BUSINESS

Milwaukee Journal Sentinel
JSOnline.com

Sunday,
June 24, 2018

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Don’t let former Fed chief Bernanke scare you

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Like usual, there’s no shortage of things to worry about when it comes to your investments.

Recently, former Federal Reserve Chairman Ben Bernanke was quoted as saying 2018’s fiscal stimulus, in the form of increased government spending and tax cuts, comes at “the very wrong moment.” After soaring in 2018 and ’19, Bernanke believes, the U.S. economy in 2020, like “Wile E. Coyote is going to go off the cliff..."

Meanwhile, it’s been nearly a decade since the Great Recession — a period remembered for its gut-wrenching stock market decline. That means we’re in the midst of a nine-year bull market. Investor sentiment has improved dramatically and investors are now more likely to complain about their portfolio not growing fast enough.

Instead of worrying about what’s coming next, stay focused on your long-term investment strategy and don’t allow the fear of loss, or being left behind, dissuade you from that strategy.

The past decade reminded us how difficult it is to predict short-term changes in market direction. If you predicted the market swoon 10 years ago or saw the current bull market in U.S. tech stocks coming, you certainly don’t need my advice. But if you’re like the rest of us mortals, the best approach is a long-term investment strategy you can follow during the unpredictable market environments that lie ahead.

Diversification

The most important strategy for successful long-term investing is diversification. The primary goal of diversification is to control the amount of risk in your portfolio. Because major shifts in markets are impossible to predict consistently, do what the pros do and diversify your portfolio to allow for investment in risk assets, yet help defend against major losses in any one asset class.

A portfolio is diversified when it contains assets from different asset classes that have different economic drivers of return.

Bonds have the lowest expected long-term rate of return, but perform well during difficult and uncertain economic times.

Inflation-sensitive assets perform well during periods of rising rates and inflation and include categories such as commodities, TIPS bonds and real estate.

Stocks have the highest long-term expected rate of return. They generally perform well during times of economic prosperity but as a group are the most volatile.

Your allocation among these three categories is a function of your personal risk tolerance, time horizon and rate of return goals.

Rebalancing

The second important strategy of successful long-term investing is rebalancing. This strategy is premised on the concept of "mean reversion" — that which goes up tends to come down, and that which goes down tends to come back up. In other words, it’s a strategy that forces you to buy low and sell high.

If your portfolio has prospered in the current bull market, there’s a good chance it has become overweight with U.S. stocks due to their recent strong performance. If that’s the case, have the discipline to rebalance your portfolio, taking some of your recent stock gains and moving them into the areas of your portfolio that have underperformed.

For example, if you originally set your portfolio to be invested 60 percent in stocks and 40 percent in bonds, and after a long bull market your portfolio shifted to 75 percent stocks and 25 percent bonds, rebalancing requires you to sell enough of your stock fund holdings and buy enough of your bond fund holdings to bring your portfolio back to its original 60/40 mix.

Generally, you want to rebalance when your portfolio allocations get more than 10 percent out of balance from your original target weight. Studies have shown rebalancing too frequently, however, is not optimal; I recommend auto-rebalancing not more than once every two to three years.

Above all, following a disciplined strategy of a properly diversified portfolio with periodic rebalancing will help you resist the urge to “chase the hot dot” or to bail out the next time the markets experience a sharp sell-off.

Some are worried about not keeping up with their colleague’s tech-heavy portfolio and being left behind, while others are convinced that Bernanke is right, and the economy is about to plunge off a cliff.

No one knows what the future holds, and using your retirement savings to wager on the market’s near-term direction is a fool’s errand. Now is a good time to reevaluate your long-term investment strategy, and check to be sure you’re properly diversified to protect against the next major swing in the market.

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