Business matters: It's up. It's down. How do I measure my portfolio's real value?

NEWS

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Guest columnist

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SKIP

Q: My portfolio lost over 10% of its value in 2022. How do I know when to sell and prevent this from happening?

A: Let's start this discussion with some important assumptions. First, we should agree that your investment portfolio should be aimed at long term results (say no less than five years). We should also agree that your portfolio is a blend of stocks and fixed income (no less than 50% stocks). Finally, let's assume and agree that either you are still saving and accumulating funds or are taking out a small percentage of the portfolio each year (typically 4-5% a year of the total in your mid 60s).

Let us first agree that you have not “lost” anything until you actually sell something at a lower price than you bought it. Conversely, you have not made money until you sell something at a higher price than you purchased it at. Given these assumptions, I’d bet you are “anchoring” to the highest price of your portfolio (probably around the end of 2021). This is a common and very human practice, but it is important to understand that you are selectively picking out dates with which to examine investment returns. Further, I’d bet that if you instead looked at the value of the same portfolio starting at a different date, you’d have a very different reaction.

As an example, let’s pretend your portfolio is 100% in the S&P 500 stock index (a popular collection of 500 large U.S. companies). You look back and see that in very late 2021 that the index was around 4700 and at the end of 2023 is about the same, so no real gain over two years. Remember, you did not make or lose any money by just holding on to your portfolio.

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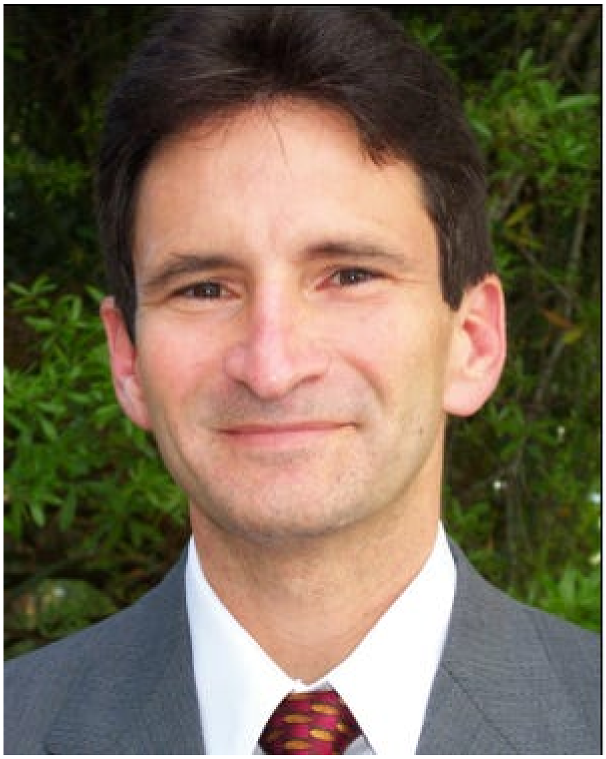
Next, let’s pick a different starting date. How about one year earlier as 2021 started off? The index was ~3750, so now we have a 25% gain in just under three years. Now let’s go back exactly five years to January 2019 and we find the index was 2650. So, the S&P 500 index has appreciated roughly seventy (70%) in price over the last five years.



So, did you lose money or make money? It depends when you start counting. Fortunately, the longer you invest, the likelihood of making money increases. The S&P 500 index makes money in over 90% of all five-year periods for the last 80 years. It is not unreasonable to expect a high single digit annual return (though not year by year) from such an investment.

So, it is very important to remember our initial assumptions (long-term investing and a balanced portfolio) and to avoid using the highest price of portfolio to compare things to. Always comparing returns to the highest historic value of your portfolio will lead to dismay and perhaps unwise investment moves. Instead, have patience and discipline (or get help to do so) in your investments and pay attention to more important things.

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