When You're Serious…

by Bradley R. Newman, CFP®

If Not Now, When?

The volatility of the past five years, combined with a healthy sense of uncertainty going forward, has left almost everyone feeling a bit anxious about their financial futures.

While the recent financial crisis has left its emotional scars on many investors, the continued economic issues in Europe and the domestic fiscal issues that will culminate the end of this year are making it both more difficult and more important to diligently manage the dollars that you are either accumulating for retirement or are currently living on during retirement. Like it or not, volatile times call for active portfolio management.

Active Management Versus Trading

To narrow the focus, we'll eliminate security selection, which is critical, and focus on broad asset allocation moves that are a key driver to disciplined portfolio management.

Let's review what asset allocations moves are, as well as what they are not. Asset allocation moves are a series of decisions that allow a portfolio to be optimally allocated based on current market conditions and provide the ability to raise and lower the exposure of various asset classes within pre-determined ranges. When done properly, asset allocation moves do not result in large sector bets or constitute market timing.

As a point of reference, some of the major choices that occur at the asset allocation level are weighting exposures between: stocks vs. bonds, large cap stock vs. mid cap stock vs. small cap stock, growth style vs. value style, domestic investments vs. foreign investments, etc.

Repatriate Your Investments

How much difference can proper asset allocation moves make in a portfolio? You would be surprised. Let's examine just one of the many branches in the asset allocation decision tree and capture some of the low hanging fruit; domestic stock exposure versus dedicated foreign stock exposure.

Based on Morningstar™ data for calendar year 2011, the broad category for the large cap value domestic market outperformed the large cap value foreign market by 12.1% (-0.8% versus -12.9%); dedicated foreign exposure fared no better in the rolling 12 month period ending July 31st with underperformance of the domestic markets by 17.8% (+4.9% versus -12.9%).

While the academic calculation of domestic versus foreign returns makes for nice dinner party conversation, the real life impact for an investor who had $100,000 of their portfolio allocated to dedicated foreign exposure over those discrete one year periods was $12,100 or $17,800 respectively; enough to make you lose your appetite.

How Much Foreign Exposure Do You Have?

What can you see? How much foreign exposure do you hold in direct foreign positions or in mutual funds that specialize in foreign investments?

What can't you see? This is the more difficult question to answer, because many mutual funds that do not have a foreign mandate or name that would indicated a foreign leaning do contain notable foreign equity exposure; for example, based on current Morningstar™ data there are currently several large cap value funds with dedicated foreign exposure that accounts for more than 25% of fund holdings – the highest being 55%.

Why haven't you made a change? Given the above illustration, the bottom line value is apparent and there hasn't much subtlety to the current issues that abound in the foreign markets. As noted, this was low hanging fruit.

What Are You Waiting For?

The dramatic underperformance of the broad foreign markets relative to the broad domestic markets has not been a market nuance. Anybody that has been casually following the news since May of 2010 should be very much aware of the chronic issues facing Europe. However, it has been rare to see people take action to liquidate their Europe-based investments; which begs the question "If not now, when?"

More importantly, if you are paying an advisor the real question you should be asking is "What are they waiting for?" Not only does the lack of prudent management have a real dollar impact on your portfolio, notable fluctuations in the value of your portfolio may be causing more than a few sleepless nights.

A Second Opinion

The cost of not diligently managing your portfolio through these tumultuous years may be surprising. Before trying to adjust the portfolio yourself, or allowing the advisor who has been inattentive to make up for missed opportunities, take a step back and consider hiring an independent firm for an arms-length review. A second opinion from a qualified fiduciary will allow you to objectively quantify your current situation, your long-term goals and provide you a clear understanding of the areas where your portfolio is invested appropriately and the areas where you are missing the mark. This will prevent you from making reactive decisions.

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