Fine-Tuning Your Entire Portfolio

By
Daniel A. Prisciotta
in conjunction with Sagemark Consulting, a division of Lincoln Financial Advisors, a registered investment advisor.

When it comes to investing, are you a micromanager? Or a hands-off type? Micromanagers obsess over their portfolios. They switch in and out of investments with every tic and tremor on Wall Street or in the economy. Hands-off types are the opposite. While they might polish and buff their cars every weekend, they pay little attention to whether their portfolios are on track to help achieve their investment goals.

Whatever kind of investor you are, you stand a better chance of reaching your investment goals if you take time to analyze your entire portfolio at least once a year. By identifying weaknesses and making adjustments, you can help ensure that your portfolio is performing efficiently.

Perform Asset Allocation Modeling

According to an often-cited — and time-tested — study* held in high regard by many professional investment managers, more than 90% of investment success is due to asset allocation rather than stock selection or any other strategy. This means that investors who carefully allocate their assets among a variety of asset classes (cash, bonds, and stocks) have a greater potential of achieving their investment goals and lowering their overall investment volatility and portfolio risk than those who invest in only one asset class. Diversification through an asset allocation strategy neither ensures a profit nor protects against a loss.

Why? Because asset classes respond differently to the constantly changing economy. Dividing your assets among the different classes makes your portfolio less susceptible to loss if one investment class performs poorly. Your financial planner can help you develop an appropriate asset allocation strategy based on your investment objectives, age, risk tolerance, and time frame.

Do a Stress Test

Will your portfolio accomplish your objectives? Take retirement, for example. Will you be able to afford the retirement lifestyle you want? Will your retirement portfolio be able to cover your future living expenses? Financial planners use software that employs "Monte Carlo" simulation to evaluate these situations.

Using key variables — such as income, assets, expenses, time frame, projected returns, tax rates, inflation, interest rates, etc. — Monte Carlo simulation produces thousands of possible future scenarios. While it can't predict the future, it can provide a picture of a reasonable probability of success under a wide variety of conditions.

Analyze Your Portfolio's Tax Efficiency

Reducing the tax bite on your investments is one of the keys to building wealth. So, you want to be sure that your portfolio is as tax efficient as possible. For example, if you are saving for retirement, it makes sense to invest through your employer's retirement plan or some other tax-deferred vehicle such as an individual retirement account (IRA). Hypothetically, all things being equal, tax-deferred accounts have the potential to grow larger over time than taxable accounts until withdrawals begin from the tax-deferred accounts and taxes are due.

For taxable accounts, a buy and hold strategy may increase tax efficiency. By limiting investment trades, you can limit capital gains taxes, thereby increasing your portfolio's ability to compound returns without a reduction for current taxes. If you own mutual funds, you should be aware of how often fund investments are traded. The more trades a fund makes, the less tax efficient it may be.

Measure Performance

We use "benchmarks" to measure everything from intelligence to baseball batting averages. Investment indexes serve the same function in the investment world. If you want to measure how well an investment is performing, compare its return with those of a comparable index. By comparing your investments to appropriate indexes, you have a way of determining how well — or how poorly — those investments are performing. Please note an index is unmanaged and one cannot invest directly in an index. The performance of an unmanaged index is not indicative of the performance of any particular investment. Past performance is no guarantee of future results.

Perform a Cost Analysis

The less money you spend buying and selling investments, the more you have to invest for your future. So, it's important that you track how much you pay for trades and spend on sales charges, fees and expenses. Compare your costs with those of similar investments. And, before you make a new investment, do your research. Read the investment prospectus and annual report.

High taxes, excessive expenses, unsuitable investments, or inadequate diversification can weaken the performance of a portfolio and slow its growth. If you want to be sure that your investments are performing efficiently, let's sit down for a thorough analysis of your entire portfolio.

For more information, please call us at 201-556-4618 or email us at Dan.Prisciotta@LFG.com.

Daniel A. Prisciotta
CFP®, CPA*, PFS, ChFC®, CBEC®

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