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Evaluating Performance: Monitoring Markets and Goals

Evaluating the performance of a globally diversified portfolio cannot be narrowed down to the popular indices reported in the news each day. While these are important benchmarks, they do not really help an investor answer the question, "How well is my portfolio doing?" In order to answer that question, we prefer a set of comparisons.

The first question to ask is "Did I get paid to take risk?" Nearly every investment carries a risk of loss. Investors understand the tradeoff of potential short-term loss in exchange for expected longer-term gains. Over a meaningful investment period, you want to know that you have done better than having remained in cash. The 3-month US Treasury Bill, a proxy for cash, is typically used to represent a "riskless" investment. This label results from its short maturity and the expectation that the US Federal Government will cover its financial obligations.

The next important question is: "Did I increase my purchasing power?" This is an inflation based question and on many investors' minds right now. The broadest measure of inflation is the Consumer Price Index (CPI-U). Over the long term, diversified portfolios have tended to provide inflation protection. We have been fortunate to have experienced lower than average inflation for the past decade. The possibility of future higher inflation could make this a more important measure to monitor.

Of course, we need to ask: "Did the portfolio capture the returns available in the broad markets?" A diversified portfolio should not be compared to just one or two indices popular in the news, such as the Dow Jones Industrial Average (DJIA) or the Standard and Poor's 500 Stock Index (S&P 500). Rather, it is appropriate to create a portfolio benchmark that represents the holdings in your portfolio. If your portfolio has allocated to emerging markets at 5%, for example, then an emerging markets index should be represented in your portfolio benchmark at the same weighting.

Finally, we have the most important financial planning question: "How has my portfolio progressed towards meeting my goals?" A portfolio built in conjunction with a financial plan seeks to earn a specific rate of return averaged over the portfolio's time horizon. If there are short-term differences between expected rates and actual rates of return, it might be necessary to make course corrections along the way. Some of these adjustments happen naturally with routine portfolio rebalancing.

Increasingly, investors are asking a relatively new question: "How well does my portfolio align with my values?" Such values questions often involve environmental, social, and governance (ESG) or perhaps religious elements. These items can be a bit more difficult to track. However, they can also be the most meaningful to investors.

In the end, no one method of evaluating performance works in isolation. While the news attempts to streamline its reporting to fit soundbites and headlines, investors' goals tend to be more complex. Accordingly, portfolio monitoring needs to capture the multifaceted elements important to you.

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Diversification does not guarantee a profit or protect against loss in a declining financial market.

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