**Investment Portfolio Review**

This guide, presented in three levels of advancing complexity, explains concepts and offers points for you to consider as you review and evaluate your current investment portfolio. If you prefer knowledgeable guidance in this process or have concerns about your investment strategy after completing this review, please contact MPPL Financial at 1-800-236-6775 to schedule a free no-obligation professional portfolio review.

**Level 1**

1. **How much risk are you taking?** - Asset allocation is a primary determinant of investment return and risk. Start by calculating the percentage of your total portfolio invested in the major asset classes - stocks, bonds, and cash. Compare your current stock percentage to the table below to determine your risk level and make sure that matches your expectations.

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| --- | --- | --- |
| Stock Allocation Ranges | Risk Level | Expected Return range |
| 80-100% | Aggressive Growth | 8-12% |
| 60-80% | Moderate Growth | 6-8% |
| 40-60% | Moderate | 4-6% |
| 0-40% | Conservative | 1-4% |

Additional notes: There is no one “right allocation.” Understanding your current allocation is the starting place for evaluating your portfolio.

1. **How much are you paying to invest?** - Investment costs can significantly impact long-term investment returns, so getting a fair and competitive price for investment management is critical. Be aware there are usually multiple layers of expenses when investing, so consider the following areas.
   1. **Commissions** are the prices charged by a brokerage firm to buy or sell an investment. They may be charged up front or over time through higher expenses on a mutual funds. You may also have to look in a fund’s prospectus to understand what commissions or deferred sales charges apply as they are not usually shown on a statement.
   2. **Investment Advisory/Management Fees** are preferable to commission-based cost structures in many instances due to reduced conflicts of interest. They’re often charged as flat fees or as a percentage of portfolio value. If your annual fee is over 1.5%, you may want to re-evaluate or get a second opinion to ensure your fees are reasonable based on the services performed.
   3. **Transaction Costs** are the costs to buy or sell investments. Review your historical statements to see if you are charged a transaction cost when you buy and sell investments. If so, you may want to consider another provider since many custodians now have no transaction costs.
   4. **Expense Ratios** are expenses associated with mutual funds or exchange-traded funds (“ETFs”) and are in addition to investment management fees/commission charged by the advisor. If you are paying investment management fees and higher mutual fund expense ratios for standard strategies, your total cost could be getting too high.
2. **Is your portfolio prepared for retirement?** For investors approaching retirement, consider how many years of cash flow needs are held in nearly risk-free investments. Holding three years’ worth of these type of investments can protect income and help avoid having to sell stocks at a bad time, such as during surprise drops in the markets. Consider using individual bonds instead of mutual funds or exchange-traded funds for more predictability.
3. **Do you still have money in a prior employer retirement plan (401(k), 403(b), etc.)?** Given that each plan has unique investments, having multiple plans can create more work to keep everything straight. In addition, there are scenarios where combining accounts together can achieve lower fees due to breakpoints. It’s important to review all your options and understand the costs and benefits associated with each to determine if you should keep assets in the plan or combine it with your new employer’s plan or your personal IRA.
4. **Are you making any common investment errors?**
   1. **Setting and forgetting** – If you set up your investments long ago and haven’t looked since, you want to consider how markets and personal scenarios have changed and determine if adjustments should be made.
   2. **Using the Default options** - Was your 401(k) or other employer plan invested based on defaults, or did you make an investment election? Rarely is the default option the correct choice for an individual’s personal situation.
   3. **Investing your retirement account equally to all available options in the plan** - This approach has many problems, but there is an optimal way to construct a portfolio.
   4. **Investing in funds with the highest past performance** - Numerous studies on this approach suggest it doesn’t work and should be avoided.
   5. **Avoiding risk** – Over the long-term, individuals taking investment risk have almost always been rewarded with higher returns. Given the length of time people are retired, avoiding risk is a strategy for most people that will ensure they run out of money.

