FPA FINANCIAL PLANNING PERSPECTIVES

Making (and Keeping) Investment Portfolio and Financial Planning Resolutions for 2006

Even if you aren't among those who normally make New Year's resolutions—and keep them—this may be a time when you will want to make and keep them in the year to come.

With the Standard & Poor's 500 Stock Index up 1.05 percent through October and the average U.S. taxable investment grade bond returning an almost identical 1.12 percent, as indicated by the Citigroup Broad Investment-Grade Bond Index, barring a year-end rally, 2005 could wind up as a flat year in both stock and bond markets.

Whether the ultimate results are flat, up a little, or down a little, you could be thinking of adjusting your portfolio to improve its performance by taking bigger risks—perhaps more than would be appropriate for you. Given the potential losses inherent in such a strategy, the following resolutions may be helpful as you consider your year-end strategy:

Allocate your assets among bonds, stocks, money market instruments, and funds in proportions that reflect the amount of risk necessary to achieve your goals. In some cases, that may mean that portfolios don't need to be or shouldn't be more conservative 'just because' someone is older. It should really be about allocating for your particular goals and needs, not 'just because' you are at a certain age or spending level. Disregard recommendations of all-purpose model portfolios' asset allocations. They may indicate how various investment strategists feel about the near-term attractiveness of stocks and bonds but weren't offered with your particular investment goals and risk tolerance in mind. (Do consider so-called lifestyle or lifecycle funds. If you don't have the time or inclination to do the necessary initial portfolio construction, disciplined re-balancing and continuous re-alignment as you approach your goal, these will perform these functions.)

Have realistic expectations of performance. The years of exceptional annual returns for stocks, on the average, are a memory now. Annual returns averaging below the long-term average of about 10 percent annually seem more likely in the foreseeable future. Whatever they are, the average returns for balanced portfolios are likely to be single-digit.

Resolve to maximize your net returns by holding down (a) excessive commissions when buying or selling individual securities and (b) excessive expenses when investing in mutual funds. When investing in taxable accounts, be mindful of the tax consequences of owning mutual funds that make large taxable distributions of realized short- and long-term capital gains. Recent research published in the *Journal of Financial Planning* suggests that funds with low turnover and long-term capital gains still belong in taxable accounts and that funds that have large amounts of short-term gains distributions should be placed in retirement accounts, such as IRAs, 401(k)s, or other tax-deferred accounts.

When investing for income, resist the temptation of chasing high yields. Higher yields are generally associated with higher risk, and with some investments what appears to be yield may actually be a return of capital.

Don't forget bond funds. Tax-exempt state or local government bonds or "municipal" bond funds, whose yields are usually lower than those of taxable issues of comparable credit quality

and maturity, may pay you more than you'd have left after taxes when investing in the comparable taxable securities. Do the math: compare your prospective after-tax income from the taxable securities with what you'd get from the tax-exempts.

Accept that there is no shortcut to mutual fund selection. Whether you do it or an adviser does it for you, funds have to be studied—primarily in funds' own, SEC-mandated literature—to determine their suitability. Data indicating superior past performance—which funds must report in accordance with SEC regulations and update periodically—don't assure you of superior future performance. Neither do ratings, such as the 5-star ratings for risk-adjusted performance calculated by Morningstar. They may provide you an additional dimension of past performance, but, as Morningstar has long reminded investors, they don't have predictive value. Such data constitute the beginning, not the end, of the selection process, indicating which funds' literature you might study.

Don't be too impressed by high absolute returns. Compare past performance data for an equity fund with performance data for the same periods for the S&P, Russell, or other index—for the broad stock market, for large or small companies' stocks, for growth or value stocks, and so on—which the fund management has chosen as its benchmark. You may also compare them with data for peer funds computed by Lipper or Morningstar. By focusing on relative returns, such comparisons tell you whether the fund has performed as well as could be expected, better, or worse, given the stocks it owns.

Always remember that stocks and bonds—and the funds that own them—are long-term investments, requiring patience and the ability to ride out market volatility. Stocks and stock funds are unlikely to be, as magazine covers will have you believe, "the 10 (whatever) you must own in 2006."

December 2005 — This column is produced by the Financial Planning Association of Southern Wisconsin. We can be a continued resource for your personal finance coverage. If you use this column in whole or part, please credit the chapter or one of our CERTIFIED FINANCIAL PLANNER™ members.

CFP®, CERTIFIED FINANCIAL PLANNER™ and the federally registered CFP (with flame logo) are certification marks owned by Certified Financial Planner Board of Standards, Inc. These marks are awarded to individuals who successfully complete CFP Board's initial and ongoing certification requirements.