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How to Better Evaluate Your ETF or Mutual Fund Portfolio's Performance

Financial statements are investors' primary way of measuring performance but they may lead you astray.

By Coryanne Hicks, Staff Writer, Posted from Aug. 12, 2019

EVALUATING YOUR portfolio's performance is an integral part of investing, but how you go about measuring that performance can turn a productive activity into an unproductive one. The trick is to make sure you're using the right tools and metrics in the right way to give an accurate reflection of your progress toward your goals.

For many investors, evaluating their portfolio performance begins with their financial statements. Every month or quarter, your financial services firm sends you a little reminder to check your investments in the form of an account statement.

Statements were put in place by financial services firms to tell people what they own on a regular basis, says Tim Paulin, senior vice president of investment research and product management at Cincinnati-based Touchstone Investments. But what used to be a simple accounting of your investments and what they're worth has become a misleading tool of performance evaluation.

Financial statements often open by showing you how your account has performed during the period and alongside that how a broad-based index like the S&P 500 did, in case you want to compare. And this is where both the statement and investors trying to evaluate their portfolio performance often go wrong.

Stop Comparing Yourself to the S&P 500

Unless you're invested only in an S&P 500 index fund or have the sole goal of matching or beating the index, comparing yourself to the S&P 500 is a fruitless exercise without context.

If your account is a healthy mix of stocks, bonds and alternative investments, your portfolio's performance likely won't look like the S&P 500's performance. This isn't a bad thing. In fact, it's probably a good sign because it shows your portfolio is successfully giving you the smoother ride it's intended to provide. But your financial statement won't tell you this.

Your statement may show that you got a 3% return against some faraway index, but it tells you nothing about if that's a good thing or bad thing, says Robert Krugman, chief digital officer for Broadridge Financial Solutions in New York City. Without context, statements raise more questions than answers.

What most investors really want to know is not how they're doing against the S&P 500 or some other index, but rather how they›re progressing toward their financial goals.

And if you think your goal is to beat the index, ask yourself this: If the index was down 25% and your portfolio was down only 20%, would you be happy? If the answer is no, then beating the index is not your objective, says James Beam, regional investment director at TD Wealth. "And if that's the case, why let the index dictate your success or failure as an investor?"

There's a Better Way to Measure Performance

A much healthier way to use your financial statements and better way to evaluate your portfolio's performance is to ask how relevant your performance is to whether you're on track to meeting your goals, Paulin says. "If people asked that question and explored the answer, it'd be a lot more healthy than just judging whether (they're) up or down."

It doesn't matter what the S&P 500 did today, or even what your portfolio did today; what ultimately matters to most investors is if you'll achieve your goals.

"The most important benchmark for any investor is the rate of return you have to get given your savings rate, time horizon and goals that gives you the highest probability of achieving those goals," Paulin says.

Instead of looking at if your portfolio's performance puts you above or below some broad-based index's return, examine if it puts you above or below the return you need to reach your goals, then ask yourself what you're going to do about the answer.

If you're above your required rate of return and on track to have more money than you need, you could leave your portfolio as is, Paulin says. Or you might decide to take some risk off the table by investing more conservatively. The flip side of the equation is if you're below your required rate of return, you may want to invest more aggressively or save more to bring yourself up to trend.

How to Read Your Financial Statements

Unfortunately, today's financial statements don't tell investors how they're doing in relation to their financial goals. This doesn't mean your statements have no bearing on evaluating your portfolio performance, however. You can and should still read your statements, just do so with an eye toward what information they provide that's actually useful.

For instance, "one of the ones that most often gets missed is having a discerning eye toward the fees you're paying," Beam says.

Investment fees can significantly impact your overall performance. Over a 20 year period, a 1% annual fee reduces a $100,000 investment portfolio's value by nearly $30,000.

Financial statements are great at highlighting the fees you're paying – both the fees on individual ETFs and mutual funds, and those you pay a financial advisor.

"It's a fair question to ask what am I paying for this?" Paulin says. Also: "What is the value of the advice I'm getting for the fees I'm being charged?"

The financial industry is complex, and so are the financial instruments it uses. Understanding what you're paying for what you own is as important as understanding the actual investments you own.

To that end, Krugman suggests using your financial statements as a means of identifying where you may want to broaden your financial literacy.

Find the areas in your statement you don't understand or that give you concern and educate yourself on those areas, he says. You can do this either through online research or by bringing them up with your financial advisor.

Coryanne Hicks is an investing reporter for U.S. News & World Report. She is an expert at investing strategies and theories, investor education, investing psychology and behavioral finance. Previously, she was a fully-licensed financial professional at Fidelity Investments where she helped clients make more informed financial decisions. She has ghostwritten financial guidebooks for industry professionals and even a personal memoir. She is passionate about improving financial literacy and believes a little education can go a long way. You can contact her at crhicks@usnews.com.