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Investing

A Rush to Safety on College Savings

By JOHN KIMELMAN

Dwindling Funds for Tuition

People who invested in stocks through state-sponsored college savings plans lost money this year, but most did better than the Standard & Poor's 500-stock index. Following are the best- and worst-performing age-based funds for 5-year-olds. These funds contain mainly stocks, but will shift toward bonds as a child grows older.

MANAGER	STATE FUND	2002 RETURN THROUGH OCT. 31
BEST PERFORMERS		
TIAA-CREF	Tennessee Best College Savings Plan	−8.0%
TIAA-CREF	Connecticut Higher Education Trust	−9.9
TIAA-CREF	Missouri Saving for Tuition	−10.0
TIAA-CREF	Minnesota College Savings Plan	−10.9
TIAA-CREF	Michigan Education Savings Program	−11.2
WORST PERFORMERS		
Fidelity	Delaware College Invest Plan 2015	−19.5
Strong Capital	Wisconsin Tomorrow Scholar 10+ to Coll.	−19.7
Strong Capital	Wisconsin EdVest Age-Based 10+ to Coll.	−20.7
Waddell & Reed	Arizona InvestEd 0-8 Years Old	−21.7
Strong Capital	Nevada 10+ to College Aggressive	−22.3
Standard & Poor's 500-stock Index		−21.8

Source: Morningstar

The New York Times

STEVEN GRANT, a retired mechanical engineer from Skokie, Ill., regrets that he invested a total of $20,000 in college savings plans for two of his grandchildren in February 2000.

By Sept. 30 this year, when he received his most recent quarterly statement from Fidelity Investments, the portfolio of his 10-year-old granddaughter had lost 22 percent of its value, while one for his 12-year-old grandson had lost 12 percent.

Mr. Grant is bitter about the losses. "I am not sure whether these Fidelity portfolios will recover," he said, "but these funds are supposed to do more than recover; they are supposed to give you a gain."

Mr. Grant is among many Americans who, in the bear market of the last two years, have made money-losing stock investments through state-sponsored college savings programs. The programs, which became popular only in the last two years and are known as 529 plans after a section of the federal tax code, offer a tax-sheltered way to make a long-term investment for a child's education. But looking at the short term — the year so far — every plan with a substantial stock component has lost money, according to Morningstar Inc.

Compared with the overall market, the stock funds have not done too badly. The average 529 stock fund declined 21.2 percent this year through October, according to Morningstar — slightly better than the Standard & Poor's 500-stock index, which fell 21.8 percent, including reinvested dividends.

There are also 529 plans that focus on bonds and "age-based plans," containing a mix of equity and bond investments that shifts as a child grows older. The average 529 bond fund gained 2.5 percent during the period, but the average age-based plan for a 5-year-old child lost 16 percent. Age-based funds are the most popular single option, according to several leading fund companies.

The ratio of stocks to bonds in age-based funds declines as a child ages; the funds for 5-year-olds are mainly stock funds, although the formula varies from plan to plan, and those with the heaviest concentration of fixed-income investments have had the best performance this year.

Investors may shop for these plans anywhere in the country, but some states provide additional tax advantages for in-state investors, so it is important to carefully research individual plans and their investment options.

Many financial advisers say the 529 portfolios should not be judged on short-term performance. They are intended to provide returns over a decade or more.

Nonetheless, many investors have responded to short-term stock losses by pouring their 529 money into fixed-income funds over the last six months, according to leading managers of 529 plans across the country. In that period, about 40 percent of new investor assets flowing into college savings plans managed by TIAA-CREF in 13 states, including New York, California, Connecticut and Michigan, wound up in guaranteed investment options. This portfolio assures investors of a base annual return of 3 percent, with the possibility of more depending on prevailing interest rates.

THE guaranteed investment option, rarely chosen by investors as recently as a year ago, has become almost as popular as age-based portfolios in the last six months, said Timothy E. Lane, TIAA-CREF's vice president for tuition financing.

Similarly, Richard A. Davies, an executive at Alliance Capital who oversees the nationwide marketing campaign for the Rhode Island-based plan from his firm, said that about a third of all new investor dollars were now going into its insured fixed-income portfolio, currently yielding about 4.45 percent a year.

Two years ago, he said, investors were directing about 40 percent of their college savings funds into all-stock portfolios. That share has plunged to about 12 percent.

These trends trouble some financial planners. "These guaranteed plans are very exciting for someone concerned about the safety of their savings," said Steven Klane, a partner at Sands & Klane, an accounting and financial planning firm based in Minneapolis. "But investors should be seeking to exceed the rate of inflation and grow their college funds."

Peter Thompson for The New York Times

Steven Grant is angry over losses in savings plans for his grandchildren.

Despite the gains of fixed-income funds, fund managers report that age-based portfolios remain popular, and most advisers recommend them. A portfolio for an infant or preschool child would generally consist almost entirely of a mixture of equity mutual funds, the companies that manage them say. Fidelity Investments bases its 529 age-based portfolio on mutual funds like its Blue Chip Growth, Equity-Income and Disciplined funds. As a child grows older, the share of fixed-income investments in the portfolio grows.

The best-performing age-based portfolios this year through October were all managed by TIAA-CREF for various state plans, including those of Tennessee, Connecticut and Missouri, according to Morningstar, with losses of between about 8 and 11 percent this year through October. The funds achieved these returns because of heavier weightings in investment-grade bonds than other age-based funds, said Tricia Rothschild, a Morningstar product manager who oversees the firm's analysis of college plans. By contrast, the laggards in this category tended to have a higher allocation of stock investments, she said. That is why Strong Capital's aggressive equity portfolio, managed for Nevada, lost 22.3 percent through October, she said.

Over the long term, many financial advisers say, funds weighted more toward stock portfolios may well outperform those with more bonds. Stocks, after all, have generally outperformed fixed-income investments over the decades.

Mr. Grant, who conceded that he knew of the inherent risk of stocks before he made his investment, said that his grandchildren's college savings portfolios have recovered some of their losses over the last two months. But he said he was restricting additional investments for his grandchildren to inflation-protected Treasury bonds.

COLLEGE plan portfolio managers and certified financial planners say most investors should have exposure to stocks in their college investing if they want the money to keep pace with education expenses, which are expected to grow faster than the cost of living.

Ren W. Cheng, a Fidelity portfolio manager who oversees investment in his firm's college plan programs, said he made that point recently to a customer, whose $3,000 investment in an age-based account for a 2-year-old had lost a quarter of its value in the last year and a half.

Mr. Cheng said he asked the investor, "Should you be worrying about the 'short-term market behavior,' " or about the hundreds of thousands of dollars needed by the time the child was ready for college?

Mr. Davies of Alliance said that while his firm does not make individual investing recommendations, "We do believe that an age-based portfolio makes the most sense for most people." The portfolios are adjusted automatically over time, he said. "You can put the money away for 15 years and not worry about it. If you have an all-equity account, you will have decisions to make down the road."

Mr. Klane agreed that the age-based approach probably makes the most sense for the plans' participants. "Most of my clients don't have the discipline to do this all by themselves," he said.

Like other financial advisers, he thinks investors should make regular, fixed contributions into age-based accounts, a technique called dollar-cost averaging. That lets them buy more shares of underlying stocks when prices are low, and less when prices are high.

While any paper investment loss hurts, the pain of a falling college savings plan can be particularly acute. That is because the time to regain lost ground can be short.

"College is a fixed target in time," said Judy C. Miller, the principal of College Solutions, a college preparatory consulting firm in Alameda, Calif. "You can't postpone college the way you can retirement." □

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