7 Easy Steps to Give Your Retirement Portfolio an Annual Checkup

A SPECIAL REPORT BROUGHT TO YOU BY

Motley Fool Wealth Management

Dear Fellow Investor,

Whether you're already enjoying a hard-earned retirement… or you're still grinding out those long 9-to-5s to get there… you should most likely be giving your portfolio regular "checkups" to make sure everything is up-to-date, optimized, and working in sync to make sure you're on track for your goals.

Of course, when I say regular, I don't mean monthly or even *necessarily* every few months. Annually is fine.

The real question for everyday investors is, as always, "Okay, great. How do I get started?"

As my good friend Robert Brokamp, CFP®, and head of The Motley Fool's (our sister company) *Rule Your Retirement* newsletter, points out in the article below, there are seven easy steps you can take each year to make sure your portfolio is firing on all cylinders.

I urge you to take a few minutes of your time to give it a quick read. In fact, I did so just yesterday, and I sincerely believe you'll be a better, not to mention *more confident*, investor for it.

On the other hand, if Robert's seven steps just end up feeling like a lot of work to you… or simply something you likely won't ever have the time or dedication to do yourself…

Then I invite you to go ahead and explore our Motley Fool Wealth Management home page at www.foolwealth.com to see if you might be interested in taking advantage of our innovative money management solution that is available *specifically* for time-strapped investors like you.

You see, we launched Motley Fool Wealth Management six years ago with one goal in mind…

To *take off your plate* the hours, or even *days*, of exhaustive research and thought that go into every portfolio buying… selling… and rebalancing decision you're forced to make in order to responsibly maintain your portfolio, so you can enjoy the truly important things in life.

Whether that's spending time with your close friends and family… visiting exotic new locations around the world… simply doing what you most love *more often*… or a combination of all three and more, know that Motley Fool Wealth Management is here to ease your portfolio burden.

My team and I are so proud of what we've created here in Fool Wealth. We'd be delighted for you to be a part of it, and I hope to hear from you soon!

In the meantime, please enjoy Robert's article below, and Fool on.

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Nick Crow, CFA — President, Motley Fool Wealth Management

7 Easy Steps to Give Your Retirement Portfolio an Annual Checkup

BY ROBERT BROKAMP, CFP®

Greetings, Investor. I'd like you to take a few moments to ask yourself these questions:

- Do you know what your investments earned over the past year or few?
- Do you know whether your investments have beaten their respective benchmarks?
- Do you have the right asset allocation?
- Are you saving enough to retire?
- If you're retired, will your money last as long as you do?

Don't know the answers to all those questions? Don't worry — most people don't. Plus, this handy-dandy special report is going to help you answer those very questions, and also put you in a rarefied group of Americans: those who actually take control of their financial futures.

It's too bad more people don't do it, because no one is going to do it for them. Not Uncle Sam (the average Social Security retirement benefit is just over $17,000, assuming you get everything that's promised). Not employers (the traditional pension is disappearing, and your boss probably isn't offering much help with managing your 401(k)). Not estates of older relatives (according to the Federal Reserve's Survey of Consumer Finances, the median bequest is just $69,000 — and financial services firm HSBC says approximately a third of people won't inherit anything).

No, your financial future is up to you. But that doesn't mean you have to do it alone. We're here to help, and giving your portfolio and plan an annual checkup with the following seven simple steps is a great place to start.

CHECKUP STEP #1: CHOOSE YOUR "PORTFOLIO GPS"

To perform a portfolio checkup, you need a tracking system that can take a look at *every* investment you own. Analyzing your entire portfolio will be much easier once all your information is in one place. You may already be able to do this if you use personal finance software such as Quicken, which consolidates all your accounts in one location and can give you a quick snapshot. Many investors also use free online portfolio-tracking tools, such as those offered by Yahoo! Finance, Morningstar, or the Fool's very own Scorecard.

Another option is to use a spreadsheet — the portfolio tracker of choice for many of the heavy-duty investors at Fool HQ. You can create your own or download a free template.

CHECKUP STEP #2: WERE YOUR INVESTMENTS GOOD TO YOU?

