ADVISER INVESTMENTS

# ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

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## 529 Plans of Note

In our last two *Adviser Fund Updates*, we covered the basics of 529 plans, followed up by a review of state-by-state tax treatment and financial aid implications. To wrap up the series, we're taking a look at four 529 plans that may be worth considering if you live in the states that offer them, or in a tax-parity state or one that provides no tax benefits. If your state does give favorable tax treatment to 529 plan contributions, you may be happiest investing at home.

The plans we've chosen to look at generally have a wide variety of portfolios, age-based tracks and, in some cases, individual funds to choose among. The first two plans, the Maryland College Investment Plan and the T. Rowe Price College Savings Plan (sponsored by Alaska), charge slightly more in fees, but consist mainly of actively managed funds. The second two plans, the Vanguard 529 Plan (sponsored by Nevada) and the Utah Educational Savings Plan, both rely predominantly on low-cost Vanguard index funds to fill out their rosters, although Utah does include a number of actively managed funds as well. Finally, we review Fidelity's 529 options.

When comparing plans, after considering the tax implications, pay attention both to the funds and portfolios offered, and expenses. Keeping costs down is a great way to help your investment go further, but it may be worth paying more in fees to get access to a manager or strategy you think has the potential to outperform over the long-term.

### Maryland College Investment Plan

The Maryland College Investment Plan provides portfolios managed by T. Rowe Price, made up of the firm's mutual funds. As mentioned above, most of the portfolios have an actively managed component; only two of the 21 underlying funds are index funds. The offerings come in two investment styles: Enrollment-based portfolios and fixed portfolios. Enrollment-based portfolios are focused on a student's expected year of college enrollment, ranging from 100% equity funds when college is 17 years away to conservative allocations as a beneficiary approaches and enters college.

**Maryland's Enrollment-Based Options**

| Portfolio | Composition | Fees |
|---|---|---|
| Portfolio for College | 80% bond, 20% stock | 0.61% |
| Portfolio 2015 | 23% stock, 77% bond | 0.61% |
| Portfolio 2018 | 40% stock, 60% bond | 0.72% |
| Portfolio 2021 | 57% stock, 43% bond | 0.80% |
| Portfolio 2024 | 72% stock, 28% bond | 0.80% |
| Portfolio 2027 | 88% stock, 12% bond | 0.80% |
| Portfolio 2030 | 100% stock (72% U.S., 28% international) | 0.80% |
| Portfolio 2033 | Same as 2030, allocation shifts begin three years later | 0.80% |

Source: State of Maryland.

The Maryland 529 also offers six fixed T. Rowe Price portfolios that do not change allocations over time: Equity, Global Equity Market Index, Balanced, Bond & Income, Inflation-Focused Bonds and Money Market. The fees on the static portfolios run from 0.07% to 0.81%. Similar options are also available in Alaska's 529, also run by T. Rowe Price, which we'll look at next.

It should be noted that while Maryland's plan does offer a good number of portfolios to choose among, you cannot create your own custom portfolio out of the underlying funds—the same is true of the next plan. This may be a deterrent to those with a strong desire to have complete control over their 529's investments.

**T. Rowe Price College Savings Plan**

T. Rowe Price's program, sponsored by the state of Alaska, offers 13 portfolios that offer varying degrees of stock and bond exposure, most of which are invested in actively managed funds. Very similar to Maryland's plan, investors can choose enrollment-based portfolios that shift allocations from stocks to bonds every three years based on the beneficiary's expected college enrollment, with annual fees ranging from 0.63% to 0.80%.

The plan also offers five static portfolios, the allocations of which do not change over time. You are allowed to switch portfolios once per calendar year should your beneficiary's goals change.

**The T. Rowe Price Plan Static Choices**

| Porfolio | Composition | Fees |
|---|---|---|
| Total Equity Market Index | 100% stock, fully invested in the T. Rowe Price Total Equity Market Index fund, which is benchmarked to the S&P Total Market Index | 0.46% |
| Equity Portfolio | 100% stock, invests in a portfolio of 11 funds, split approximately 70%/30% between U.S. and international | 0.80% |
| Balanced Portfolio | 60% stock, 40% bond, made up of a portfolio of 12 funds | 0.80% |
| Fixed Income Portfolio | 100% invested in the T. Rowe Price Spectrum Income fund, which invests in a mix of other T. Rowe mutual funds (15 currently) | 0.81% |
| Money Market Portfolio | 100% cash, invests in the T. Rowe Price Summit Cash Reserves Fund | 0.16% |

Source: T. Rowe Price.

The T. Rowe price offerings stand out because of their breadth of portfolio options and the active-management component. However, if expenses are more of a concern, a plan managed by Vanguard might be a better fit.

**Vanguard 529**

The Vanguard 529 Plan is administered by Upromise Investments and sponsored by the state of Nevada. It features a range of Vanguard funds and is open to investors nationwide. The minimum initial investment is $3,000, significantly higher than that of many other 529 plans, but additional investments are just $50. Additionally, accounts can be linked to the Upromise rewards service for automatic transfers when you spend money at associated stores, restaurants and websites.

The Vanguard plan offers three age-based options comprised of Vanguard index funds distinguished by risk tolerance —aggressive, moderate and conservative—that gradually adjust to protect to varying extents against market volatility as college nears. The expense ratio for all plans is 0.19%, significantly lower than the active plans we reviewed above.

