Managing an Investment Portfolio

Capital Ideas
June 2007

Managing an investment portfolio never has been easy, but this step in the investment planning process is a key to successful investing. Managing actually encompasses two distinct functions: portfolio management and portfolio monitoring.

Portfolio management refers to the selection of specific investments and the choice of timing to buy or sell, according to your goals and disposition. A higher level of expertise is needed for this activity than most investors possess. These investors should seek the help of a professional advisor or money manager.

Portfolio monitoring is an ongoing activity that provides investors with the information needed to evaluate a portfolio's performance and allows an investor to rebalance the portfolio to keep it on track toward achieving the planned objectives. This function, too, is often left to a professional.

If the physician has the time and expertise to monitor his or her own portfolio well, it is best to use software specifically designed for this purpose. Individuals should not attempt to monitor a portfolio manually.

The Advisor's Role

The advisor's role can be all encompassing or limited to certain tasks. Either way, the duties can be broken down into four major categories:

1. *Managing all or part of a portfolio.* Typically, an advisor will employ and oversee money managers who evaluate and implement investment options and strategies. The physician also may employ money managers to implement investment decisions.

2. *Reviewing the portfolio's performance.* This step entails measuring the overall performance of the portfolio and the performance of asset classes and individual investments within the portfolio.

3. *Reporting to the physician investor.* Reports from the advisor should provide information about the portfolio's performance, compliance with the investment policy, progress toward financial goals, and the effects on cash flow and taxes.

4. *Recommending changes to the investment plan.* A rebalance plan should be proposed, unless a buy-and-hold strategy is recommended.

Managing a portfolio requires some understanding of environmental factors (such as political and social influences) that may affect the portfolio's performance, so when certain events occur, the physician can respond appropriately. The investor also needs to be aware of the costs involved in managing the portfolio so that he or she can control

investment-related expenses. Of course, to monitor performance, the physician will need to get educated on the various measuring techniques. Most important, the investor must have a clear vision of investment goals, a thorough knowledge of the investment and rebalancing strategies, and an understanding of vehicles being used.

One of the most important functions of a portfolio manager is to monitor performance. One way to do so is with benchmarking, which measures the performance of an investment portfolio against certain models. Some investors use the latest 10-year Treasury bond as a benchmark for all bonds. But the term 'benchmarking' usually refers to comparisons with standardized indices. The best known and most reliable indices include the Standard & Poor's 500, the NYSE Composite Index, the NASDAQ Composite Index, Dow Jones 30 Industrials, the Wilshire 5000, the Russell 2000, and NASDAQ 100. Although benchmarking has proved highly effective, the frequent caveat about past results as reflected by the various indices bears repeating. Past performance will not necessarily predict future performance.

Selecting Investments

When designing an investment portfolio, investors decide what types or categories of investment vehicles to use based on such factors as goals and tolerance for risk. Investors also decide how to allocate assets among these different categories (such as 10% to Treasury securities, 30% to growth funds, 30% to blue chip stocks, and 30% to aggressive stocks). The next step involves selecting individual securities to buy within each of these groups. This is when working with an advisor is most essential.

When selecting securities, investors should implement a screening system based on certain criteria or minimum standards that the or she expects the investments to meet within each category. If selecting bonds, for example, examine the creditworthiness of various debt issuers. If choosing growth funds, look at the growth companies' total returns over the past year.

Over the past two decades, many investors have favored mutual funds over individual securities. Here's a review of the strengths and weaknesses of each vehicle.

Individual securities can be customized to fit the investor's personality, are especially suitable for large cap stocks, protect against the herd mentality, have potentially higher returns, may lower costs, and may allow the investor to mange his or her tax liability. Conversely, with individual securities, diversification requires a higher minimum investment, there is a lack of professional management unless the investor works with an advisor or money manager, and there is a potentially higher risk.

The strengths of mutual funds include the ability to diversify for a smaller investment and professional management is provided. Mutual funds are especially suitable for small cap, foreign, and emerging-market stocks and may have potentially lower risk than purchasing an individual security. On the other hand, the disadvantages of mutual funds include difficulty in choosing among funds, these funds are "off-the-rack," they have potentially lower returns, higher costs, no ability to manage tax liability, may contain large imbedded

capital gains, and are susceptible to the herd mentality. Please note that diversification does not ensure a profit or protect against a loss in a down market. Small company stocks typically carry additional risks, since smaller companies generally are not as well established as larger companies. There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries.

Many Factors Affect Performance

Every investor should know that a wide range of factors can affect the performance of one's investment portfolio. Here's a look at some common factors that affect returns.

War. Historically, the stock market declines when the United States is on the brink of war, because foreign and domestic investors become cautious. Conversely, if war breaks out, it could stimulate the economy and lead to more investor activity, which normally has a positive influence on the stock market. Also, foreign wars can affect a portfolio, particularly if the investor holds international stocks or mutual funds.

The Federal Reserve Board. The Fed is the national bank of the United States that controls the money supply. All U.S. banks are part of the Federal Reserve System and borrow money from the Federal Reserve to lend to customers. The interest rate that the Federal Reserve charges when it loans money to member banks is called the discount rate. In general, the lower the discount rate, the more money banks will borrow and the more money gets pumped into the economy. If too much money is pumped into the economy, however, prices may escalate and inflation may result. By comparison, if too little is pumped into the economy, a recession may result as economic activity drops.

Watch for signs that the Federal Reserve is about to lower the discount rate, because when it is lowered, interest rates are typically lowered as well. This action may affect the price and return of stocks and bonds. In addition, consumers and businesses may have more money to purchase goods and services. This factor may lead to higher profits for businesses and thus raise the value of shares of stock in those businesses. Also, investors may have more money to save and invest, leading some to consider putting more money into riskier investments, as returns on safer investments may be low.

The judicial system. The return an investor receives on investments depends on the success of the companies he or she invests in. That company's success may be linked to the judicial system. If a company must pay damages from a lawsuit, its earnings and profits may decline, causing the value of stock shares in that company to drop. When stock value drops, investors holding stock may suffer a financial loss. If the setback is temporary, it may mean a financial boon to investors who buy shares when the price is low and then sell the shares when the company and stock price recover.

Federal government. The federal government stringently regulates some industries, and some states regulate industries as well. Since industry regulation can directly affect the

prices of stocks and bonds related to those industries, it's important to pay attention to the actions of the legislative and executive branches of government. These branches also set and change monetary and fiscal policies that can affect investments.

Tax laws. Tax laws (on the federal and state levels) can significantly affect one's overall investment strategy. A physician may invest in a certain vehicle because of the tax advantages it offers, for example, but if tax laws change suddenly and those tax advantages disappear or become less significant, the physician may need to revise his or her investment portfolio.

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