There's a reason you don't stick your money under a mattress. You send it to a bank, broker, or mutual fund because you want your money to grow. But unless you evaluate your portfolio at least annually, you won't know if it's growing as much as it should. This all starts with determining how each investment has performed over the immediate, intermediate, and even long-term past, depending on how long you've owned the investment.

The statements from your bank, broker, and/or fund company should provide at least some performance information. If you can view your account online, it will have the most up-to-date numbers, as will the portfolio performance features of personal finance software.

It's very important to distinguish between the "internal rate of return" (i.e., the investments' actual performance) and the beginning and ending balances (which can be a mix of investment performance and the effects of contributions and/or withdrawals). You may recall the story of the Beardstown Ladies, an investment club from Beardstown, Illinois (population 5,766), who sold hundreds of thousands of books by claiming their returns doubled those of the Dow. It turns out that this happened because they counted cash contributions to their portfolio as investment returns; an outside auditor found that the group's real returns underperformed the market.

So when you're evaluating your individual investments, make sure you analyze the returns attributable to investment performance, and not to money you have contributed or withdrawn from your positions.

Furthermore, you want performance for the relatively recent past as well as for as long as you've owned the investment, if possible.

CHECKUP STEP #3: DID YOUR INVESTMENTS BEAT THEIR BENCHMARKS?

Knowing how well your investments performed is a great first step. But there's another question to answer: Was that performance good enough? Just knowing that your large-cap stocks returned 15% in one year might sound good — until you find out that you could have earned 20% with a low-cost, no-brainer S&P 500 index fund. Comparing your investments' returns with appropriate benchmarks is the way to make sure your portfolio's keeping up.

The key here is to ensure an apples-to-apples comparison by matching your investments to an appropriate benchmark. For example, a small-cap value stock fund should be compared with an index of small-cap value stocks.

Look up your investments' performances on Morningstar.com, and you can also see how they compared with similar types of investments. Just click on the Performance tab. For a stock, you'll see how it performed relative to other stocks in its industry as well as to the S&P 500.

As for funds, the comparison will be with other funds with a similar investment objective. Look in the "% Rank in Category" row. The lower the number, the better. For example, a 6 would indicate that the fund's performance ranks among the top 6% of funds that invest in similar types of assets.

Over the long term, about two-thirds of actively managed funds underperform their indexes. If your actively managed fund isn't beating a relevant index fund over a five-year period, it's time to reconsider its presence in your portfolio.

CHECKUP STEP #4: BID ADIEU TO THE DUDS

It's fish-or-cut-bait time. If you have an investment that is losing out to an appropriate benchmark over the years, then it might be time to find a better choice. One or two years of underperformance can be acceptable, since even great investors go through periods where their portfolios lag. But any investment that is lagging over a three-year period should be scrutinized.

Deciding whether you should keep or sell a fund is easy. If a fund manager can't keep up with his fund's benchmark over a period of three to five years, then it's time to consider replacing the fund with a better money manager or a low-cost index fund.

Stocks are a bit trickier. Years of lagging doesn't necessarily mean a stock is the wrong investment for the future. In fact, it now might be more attractively priced than ever. However, you didn't originally buy the stock expecting it to underperform, so it may be time to revisit the reasons you thought the company was compelling, and whether those reasons are still valid.

It's Not Just About Past Returns

While performance is an important consideration when pruning your portfolio, there are other factors to consider. They shouldn't be the only reason to hold on, but might tip the scales if you're not sure which way to go.

- **Taxes:** Even though an investment has underperformed, it could still result in a capital gain if you sell it at a price above what you paid for it and the investment is held in a non-retirement account. While you shouldn't let the tax tail wag the investing dog, you should know the tax consequences before you sell any investment.
- **Sunk costs:** If you paid a large up-front commission, or "load," to purchase a fund, factor that into your sell decision. Keep in mind, however, that most mutual fund families allow you to "exchange" your shares of one fund for another in the same family at no cost (though this is a taxable event if the investment is in a non-retirement account).
- **Selling costs:** If you bought "B" shares of a mutual fund, you may pay a "back-end load" if you sell the fund within a certain number of years of your purchase. However, again, you should be able to exchange your fund for another in the same family at no additional commission.

