Keeping Your Financial Plan Aligned With Your Goals In Today's Market Environment

The extreme market volatility of the past seven months has left many investors wondering how their investment portfolios have held up during 2020's rollercoaster ride. We believe that rather than just thinking about the status of your investment portfolios relative to certain short-term equity or fixed income benchmarks, investors should remain focused on the long-term rate of return which will drive their progress toward achieving their long-term goals.

While the market volatility of 2020 has been remarkable, valuations and capital markets assumptions are always evolving. Your goals and family situation may be changing as well. That is why is it so important to meet with your advisor regularly to revisit your overall financial plan and ensure that it remains aligned with your long-term goals.

In this article, we identify five principles of our planning and investment process that we reinforce during conversations with clients to review their financial plans.

1. Goals drive portfolios, not vice versa.

Identifying one's financial goals is the critical first step in devising a plan and structuring a portfolio to achieve those goals over time. The purpose of investing is not simply to "beat the market" or outperform some benchmark that may be unrelated to one's goals and timeframe. The purpose is to achieve your goals with a portfolio that is constructed appropriately and incorporates your timeframe and capacity for temporary volatility risk.

Goal-oriented investing takes discipline. When the stock market environment is volatile, many investors feel they should react. But that often means buying near the top or giving into fear and selling as the market is dropping. History has shown over and over again that pulling money out of the market during a decline, can mean missing out on a big portion of a recovery.

This highlights a key reason to review your financial plan with your advisor every year: your advisor needs to be aware of these changes so that your financial plan and thus your portfolio will be in step with what you want to accomplish with your wealth.

2. Long term success requires disciplined rebalancing.

When using a process of disciplined rebalancing, the normal swings in a portfolio that result from market volatility present opportunities to increase and trim positions at attractive levels. This process recognizes when a portfolio has drifted away from its intended allocations due to market movements and makes adjustments to put the allocations back into balance. Undisciplined investors tend to buy when stocks are rising to avoid "missing out" (a.k.a. "FOMO", the fear of missing out) and sell when the market news is negative. That is a recipe for buying near the top and selling at a low point.

Disciplined rebalancing naturally leads investors to buy into weakness and trim into strength. For example, assume a portfolio is intended to have 65% in equities, 30% in bonds and 5% in cash, and markets move so that equities are now 60% and bonds are 35% of the total. Disciplined rebalancing will sell some of the bonds that have risen in value to buy more equities at an attractive price. This helps investors to avoid the dual traps of fear and greed and benefit from the market's ups and downs over time. The extreme market volatility of the past seven months has left many investors wondering how their investment portfolios have held up during 2020's rollercoaster ride. We believe that rather than just thinking about the status of your investment portfolios relative to certain short-term equity

3. Focus on total return, not yeild.

A key objective of financial planning is to determine how to build a portfolio that will meet your many goals (e.g., college education, charitable giving, etc.) and fund your desired lifestyle in retirement. Many investors mistakenly believe that their investments should meet those needs by generating a recurring stream of payments through interest and dividends, leaving principal untouched. Given today's low bond yields, this approach is very challenging and may cause investors to seek higher yields by investing in riskier asset classes.

In reality, it's the total return a portfolio generates that matters, not the source of that return. Whether a $1 million portfolio generates a 5% return from interest and dividends or the securities in the portfolio increase in value by 5% net of taxes and fees, the return is the same in both cases. This focus on total return, rather than yield, leads to better decisions that are consistent with long-term investment goals.

4. Risk and volatillity are not the same thing.

Volatility has surged in 2020's uncertain environment, and large daily swings have caused many investors to perceive today's market to be especially risky. But it is important to note that volatility and risk are not the same thing. In a financial context, volatility is a mathematical measure of how much asset prices vary from their long-term trend line—both on the upside and the downside. Risk, on the other hand, is the threat of a permanent loss of capital.

It is important to realize that a permanent loss of capital doesn't occur unless an investor sells an asset before its value has recovered. The V-shaped downturn and subsequent recovery of equity markets from February to July of 2020—the starkest example of volatility in our lifetimes—illustrates the importance of remaining invested through times of heightened volatility. Staying focused on long-term goals and remaining committed to the plan helps investors manage risk, rather than reacting to the historical temporary nature of volatility.

5. Portfolios can benefit from lookin beyond traditional asset classes.

Diversification, a fundamental principle of investing, reduces volatility by generating returns from a variety of sources. Traditionally, investors have diversified equity exposures by holding U.S. Treasuries, blue-chip corporate bonds and other "core" fixed income assets that have historically generated yields of roughly 3%–6%. But in today's lower-for-longer interest rate environment, those yields are simply not available. Investors may want to look beyond traditional fixed income sectors to others, such as municipal bonds, mortgage-backed securities and high yield corporates, that can offer more attractive yields.

Investors might also consider alternatives such as private equity, private real estate, private credit, real assets (e.g., timber and farmland) and gold. In addition to offering potentially attractive returns, these asset classes can provide important diversification to a portfolio that is heavily concentrated in equities. Of course, it is essential to understand the risk and liquidity characteristics of each asset class and how it fits into one's portfolio before investing.

Schedule Your Annual Planning Review

Meeting with your wealth advisor at least once a year is valuable in any environment. But it is especially important given the changes in market conditions and capital markets assumptions that have occurred in 2020.