When You're Serious…

by Bradley R. Newman, CFP®

Keep Your Eye On The Ball

To say that 2016 is off to a rough start would be an understatement akin to noting that the Grand Canyon is a pretty big hole in the ground. As I pen this going into the last week of January, the S&P 500 is off to the worst calendar year start in its history.

The most distressing aspect of this year's start isn't the investment losses that are being created, although they run a very, very close second. The most distressing attribute is the complete disconnect or departure from fundamental economic data; this is not limited to the U.S. markets, but is also reflected in developed foreign markets. It is typical to see an economy and a stock market not move in lock-step, but the current environment has them going 180 degrees in the opposite directions. Unfortunately, there doesn't seem to be any single near-term catalyst that is poised to recalibrate the environment back to more normal operating levels; however energy prices and Central Bank policies are currently leading the way.

Despite the decidedly negative start to the year, this doesn't represent a "run for the hills moment". To put it into perspective, there are several things that suggest that this is not 2008-2009 all over again: 1) there is no indication of a recession on the near-term horizon, 2) there is no systemic risk at present, think housing bubble, and 3) both banks and personal balance sheets have been put in much better order over the past seven or eight years.

What To Do?

Just because we aren't on the brink of financial Armageddon doesn't mean that there isn't any action to be taken. Periods of notable risk and market stress are prime opportunities to review your overall Investment Policy to make certain that you are comfortable with your investment strategy. From there you can dive into the current asset allocation of your portfolio to identify areas where risk that is no longer appropriate can be eliminated and look for incremental ways to increase the yield.

The combination of reduced risk exposure and increased yield will provide more consistent returns and greater peace of mind during volatile periods of time.

The Fixed Income Portion Of Your Portfolio

Although most people associate bonds with safety, there can be significant amounts of risk found in the fixed income portion of an investment portfolio. We are currently in an environment where risks lurk around several corners of the bond market; the most palpable risks come from the rising interest rate environment that we've just entered into and the credit risk that has recently unfolded in the high-yield bond space. Suffice it to say that the complexion of your bond portfolio matters more today than it has in many years.

Although the return to a more normal interest rate environment should be a long, slow and steady journey; credit quality and duration will matter more than they have in the past 20 years. It is critical to understand the fundamentals of any individual bonds in your portfolio and to be certain that you know the details of the underlying holdings in any mutual funds or exchange traded funds that you hold.

This is not the environment to blindly put your faith in an index.

The Equity Portion Of Your Portfolio

Risk reduction should be the primary focus as you review the stock holdings in your portfolio. Note, this does not mean that it is time to completely exit the stock market; however, it may mean a slight reduction in overall stock levels if, as noted previously, your allocation doesn't mirror you risk tolerance. Remember, there is a tremendous difference between market-timing and making disciplined asset allocation shifts.

The secondary focus should be on increasing the yield of the portfolio, at least until the macro economic environment stabilizes. A higher yield will typically provide two benefits: first, it will create a more consistent return component of the portfolio and secondly, the yield producing components are typically less susceptible to the high level of daily valuation swings that have been occurring.

Focus On What Matters

It is definitely too soon to give up on 2016, but that doesn't mean that you can put your portfolio on a Ron Popeil 'set-it-and-forget-it' strategy. There needs to be a focus on the basic components of successful portfolio management. As you contemplate changes, ask yourself these questions: Is the structure of the portfolio aligned with my specific circumstances and needs? Am I comfortable with the inherent amount of risk in the portfolio? Will I get the downside protection that I expect from the portfolio? etc.

Too often the prevailing advice is to 'hunker down' and to 'ride it out'. Answering some of the above questions may very well lead to the conclusion that it's time to make some long overdue adjustments.

Bradley R. Newman, CFP® is with Roof Advisory Group Inc., an independent investment management and financial advisory firm based in Harrisburg. The firm is a fee-only registered investment advisor providing portfolio management and financial planning services to individual and institutional clientele. The firm's e-mail address is invest@roofadvisory.com