CHECKUP STEP #5: DO YOU HAVE THE RIGHT ASSET ALLOCATION?

How has your stew of cash, bonds, and stocks fared over the past few years? Are you — or your advisor — making overall asset-allocation decisions that compare favorably with what others are doing? To find out, compare your overall portfolio's performance with a similarly allocated target retirement mutual fund from Vanguard. These mutual funds provide instant asset allocation — a prudent mix of cash, bonds, and stocks based on a general retirement date. The managers of target retirement funds do all the rebalancing for you, and they gradually move into more conservative investments as your retirement date approaches (and then passes). The Vanguard target retirement funds contain only index funds, and a bit less than one-third of the equity allocation is in international stocks.

To give you an idea of how these funds are invested, here are the general allocations of a sampling of Vanguard's target retirement funds:

Allocation	2040 Fund (VFORX)	2030 Fund (VTHRX)	2020 Fund (VTWNX)
Cash	0.74%	1.22%	1.82%
U.S. Stocks	53.8%	44.89%	35.71%
Non-U.S. Stocks	34.67%	28.75%	22.72%
Bonds	10.62%	24.91%	39.44%
Other	0.17%	0.24%	0.3%

Source: Morningstar.com as of 11/30/2019

Here's the way to think of this: You've made the effort to create an asset allocation for your entire portfolio — or paid a financial advisor to do it for you. That takes time and money. You could instead invest in a Vanguard target retirement fund, which charges a paltry 0.14% a year and very likely has a four- or five-star rating from Morningstar. If your portfolio isn't beating the target retirement fund that best matches up with your retirement timeline, then your time and money could be better spent elsewhere.

Depending on the complexity of your finances, determining your overall asset allocation can be a daunting task. You have to look at everything you own across many accounts — IRAs, 401(k)s, dividend reinvestment plans, regular brokerage accounts, secret Swiss bank accounts — and aggregate the information in one place. Again, this task is much easier if you have one financial services provider or use personal finance software. But you can also use a trusty spreadsheet to get an approximation of your current asset allocation.

CHECKUP STEP #6: IS IT TIME TO REBALANCE?

As the markets do their up-and-down thing — as they're prone to do — your asset allocation will get out of whack. At some point, you may want to bring your portfolio back to your original allocation, a process known as rebalancing.

A portfolio that has not been rebalanced can become riskier. Consider this simplified example: On January 1, 2015, an investor decided that a portfolio invested 75% in the total U.S. stock market and 25% in the U.S. bond market was right for her. Fast-forward five years, and that portfolio had changed to nearly 85% stocks and 15% bonds, thanks to the bull market that continued to run in those years. Her portfolio became much more aggressive as she got closer to, or further into, retirement — a time when she theoretically should have been playing it safer.

To restore an appropriate level of risk to your portfolio, rebalance by selling some of the winners and using the proceeds to buy some of the laggards. There's also a moderate "sell high, buy low" component that can boost your returns a bit. Here are some tips on how to do it:

- **Follow the "5/25" rule.** Rebalancing multiple times a year is generally too much; once every year is fine. One guideline to consider was developed by investment specialist and author Larry Swedroe: Rebalance your portfolio when one of your major holdings has grown to become five percentage points higher in your portfolio than your target — or has declined to five percentage points lower. For example, if you decided to allocate 30% of your portfolio to bonds, you'd rebalance if that portion grew to 35% or dropped to 25%. For smaller allocations that make up 20% or less of your portfolio, rebalance them when they've strayed from your target allocation by more than a quarter. For example, if you think 10% of your portfolio should be in REITs, rebalance when they fall below 7.5% or grow beyond 12.5%.

Putting the Right Eggs in the Right Baskets

You've likely heard the term "asset allocation." But you may not be as familiar with "asset *location*," which is all about limiting your tax bill by being smart about which investments should go in your tax-advantaged retirement accounts and which are best to keep out.

