield negative returns extremely rarely, but they will not likely return more than 8% per year, according to charts going back to 1966 by Morningstar Inc. High-yield bonds, on the other hand, are loans to companies that might default and never return your cash -- but if they do, your return will be a percentage that's typically higher than that of government bonds. The Merrill Lynch High Yield Master II Index, a benchmark, has average five-year returns of 10.36%.

Take the Bond Route

One planner recommended bonds for young people who don't know how their financial needs will flesh out.

"So many things are going to change in your twenties that it's possible you're going to need some of this money," says Christine Fahlund, a senior financial planner at T. Rowe Price in Baltimore. When Ms. Fahlund's son inherited some money and stashed it away in a conservative money market account, she thought that was correct. "You don't want to be in stocks with this money, and you have a lot of issues on your mind right now." Ms. Fahlund remembers telling him, "you might use it next year." She recommends using \$2,000 of your \$2,500 on a mutual fund that's heavy in bonds, the T. Rowe Price Spectrum Income Fund (with fees of 0.70%), and putting the other \$500 in a conservative money market fund, her company's Prime Reserve fund (0.60% fees).

T. Rowe reports a five-year annualized return of 8.16% for the Spectrum fund and 2.21% for the Prime Reserve fund.

When many of us get a bit of extra cash, we consult a list to choose between a new laptop or a trip to some hot place with scuba diving. Perhaps we shy away from saving or investing because we're intimidated. Don't be.

How'd They Do?

If we'd invested \$2,500 in 2002 in the funds recommended by the planners, what would have happened? After each planner made a recommendation, I asked them to tally up the returns for that fund from January 1, 2002 to May 1, 2007. During that same time period cumulative total returns on the S&P 500 were 41.9%. (A note: Since many of the ETFs Kim Arthur recommends did not exist in 2002, we were unable to perform this exercise on his picks.) --E.M.

Fund	Expenses	Ending Balance	% Return
Vanguard Star Fund	\$77.80	\$3,862	54.48%
T. Rowe Price Spectrum Fund	\$156	\$3,791	51.63%
T. Rowe Price Prime Reserve	\$92	\$2,804	12.14%
Schwab Total Stock Market Index Fund	\$77.68	\$3,771.50	50.86%