



The Importance of Portfolio Hygiene

Key Takeaways:

- **Hygiene is a Proactive Routine.** Don't react to the market; stay disciplined with regular, planned check-ups.
- **Your Plan is Your Guide.** Follow your Investment Policy Statement (IPS) to avoid emotional decisions, ensuring your actions align with your long-term goals.
- **Small Actions, Big Impact.** Practices like rebalancing and tax-loss harvesting create significant value over time by making your portfolio more efficient.

Portfolio hygiene is the practice of maintaining and regularly reviewing an investment portfolio to ensure it remains aligned with financial goals. The term “hygiene” is used because, like personal hygiene, it’s a constant, disciplined process that prevents problems from developing. It’s not a one-time task, but a routine of small, consistent actions that keep your portfolio healthy, efficient, and on track to meet your long-term objectives. By regularly cleaning up, organizing, and adjusting your investments, you ensure they are working as effectively as possible.

INTEGRATING WITH YOUR WEALTH PLAN'S CASH FLOWS

A critical aspect of portfolio hygiene is ensuring that your investment withdrawals are intentional and not simply reactive. Your portfolio should be managed in concert with your overall wealth plan and its projected cash flows, which include both income and expenses. This means knowing when and how much you'll need to withdraw to fund major life events, retirement, or planned spending.

This approach prevents you from being forced to sell assets at an inopportune time, such as during a market downturn, which can lock in losses and significantly impair your portfolio's long-term

growth. Instead of a spontaneous withdrawal, a well-hygiened portfolio has a defined withdrawal strategy. This might involve holding a specific amount in cash or short-term bonds to cover upcoming expenses, ensuring that you don't have to sell stocks or other long-term assets when their value is depressed.

THE RISK BUDGET AND THE INVESTMENT PLAN

Every investment portfolio has a risk budget, which is the amount of risk you are willing and able to take to achieve your financial goals. This concept is fundamental to your investment plan. A risk budget isn't just a subjective feeling; it's a quantifiable limit that dictates your asset allocation, such as the percentage of your portfolio in stocks versus bonds.

For example, a younger investor with a long time horizon might have a large risk budget, allowing for a portfolio heavily weighted toward equities. Conversely, an investor nearing retirement might have a smaller risk budget and a portfolio weighted more conservatively toward fixed-income assets. Portfolio hygiene involves regularly reviewing this risk budget to ensure it aligns with your life stage, financial situation, and comfort level. Changes in your circumstances, such as a career change or a major life event, may necessitate a re-evaluation and adjustment of your risk budget and, consequently, your investment plan.

TRACKING WITH THE INVESTMENT POLICY STATEMENT

The Investment Policy Statement (IPS) is the foundational document for your portfolio. It's a written plan that outlines your investment objectives, risk tolerance, asset allocation targets, and the criteria for investment selection. It is the roadmap for your portfolio, and tracking it is a core component of portfolio hygiene.

Regularly reviewing your portfolio against your IPS ensures that your actions remain aligned with your stated goals and discipline. Without an IPS, you risk making emotional or impulsive decisions based on short-term market fluctuations or hot investment trends. By consistently checking your portfolio's composition and performance against the IPS, you can stay the course, avoid emotional trading, and keep your long-term objectives in sharp focus.

REBALANCING TO MAINTAIN YOUR RISK PROFILE

Rebalancing is the most hands-on aspect of portfolio hygiene and is essential for maintaining your desired risk profile. Over time, market performance will cause your portfolio's asset allocation to drift away from its target. For instance, a bull market in stocks might cause the equity portion of your portfolio to grow disproportionately, increasing your overall risk beyond your initial plan.

Rebalancing involves selling assets that have grown (and are now overweight) and using the proceeds to buy assets that have underperformed (and are now underweight). This brings your portfolio back in line with the target allocation specified in your IPS. This process is a disciplined, unemotional way to "buy low and sell high" and prevents your portfolio from becoming unintentionally more volatile or conservative than you intended.

THE ROLE OF TAX EFFICIENCY

A crucial part of portfolio hygiene is managing your investments with an eye toward minimizing your tax burden. This isn't just about paying what you owe, but strategically structuring your

portfolio to legally reduce the amount of your returns lost to taxes. Two key strategies are tax-loss harvesting and asset location.

- **Tax-Loss Harvesting:** This is the practice of selling investments that have lost value to offset capital gains from other investments that were sold for a profit. For instance, if you sold a stock that gained \$5,000, but you also have a stock that's down \$5,000, you can sell the loser to "harvest" that loss and negate your gain, saving you from paying capital gains tax. You can also use up to \$3,000 of losses to offset ordinary income. This must be done carefully to avoid the wash-sale rule, which prevents you from buying a "substantially identical" security within 30 days of selling it for a loss.
- **Asset Location:** This involves placing different types of investments in different accounts based on their tax treatment. Assets that generate a lot of short-term gains, or that are expected to grow significantly, are often best suited for tax-advantaged accounts like a Roth IRA. This is because all future growth and withdrawals are tax-free. Conversely, tax-efficient investments, such as municipal bonds or broad-based index funds with low turnover, are often ideal for taxable brokerage accounts.

CONCLUSION

In a world where investing can feel complex and unpredictable, the concept of portfolio hygiene provides a clear, actionable, and repeatable framework for success. It transforms the daunting task of managing your wealth from a series of reactive decisions into a proactive, disciplined routine. By consistently integrating your portfolio with your cash flows, adhering to a risk budget, and regularly rebalancing, you build a resilient, efficient, and tax-aware portfolio. Ultimately, the commitment to portfolio hygiene is an investment in a clear mind and a secure financial future, ensuring your wealth works for you, day in and day out.

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We'd Love to Hear from You!

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