The basic theory goes like this: Fill your tax-favored retirement accounts with the most tax-inefficient investments (i.e., the investments that generate the biggest tax bills) and use non-retirement accounts for investments that are already tax-efficient. Here's a very general order of investment tax efficiency, from lowest to highest:

- **Real estate investment trusts (REITs):** The dividends are taxed as ordinary income, and price appreciation incurs capital gains taxes.
- **High-yield (aka junk) bonds:** The interest is taxed as ordinary income — the highest rate possible (as high as 37%) — and junk bond funds have high turnover, which also generates taxes.
- **Stocks that you buy and sell within a year:** Short-term capital gains are taxed as ordinary income.
- **Corporate bonds, certificates of deposit, and money markets:** The interest is taxed as ordinary income.
- **High-turnover stock mutual funds:** A fund that frequently buys and sells investments generates lots of taxes for shareholders, even if they hold on to the fund for years.
- **Exchange-Traded Funds (ETFs):** These funds typically track an underlying index and tend to have lower turnover than more actively-managed mutual funds, which translates to fewer tax liabilities.
- **Low-turnover, index, and "tax-efficient" stock mutual funds:** Funds that tend to buy and hold investments or invest specifically with the aim of keeping taxes low are gentle on shareholders' tax bills, at least until they are sold.
- **Stocks that pay dividends and that you hold for many years:** Profits made from stocks you've held for more than a year are taxed as long-term capital gains, at a rate of 15% for most Motley Fool members, as are qualified dividends.
- **Treasury Inflation-Protected Securities (TIPS):** The interest is taxed at the federal level as ordinary income but is free from state taxes. However, the "phantom income" from the inflation-adjusted principal is taxable every year.
- **Treasury bonds:** The interest is taxed at the federal level as ordinary income but is free from state taxes.
- **Stocks that don't pay dividends and that you hold for many years:** The same favorable long-term capital gains treatment, and no dividends to be taxed.
- **Municipal bonds:** The interest is free of federal taxes and usually free of state taxes when owned by residents of the municipality that issued the bonds.

That's a very general ranking; the degree to which an investment is taxable to *you* will depend on many factors, including the specific investments, your investment behavior, and your tax bracket. But generally speaking, investors should fill their retirement accounts with the investments at the top of the list and work their way down.

- **Rebalance with cash flow.** If you're still saving for retirement, put new cash contributions in underweighted and better-valued investments. If you're retired, sell your overweighted assets when it comes time to raise cash.
- **Factor in account type.** Studies indicate that the order of account withdrawals in retirement should be taxable accounts first, then traditional tax-deferred retirement accounts, and Roth accounts last. You also have to factor in required minimum distributions (RMDs) from traditional accounts at age 70½. Keep the RMDs in mind if you're retired and deciding which investments in which accounts should be sold.

CHECKUP STEP #7: IS YOUR RETIREMENT PLAN BUILT FOR THE LONG HAUL?

You're not doing all this saving and investing just for the fun of it — you have a goal in mind. For most people, that goal is retirement. But are you saving enough? How much income will your current plan produce? If you're already retired, how long will your money last?

Those are crucial questions that should be answered every year as part of a portfolio review. After all, the value of your life savings will change depending on how your investments performed, and that change in value will have a direct impact on your future or current retirement security.

One way to answer those questions is to do some old-fashioned number crunching with some new-fashioned tools: online retirement calculators. Like all tools that attempt to project the future, these have their limitations.

You've no doubt seen retirement calculators on the Web or as part of personal finance software. These calculators can be broken down into three basic types: average-return calculators, Monte Carlo calculators, and historical calculators. Let's look at each type, and highlight an example.

1. Average-Return Calculators

You tell the calculator how much you think your portfolio will return each year, and it projects whether you'll have enough money, factoring in your preretirement savings plan, your in-retirement spending plan, and your other sources of retirement income (such as Social Security or a pension).

Example: The Fool's "Am I saving enough? What can I change?" calculator.

Benefits: The Fool's own calculator considers more variables than most other tools, even allowing you to break up your retirement income into three periods in case you intend to spend more or less earlier or later.

