Know Your Targets and Aim Carefully:
When Building a Mutual-Fund Portfolio

First things first.

Most investors still spend too much time trying to identify top-performing mutual funds and not nearly enough time thinking about whether they own the right mix of funds.

Ways to do it right: Here are some tips on building a winning mutual-fund portfolio:

1. Aim Before You Buy.

Most folks shouldn’t own just one portfolio of funds. Instead, they might own a combination of portfolios with each set of funds earmarked for a specific goal.

These portfolios could be as simple as a single fund, such as a blue-chip stock fund for your kids’ college savings. But for other goals, especially retirement, you might own a mix — of funds that span a lot of stock and bond market sectors.

2. Get the Big Decision Right.

Why bother with these different portfolios? How you manage your money should depend heavily on how soon you will need your cash.

If you are saving for a distant goal, like your own retirement or your toddler’s college education, you can afford to stick with stocks. After all, the more you buy into stocks, the higher your likely long-run returns.

But if you need the cash soon, you also run the risk of a big short-term hit. Result? If you plan to buy a house in the next five years, you really ought to steer clear of stocks and instead stash your future home down payment in more conservative investments, like a money-market fund or a short-term bond fund.

3. Pick Your Risks.

Many experts say you should pay close attention to how much risk is taken by each fund you own. But I wouldn’t.

Sure, if you have lots of portfolio growth or you’re in the stock market, you might want to diversify. Investment risk should be lower for people with long-run retirement savings.

But if you need your money in the next five years, you need a fund with lower risk.

The bottom line: Just as you diversify your asset allocation among stocks, bonds and money market funds under your long-run goals, so it will also be the biggest factor in your portfolio’s short-term price gyrations.

4. Play the Numbers Game.

Yes, more than 1,000 stock and bond funds to choose from, finding a top-notch fund can be baffling. What to do?

Before you start picking funds, decide what sort of funds you want to own. That, in turn, will depend heavily on how many funds you are willing to buy.

Are you looking to buy bonds and you settle on a three-fund portfolio? Your desired mix includes 40% in a high-quality corporate bond fund, 25% in a high-yield junk bond fund and 25% in a foreign-bond fund. Having decided what types of funds you want, you then buy the best possible funds within each category.

5. Watch for Wanderers.

Some funds buy or sell internationally, like those foreign-investment charts that others. Many buy stock and asset-allocation funds shift between stocks and bonds, depending on which looks like a better value. Similarly, funds change their mix of U.S. and foreign stocks, too.

6. See if it’s worth it.

Not to me. I’m skeptical that anyone can outguess the market. Moreover, if you own funds that make market bets, you may find that these bets radically alter the portfolio allocations that you originally settled on.

As a result, I prefer funds with stricter investment charts. For instance, to get foreign-exposure exposure, I favor international funds over global funds because international funds invest exclusively abroad while global funds keep part of their money in U.S. stocks.

7. Check Under the Hood.

Yes. If you buy funds with narrow exposures, it’s still worth taking a closer look at each fund’s portfolio. You can find that one of your U.S. stock funds has, say, 10% of its portfolio invested abroad, 15% in cash.

You can figure out each fund’s allocation to other funds or other port- folio allocations. If your U.S. stock funds tend to hold a lot of cash or a hefty dose of foreign stocks, you can compensate for keeping less of your portfolio in international funds and money-market funds.

But if you really want to control your portfolio allocations, consider index funds. These funds buy the stocks that constitute a market index in an effort to match the index’s performance. When you buy an index fund, you can be sure how the market will perform. But you do know whatever the market delivers, that’s pretty much what you will get.


If you’re not careful, you can unintentionally make a big bet on a single market sector. Every year, make a point of checking on your funds and then seeing what percentage of your portfolio is invested in each sector.

But in fact, you might have much better diversified simply because you own several U.S. stock funds. If each of those funds favors smaller-company stocks, you are actually making a safer bet on a single sliver of the market.