
MyRA Defies the Equities-First Rule

By Kerry Pechter *Wed, Feb 5, 2014*

Contributions by young workers to President Obama's proposed MyRA accounts go into a government bond fund. Does that policy contradict the conventional wisdom that young people should invest mainly in stocks?

Does the MyRA strategy contradict the investment rule-of-thumb about investing in equities when you're young?

The default investment of the automatic-Roth IRA ("MyRA") that President Obama ordained in his State of the Union address last week was a bond fund that mimics the Government Securities Investment Fund that's available in federal workers' Thrift Savings Plan.

The investment would resemble the "R-bond" that David John, William Gale and Spencer Smith described in an AARP Public Policy Institute paper in October 2012:

The R-Bond would be an account, not a specific bond. It would pay interest at a rate similar to the five-year Treasury (T-Bond), with rates set every six months. There would be no maturity date, and amounts could be added to the R-Bond account at any time.

Workers who don't opt out of MyRAs, which are intended to be "starter" Roth IRAs, buy R-bonds with payroll deferrals (with \$25 initial minimum, \$5 per pay period). Contributions wouldn't be tax deductible—which is a little strange, because Obama clearly wants to democratize the tax expenditure on retirement savings—but low- and middle-income workers can claim the Retirement Savings Tax Credit of up to \$2,000. But I digress.

When the value of a MyRA account reaches \$15,000, the IRA would roll over to an IRA custodian/fund company under contract with the government, or to a new 401(k) plan (if the employer decides to sponsor one) or, in the event of a job change, to a personal Roth IRA.

Wait. The first \$15,000 goes into a bond fund? Isn't that heresy?

Presumably, a lot of those MyRA owners will be young employees or first-time investors. Had they worked for a company that sponsored an auto-enrolled 401(k) plan, they probably would have been defaulted into a 2045 or 2050 target date fund. Those funds allocate up to 90% of their assets into domestic and international stock funds.

The asset allocation strategy of the MyRA accounts evidently defies the conventional wisdom, embedded in TDFs, that investors with long time horizons should invest mainly in stocks. As I understand it, the conventional wisdom is based largely on the historical outperformance of stocks vis-à-vis bonds.

Speaking as a 401(k) participant and a father, I've never thought that a person's initial savings should go into equities. In my case, I waited until I'd saved about \$10,000 in my 401k before I invested in stocks. I've

advised my grown children to do the same.

People with better credentials than mine endorse this strategy, for a variety of reasons.

What the experts say

In the Fall 2013 issue of the *Journal of Retirement*, Robert Arnott of Research Affiliates, LLC, wrote that “the heuristic of buying stocks when young and bonds when mature—a rule of thumb by which many billions are invested—is flawed.” One reason, he says, is that when you’re young, your account is too small for an uptick in stocks to make much difference.

On MyRA specifically, Arnott’s opinion is nuanced. “Obama’s MyRA has a few Achilles’ Heel’s, notably the fact that there’s only one investment option, which happens to offer roughly zero real interest rate, and that the enrollee has to take the initiative to sign up. Accordingly, few will,” he told RIJ in an email.

“But, you are correct that the notion that starting conservative and becoming more aggressive beats the opposite strategy, which is dominant in target dated strategies.”

Moshe Milevsky is the well-known York University professor who wrote a guide to life-cycle investing called “Are You a Stock or a Bond?” He links asset allocation to employment; people with volatile careers should hold bonds, and people with safe university or government jobs can afford to go long on stocks.

“Early on, saving \$10,000 to \$15,000 is much more important than the asset allocation,” he said in an email. “Having equities (vs. bonds) very early on in the process isn’t as important. Of course, eventually, you want to move them into some sort of equity exposure (if their job is safe and if they understand risk, etc.).”

The United Kingdom has a new program called NEST (National Employment Savings Trust), a government-sponsored workplace savings program for the low- and middle-income workers whose employers don’t offer a plan. NEST uses TDFs, but during the initial five-year “Foundation” phase, contributions go into a low-volatility balanced fund.

NEST’s reasoning runs on the same track as Milevsky’s. “If you look at the demographics of our target group, they have equity-like human capital,” Paul Todd, NEST’s investment policy manager, told *RIJ* in 2012. “They’re the first people to experience redundancy [layoffs]; they may not have property [real estate] or personal savings, so there’s a lot more volatility to their human capital. That makes you think harder about what’s suitable for them.”

“Our research showed that for people who don’t have diversification of resources, it’s not helpful to expose them to high levels of volatility right off the bat.” Another danger: early disappointment could discourage those people from ever risking money in the stock market again.

Employer mandate?

President Obama's MyRA program (which has policy roots going back to 1999) has already come under some criticism. People have scoffed at the low returns on the R-bonds. But a riskier default investment would risk a backlash—just look at the criticism of TDFs after the 2008 crash—and the use of a balanced fund might have introduced administrative chores and expenses. Government bonds were clearly the safest, simplest default investment for the beta-version of a national workplace savings plan.

So far, I've seen only a few signs that the MyRA program will trigger the kind of backlash that exploded in 2010, after Obama included a similar if not identical initiative in his annual budget. The conservative blogosphere went ballistic with accusations that the program was government confiscation of private savings in disguise. You can find that sentiment [here](#).

That's just a sideshow, however. A larger potential problem is that employees will opt out. The biggest threat to the MyRA program will come from small employers (excluding the very smallest and newest firms) who resent a federal mandate to set up automatic payroll deferrals (of at least \$25 to start and \$5 per payday) for their employees.

"Employers that do not provide any employer-sponsored savings plan would be required to connect their employees with a payroll deduction IRA," said the White House Fact Sheet on MyRA. A presidential memorandum on MyRA for Treasury Secretary Jacob Lew said:

"Within 90 days of the date of this memorandum, you shall begin work with employers, stakeholders, and, as appropriate, other Federal agencies to develop a pilot project to make the security developed pursuant to subsection (a) of this section available through payroll deduction to facilitate easy and automatic contributions."

Here's what the advocate for small businesses said last week: "Similar to the concerns with health care, where you're trying to expand coverage, when you mandate options, you drive people to something that's not as good as what the private market is offering," said Aliya Wong, head of retirement policy for the U.S. Chamber of Commerce.

Of course, the point of MyRA is that the status quo doesn't have a remedy for the fact that 87 million of America's 120 million households have an average of less than \$17,000 in investable assets. Sure, people can save without a workplace plan. But they aren't. From a public policy perspective, MyRA isn't a panacea—for one thing, Roth IRAs are easier to dip into and squander than 401(k)s or traditional IRAs. But it's a start. It has already inspired Sen. Tom Harkin (D-IA) to revive his *USA Retirement Funds Act*. We shall see what the Treasury pilot program produces.

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