Drawbacks: This calculator has many inputs — and many opportunities to misunderstand exactly what information it wants. Also, this calculator assumes that variables such as investment returns will remain constant

throughout the rest of your life, which of course will not be the case. A portfolio that drops 5% one year and increases 20% the next has the same average annual return as a portfolio that returns 9% a year. But those differences can mean big bucks when applied to real-money portfolios and their inflows and outflows.

2. Monte Carlo Calculators

Instead of assuming your portfolio will return the same amount each year, Monte Carlo calculators subject your portfolio to various hypothetical scenarios and give the probability that your portfolio will last, given your asset allocation and withdrawal rate.

Example: T. Rowe Price Retirement Income Calculator.

Benefits: The Retirement Income Calculator is straightforward and easy to use. The results it provides are based on 1,000 market simulations, so you get a good idea of how likely it is your savings would prevail in various conditions.

Drawbacks: You have to register with the site, though it's free.

3. Historical Calculators

These calculators use actual historical returns to see how your portfolio would fare.

Example: The FIRECalc.

Benefits: The FIRECalc starts by assuming you retired on Dec. 31, 1871, and estimates whether your portfolio would have survived the subsequent markets. Then it starts over, assuming you retired the next year (1872), and so on. It also has ways to account for withdrawal adjustments, windfalls, and one-time expenses down the road.

Drawbacks: This isn't a glitzy tool developed by a big-budget financial services firm, but the work of one man — supported by a dedicated online community. It's not the prettiest thing on the Web and may take some time to learn how to get around.

So which calculator should you believe? None of them — and all of them. No contraption of mathematical wizardry can account for all the moving parts that'll determine your retirement, and no one but that Great Portfolio Manager in the Sky can predict the future. But if you run your scenario through many of the tools, some trends should emerge.

THE CHECKUP'S OVER; NOW FILL THE PRESCRIPTION

If you have taken the steps recommended in this report, you are a veritable financial planning hero. You know how your investments have done, whether they're good enough, and whether all your work will eventually result in the realization of your financial goals.

Only one step remains: Do something with what you learned. If you have tax-inefficient investments in your non-retirement accounts, get them shelter. If you're not saving enough to retire when you want and how you want, change the amount you contribute to your work retirement plan or sign up for an automatic investment plan into an IRA. If you've found that your mutual funds can't keep up with their benchmarks, find solid replacements. Take action to improve your plan. Set your portfolio up for successful wealth generation. Then, a year from now, perform another checkup.

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DOES THAT SOUND LIKE A LOT OF WORK? HERE'S A SOLUTION YOU MIGHT PREFER...

If you have taken the steps recommended in this report, you are a veritable financial planning hero. You know how your investments have done, whether your portfolio is good enough, and whether you're well-positioned to realize your financial goals.

Of course, if this level of portfolio upkeep all sounds like a bit too much work for you, there is another solution you should know about...

Motley Fool Wealth Management now makes it possible for time-strapped investors like you to maintain a Foolish philosophy and approach to investing... while actually handling all the trades and (far more important) the decision-making *behind* those trades for you!

Here's how it works. Using what's called a Personal Portfolio, Motley Fool Wealth Management actually allows Fools like you to put their investment portfolio on "autopilot."

Which means that Fool Wealth's dedicated team of portfolio managers (all of whom cut their teeth coming up through the investing ranks of The Motley Fool before moving downstairs to work for Fool Wealth) will manage your portfolio for you, including the buying... selling... and rebalancing.

Additionally, for clients with at least $1 million in assets, you will have access to our highly trained in-house team of Certified Financial Planners.

If all of the above sounds like something you might be interested in learning even a little bit more about, I urge you to go to the Fool Wealth home page at www.foolwealth.com for a copy of our brochure, a slew of explanatory videos, additional reports, a FAQ, and other content about Motley Fool Wealth Management.

If you're ready to save yourself the time, hassle, and stress of managing your portfolio... and you'd like our dedicated team of portfolio managers to do the heavy lifting for you, simply visit our website at www.foolwealth.com to learn more.

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