

## How to Find the Best 529 Plan for You

I recently conducted some research on 529 plans while deciding which plan to open for my daughter. I had chosen Utah's 529 plan a few years back for my son, but wanted to make sure it was still one of the best choices given the market challenges of the past couple of years. Several states' plans struggled during the financial crisis due to too-aggressive asset allocations or poor performance of some of the investment options. In fact, one of the age-based options in my son's Utah plan suffered because it keeps 65% of a college-enrolled student's assets in stocks, which is aggressive given the short time horizon of those savings, particularly in a bear market. Fortunately, the age-based option I chose for him is all in cash by the time of college enrollment.

My criteria for choosing a plan are low fees, good selection of investment options (particularly age-based options using index funds) and sensible asset allocation. My rationale for these criteria is as follows:

1. **Low fees.** Research shows that low fund expenses are one of the highest predictors of superior long-term performance. As one of the few things you can control, why pay more in fees in the hopes that you'll outperform the market? The three states with the lowest all-in fees are New York, Utah and Nevada.
2. **Good selection of investment options.** Related to my point above, one of the best ways to lower expenses is to use index funds, as you don't have to pay for active manager "talent". So I like to see a wide variety of different index fund options, including bonds, US large stocks, US small stocks and international stocks at a minimum. Ideally, emerging market stocks and real estate stocks would also be options, but few 529 plans include these asset classes. In addition to a nice selection of index investment options, I also tend to focus on age-based options so that the asset allocation will automatically change gradually as the child ages. However, the caveat here is that there is no consistency about how fund managers think a fund for a child entering college should be allocated, so you'll find a wide range of asset allocation mixes and need to be sure the one you use is in line with your risk tolerance.
3. **Sensible asset allocation.** One of the biggest lessons for 529 plan owners from the financial crisis is to pay close attention to how your investment choice is allocated at various points along the way. Many funds for kids in or entering college were still heavily allocated to stocks and so took a heavy hit in the downturn. Personally, I'd prefer to have my savings invested in cash by the time my child enters college and so I look for funds that follow a similar approach (also known as a glide path). Another aspect of asset allocation is what asset classes are represented and in what proportions. Most funds are woefully under-diversified in my opinion, allocating mainly to US stocks and bonds. Some have ventured into developed-country international stocks, but usually in small doses and almost none have emerging market stocks, real estate stocks or commodities included in the investment line-up, a weakness in my view. I generally look for age-based options that are well-diversified among bonds, US small and large

stocks and international stocks, at a minimum. I tend to prefer options with as large a dose of international as possible.

### **What about California's two plans, you ask?**

I did take a look at these, not out of loyalty to California, but because some state plans offer state tax deductions for in-state residents. Alas, California is not one of those states, removing one reason to use a California plan. The two ScholarShare plans, one direct-sold and one adviser-sold, are both managed by Fidelity, the largest manager of 529 plans in the country, with \$14B under management. Given that I wasn't going through a broker, I looked at the direct-sold option. As a result of recent fee cuts by Fidelity and no annual account maintenance fees, I was surprised to discover that the age-based option that uses index funds was close in total cost to my son's Utah plan.

However, in digging a bit deeper, I decided to stick with my son's Utah plan. First, it has five age-based options instead of one in the California plan. Four of the five are 100% in cash by the time the student enters college, another positive, whereas the California plan has 20% invested in stocks while the student is in college, exposing the savings to some market volatility. Secondly, I'm a big fan of international diversification and one of Utah's age-based options has a healthy dose (though it could be higher) of international, at 24% for a child under age 3. This compares to California's 13% in international for the youngest age group. I didn't look into the California plan's actively-managed age-based options as I'm a big believer in reducing expenses as one sure way to improve performance and so steer clear of most actively-managed funds.

Although not an exhaustive search, I came to the conclusion from my search that, given my criteria and preferences (e.g., low fees, index funds and age-based options, sensible asset allocation), the Utah 529 plan remains the best choice for my family. However, there is no one best choice and it is up to each person to decide what is important to them and find funds that offer that. Fortunately, there are several websites that can help make the process easier:

### **Resources**

1. Morningstar.com. This mutual fund research website also offers advice on 529 plans and publishes an annual review of 529 plans.
2. Savingforcollege.com. A great website with comprehensive information on college funding, including 529 plans.

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