HOW TO BUILD A DIY PORTFOLIO WITH ETFs

Audio Script

iShares by BlackRock

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In this video, we will discuss how to build a "do it yourself portfolio" with Exchange Traded Funds or ETFs. When it comes to our portfolios, most of us immediately focus on the different investments that we can make to reach our goals. But no matter how good the chosen investments, you can't earn if you aren't saving and putting those savings to work for you. The psychology of investing can make it difficult to get started as we worry whether now is the best time to invest. So let's start by reviewing why waiting for the perfect time may actually hold someone back. Time is a valuable asset that we want to have on our side.

Consider two investors over a 30-year period, Investor A contributes $1,000 every year into her investment portfolio for the first 15 years and then watches it grow until year 30. Investor B starts his program 15 years later but invests a larger sum of $3,000 each year for the remaining 15 years. In this hypothetical example where both investors earn 10% every year, Investor B invested three times as much, but ended up with almost $37,000 less. Both investors built themselves a better financial future by putting their savings to work but starting sooner gave investor A an edge.

I was lucky to learn this lesson when I was 14 years old. I had just earned my first paycheck a whopping $82. And instead of driving me to the bank so that I could cash it and spend it on whatever my teenage-self desired, my dad opened a brokerage account for me and had me get started on my retirement savings. I wasn't even old enough to drive, so the thought of focusing on retirement sounded absurd. But I soon realized my dad had taught me the first ingredient for investment success. The sooner you get started, the better positioned you are to take advantage of the power of compounding gains. Albert Einstein reportedly said that compound interest is the eighth wonder of the world, "He who understands it earns it. He who doesn't pays it."

Even with this knowledge, it could be hard to start an investment program or to regularly contribute to one that's already in progress. Given the market has historically risen over the long term, we often find ourselves saying *with the markets hitting new highs, I'll wait for a better time to invest*. But it's important to consider your time spent in the market rather than trying to time the market by entering and exiting opportunistically. Missing just the five best performing days over the last 20 years could have cost your portfolio nearly a third of its potential value. And if you were unfortunate enough to miss the 25 best days, you'd barely have more money than you started with. Importantly, many of the best market days occurred within weeks of a market crisis, times when it's been most scary to put money to work. So there is no ‘best time’ to invest. But starting sooner rather than later can put the power of time on your side.

For the remainder of this video, we'll discuss portfolio construction, introduce the major types of ETFs in the investor toolkit and provide some tips for choosing the right fund for a given investment objective.

The two most important concepts I learned on my journey as a do it yourself investor, were the benefits of diversification and rebalancing. I started investing the same way I imagine many people do. I bought a couple of stocks I heard about and thought had good prospects. As I kept studying markets and refining my craft, I noticed while there are many different opinions on which strategy is optimal for success one piece of wisdom held almost universally is that you should diversify. The famed economist Harry Markowitz has even called diversification ‘the one free lunch in investing’. So I changed my process. I started holding more

companies, investing in all sectors, countries and styles. And instead of buying these stocks on my own, I got easy access to them through mutual funds and ETFs. This was the most important action that I took that improved my results and put me on track to meet my financial goals. But let's move beyond my journey and look at some data that supports how diversification may help you to improve your results as well.

The US stock market went up more than 25% in 2021. Though the market as a whole did very well many individual stocks struggled. 36% actually lost money, delivering negative returns to investors. Incredibly, the average loss among stocks that declined last year was 35%. If buying single stocks, it could have been easy to lose in this winning market. So how do you help protect against holding only underperformers? You can diversify. Equity mutual funds and ETFs can provide diversification since they hold multiple stocks. For example, just 2% of mutual funds and ETFs investing in US stocks lost money last year. This is a pretty eye-opening statistic that speaks to the value that funds can provide investors by giving them instant diversification.

Diversifying across stocks is a great start, but it's not enough for most investors. If we enter a recession, even the best stocks may perform poorly. To build resilience into our portfolios, we should think about adding other asset classes which have tended to behave differently than stocks. For example, high quality bonds like those issued by the US government have historically gone up when the economy is slowing. So they can potentially add gains to a portfolio at the same time that stocks are falling.

