



FAIRMAN GROUP

FAMILY OFFICE

Financial Planning | Investment Advice | Tax Preparation & Tax Planning



CONSTRUCTIVE PORTFOLIO ACTIONS: PORTFOLIO IMPROVEMENTS AMID COVID-19

THOUGHT LEADERSHIP PERSPECTIVES

BY DOUG MORISOLI, CPA, CFA, CFP®

The COVID-19 pandemic has had a significant impact on global economies and world markets (to say nothing of the health tragedies). In volatile times like these, human nature causes many investors to want to sell their portfolios for fear of major losses—short-term and potentially long-term. Before we delve into this topic further, we want to remind clients about a few core tenets of portfolio construction and asset allocation.

REAFFIRM YOUR ASSET ALLOCATION, TIME HORIZON, AND RISK TOLERANCE

The primary determinant of portfolio return is your asset allocation to the major asset classes – stocks, bonds and cash. The specific allocation targeted to each asset class is largely influenced by the timing of your cash needs and your risk tolerance. Among the major asset classes, stocks provide the highest expected returns for the long run, but that return is accompanied by the highest short-term volatility. Your allocation to stocks should consider the ongoing potential for extreme volatility and the inevitable broad market crashes that

occur with some regularity. Long-term investors should have a time-horizon of at least seven to ten years when allocating funds to stocks. The allocation to bonds should have a time horizon of at least two years. Investors should consider dedicating an amount to bonds that is enough to cover expenditure needs for at least three to five years, as a safety net to weather extended equity market downturns. Funds that will be needed for short-term expenditures, within two or three years, should be held in cash or cash-equivalents. For clients, we tailor your allocation along these guidelines refined by detailed analysis of your long-term cash flow and projected net worth.

This method of portfolio construction enables investors to leave the equity portion of their portfolio undisturbed, or better yet, improved as noted below, while markets are down significantly. Historically, market downturns have generally recovered back to prior levels in under six years. We believe that this type of portfolio construction should help clients resist human instincts that can be destructive to long-term wealth.

Since WWII, stock market declines in bear markets have averaged 34% (ranging from 22% to 57%). If recent stock market volatility has been unsettling to you, it may indicate that your asset allocation may be too aggressive for your risk tolerance. Volatile markets can reveal your true risk tolerance. If you find yourself fighting an urge to sell during downturns, take a moment to reassess. Consider your income sources, living expenses and the time horizon until withdrawals are needed for your portfolio. A course of action that could devastate your wealth would be to watch markets continue to fall well beyond your risk tolerance levels, flinch, and then abandon your allocation strategy to sell out at the market bottom. Adhering to your investment policy requires: 1) reaffirming that the course you are on is truly appropriate for your risk tolerance and 2) having the discipline for ongoing rebalancing to adhere to your asset allocation targets in both bull and bear markets.

REBALANCING

Many portfolios may have drifted away from their targeted asset allocation during the recent market volatility. While it can feel counter intuitive, we recommend investors consider rebalancing back toward their target. This discipline encourages a “buy low, sell high” process, and may also help to remove some of the emotion from investing during these significant market moves. It may also be an opportune time to deploy available (not required for spending within five years) cash into the equity market to bring portfolios up to target.

TAX LOSS HARVESTING

The recent market volatility can bring an opportunity for loss harvesting, where an asset is sold at a loss and replaced with similar, although not substantially identical asset. Investors must be careful not to perform a wash sale, where an asset is sold at a loss and repurchased within thirty days. A wash sale would negate the investor's ability to recognize the loss. With mutual

funds and ETFs, investors can sell a current holding at a capital loss and purchase a similar fund within the same asset class, so they do not lose market exposure for thirty days while waiting out the wash sale holding period.

“UPGRADE” FUNDS

Along with loss harvesting, this may be a good time to re-evaluate the holdings within portfolios. Given the steady increase markets have seen over the past several years, many portfolios hold securities that until recently had large unrealized capital gains. Due to a variety of factors, these holdings may no longer be the first choice vs. their peers within the same asset class. Investors may have been holding on to those securities because selling them would have created a large tax liability. This may be a time to sell the asset and “upgrade” for a mutual fund or ETF that currently compares better to its peers while paying little to no tax on the transaction. In this environment, it is also important to evaluate fixed income holdings. Investors should ensure they have the appropriate credit quality and duration for their risk tolerance.

Generally, our investment advice would be to “stay the course” and rebalance towards your elected target allocation. However, we realize that in times of extreme market volatility, clients may be re-evaluating their risk tolerance.

PLEASE CALL OR EMAIL YOUR FAIRMAN GROUP FAMILY OFFICE SERVICE PROVIDER IF YOU WOULD LIKE TO DISCUSS YOUR SPECIFIC PORTFOLIO CONCERNS. WE CAN HELP YOU DECIDE IF YOU STILL HAVE AN APPROPRIATE PORTFOLIO ALLOCATION AND IF ANY OF THE ABOVE STRATEGIES ARE APPROPRIATE IN YOUR SITUATION.

ABOUT FAIRMAN GROUP FAMILY OFFICE

Fairman Group Family Office is a fee-only financial planning firm, located in Chesterbrook, PA, offering financial planning, investment advice, tax preparation and tax planning services to individuals and families in the greater Philadelphia area since 2002. We are a fiduciary who serves you with skill, care, prudence and diligence through a disciplined and integrated process. We do not sell products or insurance and do not accept commissions, referral fees, loads/12b-1s, trails, or any other compensation from outside sources. Investment advisory services are offered through The Fairman Group LLC. The Fairman Group LLC is registered with the Securities and Exchange Commission under Section 203(c) of the Investment Advisers Act of 1940.