ADVISER INVESTMENTS

ADVISER FUND UPDATE

Market Summary and Commentary for Individual Investors from Adviser Investments

April 21, 2017

In This Issue:

- 529 Plans of Note
- Virginia Invest529
- T. Rowe Price College Savings Plan
- The Vanguard 529
- Utah Educational Savings Plan
- Fidelity's 529s

529 Plans of Note

In two recent *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 are typically highly ranked by the media or industry watchdogs. If your state gives favorable tax treatment to 529 plan contributions, you may be happiest investing at home, however.

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 Virginia 529Invest 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 as well as 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.

Virginia Invest529

Gold-rated by Morningstar, the Virginia 529 program was one of the country's first and is available nationwide—with more than $55 billion in assets, it is America's largest 529 plan. As mentioned above, many of the portfolios have an actively managed component, but cost-conscious savers can pick from nine passively managed static portfolios featuring Vanguard funds as well.

Virginia's actively managed offerings come in two investment styles: Static portfolios and age-based portfolios. The age-based portfolios are focused on a student's expected year of college enrollment, ranging from 80% stock funds and 20% bond funds when the beneficiary is still wearing diapers and taking her first steps to conservative allocations as she approaches and enrolls at college.

The portfolios invest in funds from a wide range of managers and fund providers, something that may appeal to investors looking for diversification. However, portfolios overloaded with too many managers can dilute the effects (for better or worse) of active management, taking away the chance of one manager tanking a portfolio, while also reducing the ability of a top-notch manager to drive performance.

Virginia's plan divides the management of the age-based portfolios among 10 different firms: Two emerging markets stock funds run by Aberdeen Asset Management and DFA Investment Dimensions Group; two international stock funds (Capital Research and Management, Templeton Institutional Funds); a global real estate fund (Morgan Stanley); a high-yield bond fund (Prudential Investment Management); a small-/mid-cap domestic stock fund (Rothschild Asset Management); an emerging markets debt fund (Stone Harbor Investment Partners); a stable value fund (Invesco Advisors); and index funds from Vanguard concentrated on bonds, as well as small- and large-cap U.S. stocks. That's a lot of managers to keep track of, but the plan's popularity speaks for itself.

Invest529's Age-Based Portfolios

Portfolio	Composition	Fees
Portfolio 2018	25% stock, 75% bond	0.27%
Portfolio 2021	40% stock, 60% bond	0.37%
Portfolio 2024	50% stock, 50% bond	0.43%
Portfolio 2027	60% stock, 40% bond	0.48%
Portfolio 2030	70% stock, 30% bond	0.53%
Portfolio 2033	80% stock, 20% bond	0.58%
Portfolio 2036	Same as 2033	0.62%

Source: Virginia Invest529.

The Virginia Invest529 also offers four fixed actively managed portfolios (Stable Value, Active Aggressive, Active Moderate and Active Conservative) that do not change allocations over time and invest in the same funds that comprise the age-based offerings. In addition, there's a Socially Targeted Investment active portfolio, the Parnassus Core Equity fund, which focuses on firms that meet its socially responsible or ESG (environment, social and governance) criteria. The fees on the actively managed static portfolios run from 0.16% to 0.77%.

It should be noted that while Virginia'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 give varying degrees of stock and bond exposure, most of which are invested in actively managed funds. As with Virginia'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 date, 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

Portfolio	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	100% stock, invests in a portfolio of 11 funds, split approximately	0.79%

Portfolio	70%/30% between U.S. and international	
Balanced Portfolio	60% stock, 40% bond, made up of a portfolio of 12 funds	0.80%

Portfolio	Composition	Fees
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 U.S. Treasury Money fund	0.17%

Sources: T. Rowe Price, Morningstar.

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.

The 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 ($1,000 for Nevada residents), 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 of the underlying portfolios is 0.17%, significantly lower than the active plans we reviewed above. Vanguard revamped the underlying investments for the age-based tracks in 2017 to offer a more gradual transition from stocks and bonds by adding new portfolios that shift the balance between the two in 10% increments.