After the tech bubble burst in the early 2000s, the S&P 500 fell more than 40 percent, while long term US treasury bonds rose by about the same amount, helping to buffer losses in a diversified portfolio. In fact, 10-year U.S. treasury bonds delivered positive results in each period for which the stock market fell by at least 15% over the last 20 years, including the global financial crisis and the Covid-19 related sell off of 2020. Asset classes like stocks and bonds are expected to add to wealth over time, and they often deliver their value during different phases of the economic cycle. Combining them together in a portfolio can provide the investor with a smoother ride during their investment journey. The way investors choose to spread their money across asset classes is called an asset allocation. You've likely heard the term 60-40 used, which represents a portfolio that is 60% invested in stocks and 40% invested in bonds. Such allocations should be based on an investor's goals, timeline and risk tolerance. And a first step to a thoughtful investment program is deciding on an allocation that provides the right balance of potential growth and safety. Those looking for more growth who can afford to take on more risks might increase the allocation of stocks. And those that are more interested in preservation of capital might have a higher allocation to bonds.

Setting the appropriate asset allocation for your goals is a crucial step, but the work doesn't end there. Daily performance could cause the allocation to drift away from the desired balance. When stocks do well, they grow to make up a larger portion of the portfolio. And when they fall, they become a smaller piece of the portfolio. Consider an investor who went through 2020 with a 60/40 allocation. The sharp market sell off that started in February would have pushed the allocation to 50% stocks and 50% bonds by the end of March. Then the market rapidly recovered, and the portfolio did just fine. But investors who determined that 60/40 was the right mix for them, would have packed more of a punch during the rebound. Rebalancing means periodically adjusting the portfolio back to its intended allocation. In this example, an investor could have sold some bonds to buy more stocks to get back to 60/40 at the end of March, and this rebalanced portfolio would have outperformed the portfolio that was left untouched for that year.

ETFs are great tools for implementing these portfolio construction best practices. ETFs can be bought and sold whenever the market is open. The minimum investment required for an ETF is generally just the share price. ETFs are professionally managed and can make diversification easy. They generally carry low fees and are generally tax efficient, helping investors keep more of what they earn, which can mean better investment results over time.

The ETF toolkit contains funds that help you build a strong foundation, seek enhanced returns, or pursue opportunities like market trends or themes that are important to you.

A great tool for building the foundation of a portfolio is Asset Allocation ETFs. These all-in-one solutions allow investors to build a diversified portfolio with just one fund. Investors can choose between conservative, moderate, growth or aggressive risk targets, which differ by how much of the fund is exposed to stocks or bonds.

Each iShares Asset Allocation ETF invests in stock and bond ETFs and rebalances back to their target allocation generally twice each year, helping investors implement the portfolio construction best practices of diversification and rebalancing with just one click. iShares Core Allocation ETFs seek to efficiently capture broad market returns. Increasingly, investors are recognizing that companies that are solving the world's biggest challenges may be best positioned to grow over the long term. Accordingly, iShares also offers Sustainable Allocation ETFs, which provide a similar exposure as their Core counterparts, while seeking a more sustainable outcome by incorporating Environmental, Social and Governance insights.

For investors that want to customize their portfolios to their preferences, a starting point could be individual Core ETFs. These funds provide exposure to the total market or a market segment by seeking to track popular indexes like the S&P 500. They are often among the lowest cost and most tax efficient ETFs available. Investors can use these tools to customize how much exposure they want to US stocks, international stocks and bonds, and can adjust their allocation whenever needed in order to align with new goals or to potentially benefit from perceived market opportunities. While Core ETFs seek to mirror the market, other types of ETFs intentionally deviate from the market in an attempt to either outperform or reduce risk. These strategies are called Factor ETFs. They start with some screens that many of you may already incorporate when evaluating stocks. The most well-known factors are Value, which screens for cheap stocks, Quality, which invests in companies with healthy balance sheets, Momentum which select stocks that are trading higher, and Size, which screens for stocks that have smaller market capitalization. Minimum Volatility factor strategies are designed to build a portfolio with lower risk by screening for stocks with low volatility.

When I think about the potential users of these ETFs, I think about my mom and my wife. My mom is risk averse, and prone to making bad investment decisions when volatility arises. She's retired but can't just hold bonds and cash. She needs some exposure to the stock market in order to potentially earn enough to meet her spending needs. Minimum Volatility ETFs that are designed to provide broad market exposure with less volatility can help an investor like my mom keep the asset allocation intact and stick to the plan for long-term success.

