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COMMENTARY

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It's Time for a Portfolio Checkup

While our health may be more important than money, we often do not pay enough attention to our portfolios. We could benefit from regular portfolio checkups and take note from the health care industry. When the World Health Organization (WHO) developed a pilot program with a 19-item surgical checklist, which included many routine tasks such as a review of patient allergies and sterilization procedures, major complications fell by 36% and deaths declined by 47%.[1] Going through a portfolio checklist with your advisor could even be more important now as equity indices are near all-time highs and the United States is in its longest economic expansion on record, going as far back as 1854. Below are just a few items that should be reviewed.

✓ **Periodic Rebalance.** Portfolio drift is something that occurs when a portfolio is not rebalanced, and this can be significant. For example, a portfolio that was 60% equities[2] and 40% bonds[3] at the market bottom in March 2009 has seen a sizeable increase in risk if rebalancing has not occurred. By June 2019, the equity allocation would have drifted to 83% of the portfolio and the bond allocation would have dropped to only 17% because of the strong relative performance of stocks over bonds during that timeframe. This portfolio would likely no longer fit the long-term risk objectives when the portfolio was designed.

✓ **Diversify Equity Risk**. It is important to avoid concentration risk in any one sector, style, region, or individual stock holding. For example, an investor that had a diversified equity allocation would have offset negative returns in U.S. large cap stocks during the lost decade (2000-2009) from exposure to positive returning asset classes including mid cap stocks, small cap stocks, international developed, and emerging market equities. Moreover, if alternatives were also included, REITs, gold, and commodities would have provided additional performance gains. The best performing asset classes in one decade can be laggards in the next and vice versa. This is one of the main reasons to diversify equity risk.

✓ **Manage Credit Risk.** Generating income and reducing portfolio risk are among the key objectives for a portfolio's bond allocation. High yield bonds and other credit sensitive fixed income asset classes add additional income to a portfolio, but they also add risk compared to traditional investment grade fixed income categories. Including an allocation to high yield bonds is a good way to add diversification to a portfolio, but only up to a point. The downside risk for high yield bonds can approach that of equities, which offsets a key characteristic of bonds - reduce portfolio risk. A prudent approach to lower portfolio risk would be to reduce exposure to high yield bonds in favor of investment grade bonds.

Conclusion. This economic expansion could continue for some time, but there won't be an alarm that goes off when markets and the economy reach their peak. It's been more than a decade since the U.S. has experienced a recession or a bear market, so it is a good time for a portfolio checkup. Sitting down with your advisor and implementing your portfolio management checklist is a prudent approach to prepare for periods of market volatility.

(1) Gawande, A. (2010). *The Checklist Manifesto: How to Get Things Right.* New York: Metropolitan Books.
(2) S&P 500 TR Index
(3) Barclays Aggregate Bond Index

Glossary
The **S&P 500 is an index** of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

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A diversified portfolio does not assure a profit or protect against loss in a declining market.

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