New Year Portfolio Resolutions

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HAPPY NEW YEAR to our clients, friends, and colleagues! At the beginning of 2022, my business partner Albert Fox (Managing Director, Fox, Penberthy & Dehn at Morgan Stanley) wrote in JerseyMan about the pitfalls of herd behavior and mental accounting. He warned, "It took years for investors to recover from the bursting of [the internet and housing] bubbles, yet many of those same investors are now crowding into expensive stocks, low credit quality bonds, and emerging asset classes like cryptocurrency." That sounds like a time capsule, but it was only twelve months ago that many indexes were trading near record highs.

Stubbornly high inflation, Russia's invasion of the Ukraine, and the bankruptcy of a large cryptocurrency exchange drove headlines in a dismal 2022 for most asset classes. Investors who followed the herd in 2021 were met with disappointment in 2022 as stocks, bonds, and cryptocurrencies experienced historically large declines. Inflation ate away at safe havens like cash despite one-year Treasury yields rising to their highest rate in fifteen years.

This begs the question: should I stay the course, or change my strategy? The answer to that question is dependent on multiple factors, including what your current portfolio looks like, what your investment objectives are, and what your baseline allocation is. One of the most common mistakes we see is picking investments based on last year's performance. Investors who are still working sometimes consult a matrix of 401(k) investment funds and recent returns with the assumption that the next year will be the same as the last one. 2022 was a great example of why that strategy doesn't always work.

If you don't have a baseline allocation, now may be a good time to establish one. If you are in or nearing retirement, a baseline allocation can help set the tone for long-term risk and return assumptions. Even complex stochastic modeling software requires these inputs, so we view the baseline as a critical starting point for a client financial plan. I believe your actual allocation should hover around the baseline over time to ensure validity of the plan.

An exceptional financial advisor should routinely assess your risk tolerance through conversations, questionnaires, and what-if scenarios. The risk assessment should translate to a baseline that aids your objectives and allows you to sleep at night, which means different things to different people. Some investors view themselves as gamblers who can tolerate even the largest portfolio fluctuations, but others wince at the slightest loss on their account statement. Most people are somewhere in between, and a risk tolerance assessment will help establish a baseline allocation that is appropriate for you.

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The baseline typically does not fluctuate much, but tactical changes can be made along your investment journey. Perhaps tech stocks reach valuations similar to 1999 or 2021 and a sector-specific adjustment can make sense, or there are warning signs of economic recession and an overweight to high quality securities becomes prudent. What investors should avoid are rash decisions that stray from the baseline, such as selling large swathes of the portfolio when the markets are down, or adding significant risk when the markets are at all-time highs.

Contact a qualified financial advisor if you don't know where to start. For additional information on herd behavior and our market outlook, Fox, Penberthy & Dehn's video series is available to the public on our website (advisor.morganstanley.com/fox-penberthy-dehn). Remember that your actions today will impact your family's financial future for years to come, so there is no time like the present to start planning.

SOURCES: Paragraph 1: See separate PDF, which appeared in the January 2022 issue of *JerseyMan Magazine*. Paragraph 2: https://home.treasury.gov/policy-issues/financing-the-government/interest-rate-statistics.
Paragraph 6: http://www.econ.yale.edu/~shiller/data.htm