7 Rules to Power Your Investment Portfolio

The portfolio concept is easy to grasp, but what goes into it can be confusing.

By Lou Carlozo
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Finding the way.

Modern portfolio theory dates to 1952, when Harry Markowitz developed an investment paradigm that has influenced countless financial advisors since. The economist won a Nobel Prize for his work – but who influenced Markowitz? Turns out the Bard was on Markowitz' reading list, as he quoted "The Merchant of Venice" in a 1999 paper: "My ventures are not in one bottom trusted, nor to one place." "Clearly," an admiring Markowitz wrote, "Shakespeare not only knew about diversification but, at an intuitive level, understood covariance." You need not worship a playwright, professor or pundit to understand how diversification creates a solid portfolio. What does the path to one look like? Here, experts share how to get there.

Have a written financial plan.

Lacey Cobb, director of advice solutions at Personal Capital, no doubt nails how some readers will react: "Before you roll your eyes," she says, "we aren't claiming by simply writing your goals down you dramatically improve your chance of success. Your financial goal plan should be a living document that states clear and measurable goals and includes steps to accomplish them." Indeed, "Creating a written financial goal plan is arguably the most important first step any new investor should take."

Consider real estate.

While stocks, bonds and exchange-traded funds constitute building blocks of strong portfolios, “Remember the protectionary power of owning uncorrelated and alternative assets,” says Lei Farrand, director of capital markets at Kingbird Investment Management. “Value-added real estate combines bond-like attributes of current income and potential for capital appreciation, much like dividend-paying stocks and ETFs, but often with less volatility.” Where to look? “Asset classes such as apartments are particularly defensive, further insulating a portfolio against a broader market decline,” she says.

Pay yourself first.

“Put a small percentage of every paycheck into an investment account," says Tracie McMillion, head of global asset allocation at the Wells Fargo Investment Institute. Automatic transfers and investing mean “you don’t have to decide whether to save and invest.” Among the benefits, “You grow your account over time through contributions that increase as your pay increases,” she says. “And second, you contribute even when markets are correcting, which is the hardest – and best – time for investors to buy.”

Determine your retirement size.

Is it a cliché to say one size doesn't fit all? Not when it’s retirement. “The whole is greater than the sum of the parts and in financial planning it's no different," says Michele Lee Fine, president at Cornerstone Wealth Advisors. "We have access to the same investment options – however, the coordination and integration of your plan is integral in meeting objectives. … A customized solution is always best and requires meeting with an expert who can guide you through the process.”

Steer clear of investor envy.

How about that big bitcoin spike? Or those media retrospectives on high-tech stocks that have multiplied 300 times? Don't dwell on them. "Stay diversified no matter what your neighbor is doing," says Mason Williams, chief investment officer of Coral Gables Trust Co. In other words, ignore those bombastic, celebratory cannons and stick to your guns.

“Staying diversified and sticking to your long-term plan is the best recipe for success, while never trying to hit a home run."

Watch those taxes.

Seta Keshishian, a financial advisor with JSF Financial, relates this anecdote as a cautionary tale: “A new client came in with a $4 million portfolio which had handsomely appreciated over the years," she says. "The problem: 80% was in equities – far too risky for his stage in life, further exacerbated by $2 million in unrealized gains. Gains are good. But letting the positions ride all these years, this investor faces a huge tax hit as we reduce portfolio risk.”

Understand the basics of portfolio power.

"Sophisticated models developed by rocket scientists may give professional money managers an edge in the highly competitive financial industry, but knowledge of basic investment facts and portfolio theory will usually suffice for ordinary investors," says Hui Guo, finance professor at the University of Cincinnati and former senior economist with the Federal Reserve Bank of St. Louis. Surprisingly, this boils down to two foundational elements: "stock market index and Treasury bills, with the stock weight increasing with an investor’s risk tolerance."

Rules to power your investment portfolio.

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- Consider real estate.
- Pay yourself first.
- Determine your retirement size.
- Steer clear of investor envy.
- Watch those taxes.
- Understand the basics of portfolio power.