**Level 2**

1. **Do you or your advisor have a defined investment strategy?** Understanding the strategies that are being used for your investments is critical because not all strategies work in every market environment and therefore may need to be changed over time. Knowing how the portfolio is constructed and what its intended goal is provides helpful context as you evaluate whether a given fund or strategy has a role in your portfolio or not. In general, don’t buy what you don’t understand.
   1. An **Active Strategy** is a strategy or fund seeking to beat a benchmark over time. Be certain to understand how different the fund actually is from its benchmark. Active strategies are often more expensive than passive ones, and they should be materially different from the benchmark in order to have an opportunity to outperform, net of fees, over time. Being too similar to the benchmark, while claiming to be an “active” fund, is a losing proposition and is referred to as “closet indexing” (charging higher fees for active management while looking pretty much like the benchmark they’re claiming to want to beat).
   2. A **Passive Strategy** or fund seeks to match the performance of a benchmark as closely as possible rather than trying to “beat” a benchmark. Passive funds are often called “index funds” because of this characteristic. Frequently they are lower in cost than active funds. It is critical to understand the characteristics of the index the fund is trying to replicate, and what the method of replication is. Some funds use highly liquid investments in the proportions reflected in the index, and other funds use more complex methods of simulating the exposure with differing risk and tax consequences.
   3. **Factor-based or “Smart-beta” Strategies** are something of a hybrid between active and passive. They are often based on custom or arcane indices that seek to employ a rules-based approach, similar to passive funds, but the index tracked is often constructed based on fundamental, technical, or quantitative factors more often used by active managers. Fees vary widely and outcomes are sometimes below average as these are often based on historical data and then implemented somewhat blindly going forward.
   4. **Asset Allocation Strategies** are invested in a mixture of stocks, bonds, and potentially other securities. When considering allocation options, both current allocation as well as how that allocation can change must be considered. Some funds hold a relatively constant allocation to stocks and bonds while others vary widely over time. One subtype of allocation strategies is a “Target Date Fund” (TDF). A TDF investment allocation changes over time based on the proximity to its “target date,” which typically aligns with an investor’s expected retirement date. Different companies can have very different risk levels at the same age. It is important for investors to understand the allocation and how it changes over time and consider how well it fits their personal goals and risk tolerance. It’s possible for these portfolios to be very aggressive, even close to retirement, because they assume you will still be investing for 20+ more years.
2. **Are your international investments subject to exchange rate risk?** It’s important to understand whether your strategy retains or hedges the foreign currency risk inherent in any investment outside your local currency (US Dollar). It’s possible to have a foreign investment that never goes down but still ends up losing money once it is converted back into US dollars.
3. **Are you considering your pension plan (i.e. Cash Balance, Defined Benefit)?**
   1. **Who bears the risk?** - Risk in pension plans is borne by the employer, but in a 401(k) or similar plan that is a “defined contribution” plan, the worker bears the investment risk.
   2. **Have you considered this asset as part of your overall portfolio mix?** These assets play a key role in portfolio design even if you don’t control how they are invested.
   3. **Lump sum or Lifetime income?** Maintain awareness of lump sum distribution options, and compare the lump sum versus a stream of future payments to see what the implied rate of return underlying the payment stream is. Also compare these options to available alternatives on the private market before making any decisions.
   4. **Will your pension payments last?** Monitor the health and funding status of all pension plans over time to track the fund’s ability to pay future benefits. This could impact your decision to take a lump sum or lifetime income. Additional scrutiny may be necessary if funding status is less than 80%.
   5. **Are they making changes to the actuarial assumptions?** Be aware of changes, especially as they relate to the return assumptions used in the calculation. Higher rates of return increase the potential growth but also increase the risk of future funding challenges.

**Level 3**

1. **Are your stock strategies fully diversified?**
   1. **Non-Systematic Risk -** Within a stock investment strategy, the primary sources of risk are systematic (general market risk) and non-systematic (company-specific risk). Systematic risk cannot be diversified away, but non-systematic risk can be reduced through increasing the number of individual equity positions within a strategy. Statistically, at least thirty individual positions are needed to adequately reduce non-systematic risk.
   2. **Sector Exposure -** Classify your individual stock positions into their respective economic sectors and industries. Compare your sector and industry allocations to the relevant benchmark. Depending on your strategy, deviations may be acceptable, as long as they are understood and held with intent. Sector- and industry-level deviations from their benchmark will impact relative performance since economic factors impact sectors differently. For example, low oil prices will impact energy (lower revenue) and transportation (lower cost) companies differently.
2. **Are your fixed-income investments efficient for the current economic environment?** Look up or calculate the duration or interest-rate sensitivity of your fixed-income exposure. The higher the number, the more the fixed-income investments would lose value if interest rates go up. With rates as low as they are, there is risk that future increases could cause longer duration bonds to face significant downside pressure.
3. **Are you at risk of losing your investment in your employer’s Deferred Compensation plan?**
   1. Money invested in an employer non-qualified deferred compensation plan is subject to claim, under certain circumstances, by the creditors of the organization and could be at risk especially during tough economic times.
   2. Have you accounted for this forfeiture risk in how you have allocated your assets across different account and tax types?
   3. Are you monitoring the financial health of the employer over time to maintain a near real-time grasp of how this risk factor is changing?

**There certainly is a lot to consider, isn’t there? If you’d like, the professionals at MPPL Financial are happy to help with a second opinion, 1-800-236-6775.**

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