**The Vanguard 529's Age-Based Tracks**

| Age | Conservative | Moderate | Aggressive | Fees |
|---|---|---|---|---|
| 0–5 | 50% stock, 50% bond | 75% stock, 25% bond | 100% stock | 0.19% |

| | | | | |
|---|---|---|---|---|
| 6–10 | 25% stock, 75% bond | 50% stock, 50% bond | 75% stock, 25% bond | 0.19% |
| 11–15 | 75% bond, 25% cash | 25% stock, 75% bond | 50% stock, 50% bond | 0.19% |
| 16–18 | 75% bond, 25% cash | 75% bond, 25% cash | 25% stock, 75% bond | 0.19% |
| 19+ | 100% cash | 75% bond, 25% cash | 75% bond, 25% cash | 0.19% |

Source: Vanguard.

In addition to the age-based options, Vanguard offers 19 portfolios you can use to construct a custom portfolio. Colorado, Iowa, Missouri, New York and Pennsylvania also offer Vanguard-run 529 plans and 23 other states' plans include Vanguard funds.

**Utah Educational Savings Plan**
The Utah Educational Savings Plan (UESP) offers a variety of options to choose among. Its four age-based portfolios are similar to those in the Nevada plan above, with one key difference: Utah offers two variations on the aggressive track, "aggressive global," which includes international stock funds, and "aggressive domestic," which has an U.S.-only focus.

The UESP also offers eight static plans, which you can see in the table below. The static portfolios invest in a mix of Vanguard's funds and range from 100% stock to 100% cash. Both the age-based and static portfolios are invested exclusively in Vanguard's mutual funds.

**UESP's Static Portfolios**

| **Portfolio** | **Composition** | **Expense Ratio** |
|---|---|---|
| Equity—100% Domestic | 100% U.S. stock | 0.20% |
| Equity—30% International | 70% U.S. stock, 30% international | 0.21% |
| Equity—10% International | 90% U.S. stock, 10% international | 0.22% |
| 70% Equity/30% Fixed Income | 60% U.S. stock, 10% international, 30% bond | 0.22% |
| 20% Equity/80% Fixed Income | 14% U.S. stock, 6% international, 55% bond, 25% cash | 0.22% |
| Fixed Income | 100% bond | 0.19% |

| | | |
|---|---|---|
| Utah Public Treasurers' Investment Fund | Invests in corporate notes, CDs, commercial paper, money market funds and U.S. government obligations | 0.16% |
| FDIC-Insured Savings | Cash savings account | 0.16% |

Source: UESP.

Utah also allows 529 investors a great deal of flexibility in customizing their own portfolios. You can choose among any of the 26 underlying funds (which consist of Vanguard index and actively managed funds as well as several actively managed Dimensional Fund Advisors funds) to create your own age-based or static portfolios. The customized age-based option allows you to determine allocations among funds for seven age brackets and automatically reallocates every time your beneficiary hits the next stage (and rebalances annually in between allocation shifts). The customized static option also rebalances annually on the beneficiary's birthday, but does not change otherwise unless you decide to make adjustments yourself.

This plan and Nevada's will likely have strong appeal for investors concerned with keeping expenses down and who want to create custom portfolios. Utah's plan is a standout in that there are both index and active fund options for those who want to build their own portfolios.

**Fidelity's 529 Products**

The Fidelity 529 plans do offer a decent variety of choices among pre-built portfolios and customization, but the expenses are higher than the other plans we looked at, both on the index and actively managed portfolio and individual options, and there are other issues to be aware of as well.

Fidelity offers the same choices to all four state plans it manages. Arizona is a tax parity state, so residents can get the tax benefits no matter which state plan they invest in. Delaware, Massachusetts and New Hampshire offer no tax breaks to 529 investors, so unless investing in Fidelity funds is a high priority, there is no additional benefit for residents choosing those states' plans.

If you were able to create a fully customized portfolio out of the underlying options, Fidelity's plans would be a great option—but you can't. Unfortunately, the firm has gone the route of over diversification.

What do we mean by "over diversification?" In the age-based tracks, the portfolios using Fidelity actively managed funds are made up of 27 funds (eight of which are large-cap funds). Allocating among this many funds and managers defeats the purpose of active management, since any one manager's contribution to the portfolio's overall return will be minimal, and you'll end up with thousands of underlying stocks, basically giving you an overpriced index fund. The static options are marginally better, but they still are fairly bloated, with significant overlap within asset classes. The index fund portfolios (age-based and static) are much more streamlined, including at most five funds, but as mentioned earlier, they are more expensive than the Vanguard plans we reviewed, with annual fees between of between 0.23% and 0.29%, whereas the most expensive Vanguard plan charges 0.19% across the board for all portfolios.

Finally, if you take Fidelity up on its customization option, you can choose among five index funds, cash, the age-based portfolios and the static portfolios (active and index). If you allocated among two or more of the static and/or age-based actively managed portfolios, you'd have the potential to not only be allocating twice to the same managers, but also essentially creating an expensive index fund.

None of this is to say that one couldn't effectively use one of Fidelity's 529 plans to help pay for a beneficiary's college expenses. But you should know what you're getting into before choosing one of these plans.

**Conclusion**

We hope you have found our three-part series on the benefits of 529 plans informative. Regardless of which plan you choose, the sooner you start, the more time your contributions will have to earn compound interest, and the greater your potential gains. If you have any questions about 529s or would like to learn more about Adviser Investments and how we can help you, please give us a call at 800-492-6868.

**About Adviser Investments**

Adviser Investments and its subsidiaries operate as an independent, professional money management firm with particular expertise in Fidelity and Vanguard mutual funds. With 2,600 clients and more than $3 billion under management, Adviser Investments is one of the nation's largest mutual fund research and money management firms. Our investment professionals focus on helping individual investors, trusts, foundations and institutions meet their investment goals. Our minimum account size is $350,000. In 2014, Adviser Investments was named to *Barron's* list of the top 100 independent financial advisers nationwide and its list of the top advisory firms in Massachusetts for the second time in 2015. We are also recognized on the *Financial Times* 300 Top Registered Investment Advisers list.

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