



ETF Portfolio Partners

“The Smarter Way to Invest”

Is It Time to Remodel Your Portfolio?

By Richard D. Romey

Having recently endured my kitchen being remodeled, I believe I'm more than qualified to say that there is nothing pleasant about it. The dirt, the noise, the mess and the complete upheaval it causes to your normal daily routine. I wouldn't wish it on anyone.

Now that the project is completed, however, I will be the first to admit that it was well worth it. The kitchen is updated and comfortable. My wife and I love the way it turned out. We can hardly wait for friends and family to see our new kitchen. Updating the kitchen will also increase the value of our house. While the remodeling process was painful and unpleasant the results are exciting.

Believe it or not, there are many similarities between remodeling a room in your house and remodeling your investment portfolio. No different than your house, your portfolio needs to be updated or it will become outdated and no longer meet your needs. Remodeling your investment portfolio will also increase its value over the long run. Like a home remodel, however, the thought of remodeling an investment portfolio strikes fear in the hearts of most investors.

Despite the unpleasantness, there are three reasons why you need to remodel your portfolio from time to time. First, most investor's risk tolerance will change over time. As it does, their portfolio must be changed to reflect the different risk level. Second, the investment products you're using may be outdated. Finally, the asset allocation mix of your portfolio will shift over time if you don't reallocate on a regular basis.

The level of risk most investors are willing to take typically decreases as they near retirement or move into retirement. It's only natural. At age 30 it's far easier to watch your investment portfolio drop in value than it is at age 55. As your tolerance for risk changes, the overall asset allocation of your portfolio

must change as well. For example, instead of having 90% of your portfolio allocated to equities and 10% to bonds you may want a more moderate allocation of 60% equities and 40% bonds.

It's important to make sure that your portfolio's overall allocation is aligned with your goals because research has shown that the greatest determinate of your portfolio's risk and expected return is the result of how it's allocated among equities and bonds. This is commonly referred to as asset allocation. It represents the best way for an investor to build a diversified portfolio that will maximize expected return for a given level of acceptable risk. This one step alone will do wonders in helping you achieve your investment goals.

Another aspect of your portfolio, which may need to be remodeled or changed, is the investments you're using. Ironically, millions of investors who would never consider using a Polaroid camera to take a picture or an 8-track tape player to listen to their favorite music routinely use outdated technology when it comes to investing. Traditional mutual funds were introduced over 70 years ago to meet the needs of investors from a different era. It was a time when everything moved a little slower and the telegraph was the primary way investors got their news. Today, there is a better alternative.

Exchange-Traded Funds or ETFs are the most efficient way to build and manage an investment portfolio. First introduced in 1993, ETFs are rapidly becoming the investment tool of choice for millions of investors. The reason why is simple: ETFs are better than mutual funds. ETFs typically have lower operating expenses than mutual funds and are generally more tax efficient. ETFs are index-based investment products and over the years indexing has been a very

Continued on back...

difficult strategy for most mutual fund managers to beat.

Exchange-traded funds are essentially a cross between common stocks and index mutual funds. Like index mutual funds, each ETF is designed to track the performance of a specific market index or benchmark. Like shares of stock, investors can buy or sell shares of ETFs throughout the day. It's this unique hybrid structure – part mutual fund and part stock – that makes ETFs such a powerful investment tool. An easy way to modernize your portfolio and bring it into the 21st century is to update the investment tool you're using from mutual funds to ETFs.

Finally, if you're not systematically rebalancing your portfolio on a regular basis I've got news for you, the market is doing it for you. Every day the market fluctuates. This shouldn't be a surprise to anyone. As different asset classes outperform each other your portfolio's asset allocation changes as well. When you don't rebalance your asset allocation mix on a regular basis, your actual allocation can deviate dramatically from the intended allocation. The result could be a portfolio that is far riskier than anticipated.

For example, during the 1990s large cap stocks in general and large cap growth stocks in particular did extremely well. If an investor had allocated 25% of their portfolio to large cap growth stocks in the early 1990s, by the end of the decade their portfolio may have had 40% in large cap growth stocks, simply because large cap growth stocks did so well relative to other asset classes. Investors who didn't rebalance their portfolio's allocation allowed the market to increase their weighting in large cap growth stocks. When the market corrected large cap growth stocks got hit hard. For investors who were over-weighted in this area, either by their own choice or because they had not reallocated, the losses were devastating.

I think it's safe to say that few people look forward to remodeling their house or investment portfolio. It can be a painful and unpleasant experience. Yet, it's important if you want to keep up-to-date. Sometimes we have to put up with a little pain and trouble if we want to improve the value of our house or investment portfolio. By not remodeling, you avoid the mess, but it isn't the best decision in the long run - for either your home or your portfolio. Don't put it off any longer. Make a New Year's resolution to remodel your portfolio. You will be glad you did.

About the Author

Richard D. Romey is the founder and chief investment strategist of ETF Portfolio Partners, a registered investment advisor (RIA) that specializes in ETF portfolio management. He is the author of *Strategic Index Investing—Unlocking the Power of Exchange-Traded Index Funds*, and he publishes a quarterly newsletter that focuses on the Exchange-Traded Funds industry. Send questions or comments about this article to rich@etfportfoliopartners.com or 913-851-1100.

ETF Portfolio Partners is a registered investment advisor (RIA) that builds and manages highly efficient portfolios using **exchange-traded funds** or **ETFs**. Each portfolio we manage is based on:

1. The Diversification Benefits of Asset Allocation.
2. The Efficiency of Exchange-Traded Funds.
3. Continuous and Ongoing Portfolio Monitoring

To find out more about our approach to portfolio management, or to schedule a meeting, call us at 913-851-1100 or email to rich@etfportfoliopartners.com

ETF Portfolio Partners

4707 W. 135th Street
Suite 200
Leawood, KS 66224

Phone: 913-851-1100

Toll-free: 877-913-8511

Email: rich@etfportfoliopartners.com