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Benchmarks

Much is being talked about in personal finance articles in newspapers and magazines about benchmarks for your portfolio.

What is a benchmark?

"It is a standard against which the performance of a security, mutual fund or investment manager can be measured. Generally, broad market and market segment stock and bond indexes are used for this purpose." Investopedia.com

The problem with benchmarks is that there are many variations and most of them are not appropriate to the individual's portfolio mix and risk tolerance.

Many compare their portfolios to the S&P/TSX; it's easy, it looks like you're comparing your portfolio directly with the foundation of the economy, etc. etc., but this comparison would not give a true picture, as it does not allow for the presence in a properly managed portfolio which may include cash, fixed income and/or foreign securities.

The other major problem with the S&P/TSX is that it does not represent the average conservative portfolio, as it has a weighting of 35% financials, 25.8% energy and 1.8% utilities.

I believe a good portfolio has a mix of equities from the five main sectors of the economy: financials, utilities, manufacturing, consumer and resources. This does not mean just buying the stocks in an Index, but a selection suited to your financial goals. (Some portfolio managers do something called "Closet indexing" – the manager claims to be actively managing a client's money, but in fact is building a portfolio that mirrors the Index – there is no chance of underperforming. It's not a properly balanced portfolio, though, and so is much more exposed to the natural swings of the economy – precisely what a properly balanced portfolio helps you avoid.)

Some institutions have trumpeted their creation of highly individualized "benchmarks" that assess the performance of each class or type of instrument or security that might be found in a portfolio, then for any given portfolio, blend those "benchmarks" into a sort of composite number that supposedly represents a standard against which the client can measure the performance of his or her own portfolio. The trouble with this, in my view, is that a benchmark is supposed to be a standard, like the platinum bar that was the world's standard for the

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international meter, against which something can be objectively compared. But there is so much subjectivity in the creation of these individualized and personalized benchmarks that the immutable platinum bar suddenly looks like very pliable India rubber and cannot give you the objective comparison – or reassurance – you want.

Instead of relying on "benchmarks" of questionable meaning and value, consider devising your own reference points, against which you can assess your progress. Reference points that have meaning for your own lifestyle. For those looking forward to retirement, this would include a savings rate; for those enjoying retirement, your reference point would be based on a realistic capital outflow with an inflation corrector. This could result in a significantly better understanding of the performance of your portfolio as it is created based on realistic financial needs and goals, and tax awareness over the long term. Once you have a real-world reference point based on your own needs, you have a meaningful basis for comparison.