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Why advisers don't talk about clients' careers — but should

Job a pivotal element when calculating financial plan, professor claims: who's a stock, who's a bond?

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Moshe Milevsky thinks his barber Enzo should invest more in stocks than his finance students should. "The jobs of people who work on Wall Street are very sensitive to the economy and stock market," says the finance professor and author of Are You a Stock or a Bond? "I tell them, 'I don't care how risk-tolerant or young you are. You are a stock, so don't buy any more.'"

How your career, or "human capital," should guide your investment portfolio is the focus of Milevksy's academic research at Toronto's York University. Those with stable careers and regular paychecks -- tenured professors, accountants, nurses -- are bonds. Those with variable incomes tied to the market or economy -- salesmen, brokers, home builders, entrepreneurs -- are stocks.

Although Enzo's income as a barber is variable, his business isn't connected to the market's fortunes and thus is more bond-like than stock-like. In fact, his business has picked up during the economic downturn because more people want haircuts so they can look good at job interviews.

Career assets

For anyone not born independently wealthy, your career is usually your most important asset. According to Milevsky's research, the average 25-year-old's human capital accounts for 99 percent of her personal balance sheet. That is, young adults' current salary and potential salary are far more important than any savings they might have. Only when they reach age 55 does their investment portfolio become about equal in value.

Financial planners rarely take job prospects into account when creating those asset allocation pie charts. Unquestionably, asking someone to quantify human potential is asking a lot. That said, the U.S. Department of Labor routinely provides the average salary ranges and current unemployment levels for different careers. That should be enough for a financial adviser to do a rough calculation of the present value of future cash flows, as most professional investors do with stocks or bonds.

So why isn't your job the primary focus of every financial planner you meet? "The reason most financial planners don't spend time on your career is it's not a revenue source for them," says Rand Spero, a financial adviser at Street Smart Financial in Lexington, Mass. Traditional brokers can't charge commissions on your career, he observes. Even in cases where planners use a fee model based on a percentage of assets under management, how do they charge 1 percent of someone's career?

Spero tries to address this conundrum by offering two different types of fee structures, one as a percentage of assets and another at an hourly rate. For a young client in law school, he might give hourly advice about career goals, job prospects, debt levels, savings plans and whether or not a law school degree is itself a worthwhile investment. A planner charging a percent of assets under management won't take a client like that because he doesn't have enough assets, says Spero. "It doesn't fit any financial planning model."

Cash reserves

Understanding human capital means turning some of the conventional tenets of financial planning on their head. For instance, young people are often told to invest aggressively in stocks because they have many years to ride out any market volatility. But their human capital is more stock-like because their careers are unstable.

"Someone at the beginning of their career has very little job security," says planner Doug Kinsey of Artifex Financial Group in Dayton, Ohio. "They don't have a track record, so they're the most expendable employees." Kinsey recommends that college grads build up a nice cash reserve as an emergency fund and settle into careers before moving into stocks. For job market newbies, a good disability -- or life insurance policy -- could prove more valuable than stocks and bonds because it protects against the loss of human capital.

Perhaps more dangerous than buying stocks too young is investing in your employer's stock or in the same industry as your career. That's tying your human capital to your investment capital. Employees at Enron famously lost not only their jobs but their entire nest eggs because they had invested so heavily in Enron stock before the company went bust. Even if you invest in other companies in your industry, a broad downturn in, say, the banking sector could expose you to losses on both fronts.

Because of the potential industry overlap, Milevsky advises against buying broad index funds for clients exposed to major sectors such as oil or technology. He thinks investors should build portfolios of individual industry-focused exchange-traded funds to cover every other sector in the market but their own. That way, the intersection between your career and your investment portfolio is avoided.

ROE: Return on Education

Incorporating human capital into your financial plan also means taking a hard look at investments in your career. Is it worth using spare cash to go back to school for an advanced degree or should you save your money and buy an S&P 500 index fund?

Milevsky's research offers some useful, albeit brutal answers. Based on salary ranges and tuition rates, he knows the average rate of return on different academic majors and degrees. "My colleagues at the university are reluctant to embrace this concept," Milevsky says. "Certain careers and majors are dead ends."

An engineering or medical degree produces a 12 percent annualized return, according to the calculations. A degree in anthropology? A -3 percent annualized return. Milevsky advises anthropology lovers not to think of their degree as an investment but as a product they enjoy. "You are consuming education," he says. "You're studying something because you enjoy it. But please don't delude yourself into thinking you're going to get a positive internal rate of return from that tuition money you spent."

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