LEWIS
WEALTH MANAGEMENT

Quarterly Newsletter

1st Quarter 2021

April 12, 2021

Market Data as of March 31, 2021

		YTD 2021
U.S. Equities	Russell 3000 ETF	6.29%
International Equities	MSCI EAFE ETF	3.48%
Emerging Markets Equities	MSCI Emg Mkts ETF	2.08%
U.S. Bond Market	Barc Agg ETF	-3.39%
U.S. Bond Short Duration	Barc U.S. 1-3 Year ETF	-0.09%
Hedging Strategies	Credit Suisse Hedge Fund	2.10%
Real Estate	iShares U.S. Real Estate ETF	7.73%

Executive Summary

Correctly building a portfolio is a top-down process, not a bottom-up one.

Too often investors collect investments that look and feel good to them. They tend to pick the same things over and over again.

While this may feel correct, it results in an obvious lack of coordination and diversification.

Try building your portfolio from the top down instead of the bottom up using these steps:

First, decide which asset classes to include.

Second, decide the percentage to assign to each asset class.

Third, select investments to fill each asset class.

Fourth, monitor performance and rebalance.

If you need help evaluating your portfolio, please give us a call.

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My Dress Shirt Problem and Maybe Your Portfolio

When I make my weekly trip to the cleaners to pick up my dress shirts, I notice that most of them are blue and white with some sort of pattern. When I put them in my closet, I see more of the same. When I go to the store to buy more shirts – you guessed it – I am drawn to blue and white patterned shirts. The colors and patterns look good to me, and I like to think that I look good in them.

Many investors inadvertently do the same thing. For example, they like technology stocks. They think that Tesla, Apple, Facebook, Amazon, Netflix, and Google are great companies with lots of growth potential (and they are). They may even know something about technology, or they use and appreciate it. In their 401(k), they have a large allocation to mutual funds, like the "ABC Growth Fund" or the "Technology Growth Fund." They read news stories about Tesla or see ads on television for the newest Apple device. Then they buy the stocks of these companies**.** ***Over time, the collection increases, but the theme remains the same.***

At the end of the day, these investors have a portfolio of blue and white patterned shirts. They like what they see, until the technology sector has a pullback, like the tech bubble in 1999. Then they are very unhappy with the large losses in their portfolios. They wonder

how all those wonderful companies could have performed so poorly at the same time.

These investors are not alone. For others, it's real estate. They like it, they can touch it, they have their own homes and feel they understand it, and it has performed well recently. So, they invest almost all their net worth in that asset class. For others, it's precious metals, or maybe they are very attracted to high-yielding bonds or dividend stocks as they search for income to support their retirements.

The problem is an obvious lack of diversification. When their favorite sector eventually gets hit (and it always happens), they take an oversize hit to their net worth. Painful adjustments to their retirement plans must be made. These investors build their portfolios from the bottom up. That is, they go around collecting individual investments that look good to them at the time, often with very little due diligence or thought. They are overconfident. ***They end up with an uncoordinated collection of similar investments that do not work together.*** They are unprepared for volatility and rapidly changing market conditions.

Correctly Building a Portfolio from the Top Down

Investors should build a portfolio from the top down, not the bottom up. It goes something like this:

Step One: Decide which asset classes to include. Asset classes can mean many different things, but the most basic asset classes might include U.S. stocks (large, mid-cap, and small), developed international stocks, emerging markets stocks, real estate, and bonds.

Step Two: Decide the percentage to assign to each asset class. This depends on your goals and risk tolerance. It pays to remember that risk and return are ***always*** related.[1] For example, stocks have the potential to provide higher returns, but they also have higher risk. Bonds have a lower risk profile, but they also have lower expected returns. Some portfolio managers start with a portfolio of 60% stocks and 40% bonds, for example. ***This is the most crucial step in the whole process and will be the single largest factor in determining your long-term performance.***

Step Three: Select investments to fill each asset class. Here is where you get to pick the funds, exchange-traded funds, stocks, real estate investment trusts, and other investment vehicles to fill your asset classes. I believe that each asset class should have a solid diversified core. For example, the core of your U.S. stock allocation may be an index fund that invests in the S&P 500. This gives you great diversification from the start. After that, you can fill in optional satellite strategies around the core that reflect your beliefs about the markets. This would be a good place for a smaller holding of that technology growth fund you want to invest in.

Step Four: Monitor performance and rebalance as necessary.

Review All of Your Investments

I recommend that you collect the statements from all your investments accounts, including your brokerage and 401(k) accounts. What do you see? Is there a theme to your portfolio? Is your overall portfolio well diversified? Is it a portfolio built from the top down around an asset allocation, or is it a collection of investments built from the bottom up over time? Do all your investments work together? Are they consistent with your risk tolerance and long-term financial objectives? Are you ready for volatility?

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[1] If someone tells you that an investment earns a higher rate of return with lower risk or has lower risk with a higher rate of return, proceed with great caution. You are being sold something that may been harmful to your financial health.

Don’t follow my example and buy more blue and white patterned shirts.

If you have questions or concerns about your situation, please give us a call at (855) 353-3800.

Thank you,
Austin Lewis

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