Crafting a Portfolio Aligned with Your Financial Goals

The importance of coordinating portfolio construction with a long-term financial plan.

Constructing an investment portfolio that is thoroughly closely integrated with your financial goals is essential. Close coordination of the two allows you to create a blueprint for success to help meet your financial goals over the long term.

Even though most of us recognize the value of creating a long-term investment strategy,, some investors immediately focus on which stocks, bonds, or other investments to buy and sell when opening an account. But before you make these decisions, it's important to examine your goals — whether it's securing a comfortable retirement, funding your children's college savings, or making an impact in your community through philanthropy.

A goals-based approach to portfolio construction enables you to design the right type of investment strategy to ensure you reach your goals. Let's look at the most important steps in creating a personalized, effective wealth management plan.

Start with the big picture

Developing an investment plan begins with defining your goals. It's important to sit down with your advisors — perhaps on multiple occasions — so they can develop a deep understanding of what's most important to you and your family.

Some of the questions to consider include:

- What is your vision for the future?
- What are your financial goals?
- What family history do you wish to preserve?
- What type of legacy and values would you like to pass on to future generations?
- What risks need to be considered?

The way you hold your assets may also need to be considered. Some individuals and families may maintain the bulk of their wealth in illiquid assets, such as a private business or real estate. These assets are part of the investment portfolio and need to be considered in the overall risk analysis and portfolio construction process.

For instance, a business owner with the majority of her wealth residing in a closely-held business may want to be more conservative with liquid investments — as private businesses represent a greater potential

Key Takeaways

Identify your life goals, which will serve as the benchmark for evaluating the performance of your investment portfolio.

Your investment strategy should begin with a comprehensive portfolio approach that takes into account all liquid and illiquid investable assets.

Tactical shifts in allocation can proactively capitalize on market developments but should be implemented within the framework of a long-term strategic allocation plan.

downside as a large illiquid asset. But a real estate investor with a large portfolio of stable, income-producing properties may invest his liquid investments more aggressively to gain more upside potential.

When you start by understanding the big picture, you can develop a comprehensive wealth management strategy that integrates your investments and complements your overall goals.

Define and mitigate risk

Risk is a commonly misunderstood financial term. Risk is not volatility, which is defined as the movement of asset prices for a certain period of time. Volatility may cause risk, but it is not risk. Rather, risk is the chance that your actual outcome will be different from your desired outcome.

In order to properly identify and assess risk, you first need to know your desired outcome. This begins with understanding and writing down your goals and objectives. Simply put, risk is any impediment to reaching your goals.

To define and mitigate risk to your financial plan, you typically will work with your advisors to outline the different types of risk that might derail your plan. This includes engaging in contingency planning or "what if" scenario analysis to draw out various sources of risk.

Some of the types of risk you may need to consider include:

Market Risk	**Inflation Risk**	**Longevity Risk**	**Liability Risk**
The risk of losses in positions arising from movements in market prices.	The uncertainty over the future real value (after inflation) of your investment.	The possibility of outliving your assets.	Reviewing the ownership structure of assets to minimize risk from litigation or lawsuits.

Establish proper benchmarks

After considering goals and potential risks, it is essential to establish the appropriate benchmarks. Typical benchmark discussions involve the comparison of "relative" versus "absolute" portfolio returns, but that shouldn't be the main emphasis.

The focus should be your goals — whether you can retire as planned, give to your children, or buy that vacation home. Life goals are what matter the most. So investment performance should be analyzed through a lens of whether it's enabling you to achieve your specific goals.

For example, consider major market downturns like the ones in 2000–2002 or 2008–2009. Knowing that your portfolio is down less than the overall stock market index is little consolation when the market is being pummeled and you find out that you will have to work another three years to retire as a result.

To properly evaluate investments and make informed investment decisions on an ongoing basis, you need one thing: context. What does a loss of this magnitude mean for your financial situation? How does it relate to your goals? Are you still able to meet your income needs? If yes, can you afford to weather the downturn? If no, what changes can you make?

But the point is you can put it into context. You have a framework to answer the questions: "How does this affect me?" and "What now?" Having a plan in place that connects life goals with portfolio allocation enables you to be proactive rather than reactive when it comes to financial decision making.

Portfolio construction and ongoing management

Now that you have established goals, defined the risks, and set the proper benchmarks, it's time to construct your portfolio. Portfolio construction is defined around your needs and goals and reflects current income needs, future requirements (e.g., educational expenses, health care needs, retirement), and philanthropic and legacy goals. In addition, it ensures that there is liquidity to meet known requirements, which may be short term and to provide a safeguard for unexpected contingencies. In such cases, a portion of the portfolio can be invested in stable instruments to ensure cash is available when needed.

Portfolios are constructed with a strategic asset allocation to address the individual's needs. Most portfolios include a mix of return seeking and risk-mitigating strategies, that are designed to lessen market risk while achieving a more stable investment experience over time.

Properly applied, alternative investment strategies can enhance the overall portfolio return or reduce overall volatility, especially when strategies that possess lower correlations to traditional investments such as stocks and bonds are used.

Strategic allocations by their nature tend to change more slowly unless there is a change in an individual's needs or risk profile. When refinements to the strategic allocation are made, they often reflect large-scale national or worldwide events that change the overall market outlook for various asset classes and their associated risk and return characteristics. In addition, the strategic allocation may be modified to address changes in your goals and priorities.

Within this strategic framework, tactical allocations are used to respond to current or anticipated market fluctuations. Tactical strategies are typically implemented with a six- to twelve-month time horizon although the decisions are monitored on an ongoing basis to ensure they remain consistent with the outlook and rationale for implementing them. History suggests that even modest tactical changes can have a meaningful and positive effect on overall returns.

Your vision, your plan

Long-term investing success starts with two essential ingredients: Knowing where you want to go and mapping out a plan to get there. At Key Private Bank, we work closely with you to create a plan that serves your unique vision with strategies specifically designed to meet your goals and risk profile. And we stay on top of changing circumstances to ensure that your plan and investment portfolio remain closely coordinated at every step along the way.

For more information about coordinating your investment portfolio with your long-term goals, contact your Key Private Bank Advisor.

Key Private Bank