The Vanguard 529's Age-Based Tracks

Age	Conservative	Moderate	Aggressive	Fees
0-2	60% stocks, 40% bonds	90% stocks, 10% bonds	100% stocks	0.17%
3-4	50% stocks, 50% bonds	80% stocks, 20% bonds	100% stocks	0.17%
5-6	60% bonds, 40% stocks	70% stocks, 30% bonds	90% stocks, 10% bonds	0.17%
7-8	70% bonds, 30% cash	60% stocks, 40% bonds	80% stocks, 20% bonds	0.17%
9-10	80% bonds, 20% stocks	50% stocks, 50% bonds	70% stocks, 30% bonds	0.17%
11-12	90% bonds, 10% cash	60% bonds, 40% stocks	60% stocks, 40% bonds	0.17%
13-14	75% bonds, 25% cash	70% bonds, 30% stocks	50% stocks, 50% bonds	0.17%
15	50% bonds, 50% cash	80% bonds, 20% stocks	60% bonds, 40% stocks	0.17%
16	50% bonds,	90% bonds,	70% bonds,	0.17%

	50% cash	10% stocks	30% stocks	
17-18	25% bonds, 75% cash	75% bonds, 25% cash	80% bonds, 20% stocks	0.17%
18	25% bonds, 75% cash	75% bonds, 25% cash	90% bonds, 10% stocks	0.17%
19+	100% cash	75% bonds, 25% cash	90% bonds, 10% stocks	0.17%

Note: The portfolios used by the age-based tracks are not available as standalone investments. Source: Vanguard.

In addition to the age-based options, Vanguard offers 20 individual investment choices (either single or multi-fund, with a couple of active management options thrown in) that you can use to construct a custom portfolio. Colorado, Iowa, Missouri and New York 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. It also offers moderate and conservative age-based options.

The UESP 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% in stocks to 100% in 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	0.190%
Equity—30% International	70% U.S. stock, 30% international	0.202%
Equity—10% International	90% U.S. stock, 10% international	0.207%
70% Equity/30% Fixed Income	60% U.S. stock, 10% international, 30% bond	0.204%
20% Equity/80% Fixed Income	14% U.S. stock, 6% international, 55% bond, 25% cash	0.208%
Fixed Income	100% bond	0.156%
Utah Public Treasurers' Investment Fund	Invests in corporate notes, CDs, commercial paper, money market funds and U.S. government obligations	0.160% (0.00% for Utah residents)
FDIC-Insured Savings	Cash savings account	0.160%

Source: UESP.

Utah also allows 529 investors a great deal of flexibility in customizing their own portfolios. You can choose among any of the 27 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 529s

The Fidelity 529 plans offer a decent variety of choices among pre-built portfolios and customization, but the plan's portfolio construction could be a concern for some.

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 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 to choosing those states' plans. The Fidelity plan may now be more enticing to Massachusetts investors, as the state enacted a $1,000 a year state tax deduction per taxpayer on contributions to the state's 529 plan (up to $2,000 a year cap for a married couple filing jointly) for 2017.

If you were able to create a fully customized portfolio out of the underlying options, Fidelity's plans would be far more attractive—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 nearly 30 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, and have recently come down in cost, with annual fees between 0.13% and 0.21%, undercutting some Vanguard options that charge 0.17% across the board.

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, and the in-state option deserves greater consideration from Massachusetts investors who now have a tax savings incentive to put their money here. 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 operates as an independent, professional money management firm with particular expertise in Fidelity and Vanguard mutual funds. We advise more than 3,000 clients and have over $4 billion under management. Our investment professionals focus on helping individual investors, trusts, foundations and institutions meet their investment goals. Our minimum account size is $350,000. In 2016, 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 fourth consecutive year. We have also been recognized on the *Financial Times* 300 Top Registered Investment Advisers list in 2014, 2015 and 2016.

For more information, please visit www.adviserinvestments.com or call 800-492-6868.

Disclaimer: This material is distributed for informational purposes only. The investment ideas and expressions of opinion may contain certain forward-looking statements and should not be viewed as recommendations, personal investment advice or considered an offer to buy or sell specific securities. Data and statistics contained in this report are obtained from what we believe to be reliable sources; however, their accuracy, completeness or reliability cannot be guaranteed.

Our statements and opinions are subject to change without notice and should be considered only as part of a diversified portfolio. You may request a free copy of the firm's Form ADV Part 2, which describes, among other items, risk factors, strategies, affiliations, services offered and fees charged.

Past performance is not an indication of future returns. The tax information contained herein is general in nature, is provided for informational purposes only, and should not be construed as legal or tax advice. We do not provide legal or tax advice. Always consult an attorney or tax professional regarding your specific legal or tax situation.

The *Barron's* rankings consider factors such as assets under management, revenue produced for the firm, regulatory record, quality of practice and philanthropic work. This award does not consider client experience and is not indicative of future performance.

Editors at the *Financial Times* bestowed "elite" status on 300 firms in the U.S., as determined by assets under management, asset growth, longevity, compliance record, industry certifications and online accessibility.