Elizabeth O'Brien's Retire Well

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Got a risky job? Play it safe with your nest egg

'Holistic' planning aims to keep savers investments in sync with their careers

By Elizabeth O'Brien

Is your portfolio diversified? Check. You' re rebalancing periodically? Check. Are your investments synced up with your career choice and professional trajectory? Perhaps not.

A growing body of research has focused on the importance of taking a holistic view of an investor's assets. This involves incorporating into the planning process an investor's human capital, or the ability to earn a living over time.

It's a logical enough proposition: After all, your ability to save for retirement or anything else is enormously dependent on your earning power. Still, "Many financial advisers don't consider these other assets," said Philip Straehl, senior research consultant at Morningstar Investment Management and co-author of the research paper "No Portfolio Is An Island."

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If your job feels like this, you may be better off with a relatively vanilla retirement portfolio.

That recent paper looked at ways to incorporate human capital, as well as real estate holdings and pensions, into an investor's overall asset mix. It's something plenty of financial pros may not know how to even begin to do: In particular, brokers who work on commission might not have the capacity for a discussion about a client's career when they're only compensated if they sell certain products.

Yet a broader approach to retirement planning has become increasingly necessary in recent years, experts say. Many boomers won't have pensions to fall back on like their parents did. What's more, remaining in good health becomes particularly important as people are working longer, extending their human capital beyond the traditional retirement ages of 62 or 65.

Are you a stock or a bond?

When workers are just starting out, their human capital often represents their biggest asset. Over time, human capital declines and, as people save and invest their earnings, financial assets increase.

The nature of human capital varies according to profession. Moshe Milevsky, a finance professor at the Schulich School of Business at York University in Toronto, popularized the concept several years ago of classifying human capital as stock-like or bond-like. A tenured professor like Milevsky has a very stable, bond-like career—like a bond, it will presumably generate a predictable amount of income over a predictable period. On the opposite end of the spectrum, an entrepreneur has a volatile, stock-like career—with earnings that potentially fluctuate with ups and downs of the economy, as a stock price can do.

Small-Business Strategies: How To Make an Exit

Small-business owners generally are so busy that they fail to consider when they'll want to close up shop. MarketWatch's Robert Powell talks with three small-business experts about how business owners can develop an exit strategy.

Those with bond-like careers can often afford to take more risk in their investment portfolios. These might have a higher allocation to equities, including stocks that promise potentially out-sized rewards for their increased risk, such as those of developing countries. These investors may also need less in short-term emergency funds than their stock-like counterparts.

Those with less stable careers may want to be a bit more conservative in their asset allocation, with more money in bonds, for example, than they'd have otherwise considered at their age. Morningstar's recent analysis took this even further, with a breakdown of how investors in certain industries could structure their portfolios—for example, those who work in finance should go lighter on the bank stocks.

In reality, it doesn't always work out this neatly, said Rand Spero, president of Street Smart Financial, a fee-only financial planning firm in Lexington, Mass. He recalled a client who worked in construction, doing home renovations—a job with cyclical volatility. Yet this gentleman wasn't interested in smoothing the bumps in his investment portfolio: he had a strong stomach for risk, and this tolerance informed both his choice of profession and his investment allocation, Spero said. (In this scenario, he said his responsibility lay in respecting his client's views while making sure his portfolio could weather the ups and downs it would likely endure.) Conversely, it's not hard to imagine a risk-averse person seeking out a stable government job and investing her assets conservatively.

Spero, a former strategic planning consultant for companies, talks to clients in-depth about their current careers and future plans. “You really need to probe to find out more specifics about their individual situation,” he said. For example, a client could say she works in the health-care field. An adviser who doesn’t question any further might assume she has a recession-proof job, when in reality she could be a pharmaceutical sales rep who works on commission.

Matching investments to careers

To be sure, some investments factor in human capital already. Target-date mutual funds, which automatically shift into more conservative securities as the investor approaches retirement, reflect diminishing human capital.

Yet even these set-it-and-forget-it funds can pose a problem for those who delay retirement, Spero said. A worker who selected a target date fund based on the year he thought he would retire—then forgot about it years later when he decided to work another five years—might wind up with a more conservative allocation than is optimal for his situation. Those who remember can switch to a fund that more accurately reflects their new retirement date.

People with bond-like careers often have more control over the timing of their retirement, said Michael Kitces, partner and director of research for Pinnacle Advisory Group, a fee-only financial planning firm in Columbia, Md. A tenured professor can generally decide when she wants to stop working—and until then often enjoys a flexible schedule that can accommodate someone who’s slowing down physically. A corporate manager, on the other hand, might get downsized, feel marginalized by younger co-workers, or grow tired from the physical demands of the job.

For this reason, people with stock-like careers need to be especially vigilant with their retirement savings, Kitces said. Ideally, they should sock away more than someone who knows he can work into his 70s or even beyond.

What’s more, workers often overestimate their human capital as it pertains to their future earnings potential. We’re trained to believe that the steeply upward earnings trajectory that many workers enjoy in their 20s and early 30s will continue indefinitely, when this isn’t the case on average: women’s earnings peak at age 39, in real terms, while men’s peak at age 48, according to an analysis by PayScale.

This misperception can have real-world consequences. A first-time home buyer in her early 30s might bank on future big raises and buy more home than she can comfortably afford, and a younger worker might defer saving enough for retirement, thinking future pay increases will make it easier for him to make catch-up 401(k) contributions in his 50s.

Extending human capital

Yet there’s good news for people who want—or need—to work past traditional retirement age. In today’s still-shaky job market, many employers are favoring temporary workers over full-time hires, said Marc Dorio, an executive coach and management consultant based in Titusville, N.J. While this trend can hurt younger workers who need stability and benefits, it can benefit older workers seeking flexibility, Dorio noted. “There might not be a lot of jobs out there, but there’s still a lot of work to be done,” he said.

Indeed, the possibilities for work beyond a traditional full-time job expand greatly when people free themselves from the mind-set that their next position needs to be an upward or at least lateral move, Kitces said. Oftentimes, successful professionals have trouble scaling back their work lives, when that could be just what they need to buttress their nest eggs and to feel engaged, experts say.

Kitces recalled one client in his late 50s, the owner of a luxury car service who had a fleet of about 20 cars and employed some 35 drivers. He earned a healthy six-figure income, but the administrative aspects of the job gave him headaches.

The man downsized to just two vehicles, which he drives himself. He now earns a decent, if smaller income, Kitces said, and has rediscovered his passion for driving. This man’s health will likely benefit, too, from his greatly reduced stress levels. Not only has he cut down on his administrative hassles, but he has also chosen to drive only his favorite clients from before. This boosts his positive social interactions, which research has shown confer health benefits as we get older.

Like Spero, Kitces believes in helping clients maximize their career potential. “With your financial capital, you take what the market gives you,” Kitces said. “But you have a lot more control over your human capital.”

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