My wife is very different from my mother in a lot of ways. She's an entrepreneur and she's more of a risk-taker. She wants to try and beat the market. So investors like her might find value in Factor ETFs, which employ the strategies that have historically been used by active managers and do so in a transparent, low-cost and tax efficient way.

Every one of us has probably heard about a trend at some point that we felt was going to change the way that we live our daily lives. Some emerging themes may seem like good investment ideas, but it isn't always easy to find a list of companies that are likely to benefit from these new developments. Thematic or megatrend ETFs can help here. They screen for the companies that fit the target theme and bundle them together in one ETF. If there's a trend that you've been looking to invest in, there's probably an ETF that provides exposure to it and could be beneficial instead of just focusing on a stock or two, for all of the reasons that we discussed on the benefits of diversification. These ETFs may help investors that are interested in the trend avoid missing out on the potential benefits because they chose the wrong stock. We've seen popularity in the themes that are listed on the slide, including the growth of clean energy and the importance of cybersecurity. There are ETFs that make it easy to capture these trends and others in a diversified manner.

With all of these great tools available, how do we sift through the roughly 2000 ETFs in the market to choose the right ones for our needs?

When evaluating funds, keep four items in mind. First is the fund manager. You want to ask whether the fund provider has experience and expertise in investing in the specific market. Next is the structure or what the ETF is built to do. Here, you may want to ask yourself does the ETF’s objective align with my financial goals.

Once you've decided on the objective, the next item to consider is exposure, which means asking what asset classes and markets does the fund invest in. And last but not least, is cost. Finding lower-cost, tax-efficient investments can help you keep more of what you earn.

Since understanding exposure is important, let's look at a few attributes to consider. For stock funds, it helps to look at the average size of companies held because large stocks behave differently than small stocks. Similarly, cheap companies or value stocks behave differently from firms that are growing faster than average. So it can help to look at: valuation ratios, dividend yields and earnings growth. Knowing the sectors a fund is more exposed to, like tech vs. financials, and when going international, knowing the exposure to developed markets vs. emerging economies can help you better understand potential risk and how the fund may behave over time. For bond funds, consider the credit quality and know whether the fund holds bonds of investment grade or lower quality bonds that deliver a higher yield. It's also important to look into sectors in the bond space as government bonds have different characteristics than bonds that are issued by corporations. Importantly, the average maturity of bonds in the portfolio or the fund's duration helps you to understand the interest rate sensitivity, so you can gauge how the fund may respond to changes in interest rates. This information can be found on fund websites or through your brokerage.

It's important to emphasize that not all ETFs are the same, we've been mostly discussing ETFs that seek to track indexes of either stocks or bonds, and these are some of the most common ETFs. There are also funds that help investors access alternative asset classes, such as commodities like gold or silver, which can further diversify a portfolio or provide potential inflation protection. Some ETFs are actively managed, meaning the holdings are picked up by an active portfolio manager based on their investment views. Some active strategies may be less diversified in the pursuit of higher returns, and they may carry higher fees. These strategies may also be more subject to the skill of the manager than the returns of the market segment from which they're picking securities. And lastly, there are leveraged and inverse exchange traded products, or ETPs, which iShares does not offer. Leveraged funds look to deliver multiples of an index return on a given day, and inverse funds are short the given index looking to benefit from the market falling in value. These products can carry meaningful risks and are generally meant for sophisticated institutional investors with very short-term needs.

Reducing costs or fees can be important to investment success. To evaluate what a fund costs, you have to do more than look at the expense ratio. Just like when we go to buy a car, we don't look at a sticker price alone. We also evaluate things like fuel efficiency and expected maintenance costs. An ETF's costs to consider include trading costs, which can be measured with things like a bid ask spread. ETFs with lower trading volume tend to have higher trading costs. You may also want to consider the frequency of a fund's distributions, as some funds distribute capital gains more regularly than others, which could result in a tax liability. Finally, you should consider any meaningful difference between the fund's performance and the benchmark that it seeks to track. This information is available on fund websites or through your brokerage. Keeping these components in mind gives a holistic view of cost when comparing funds.

Let's recap the key takeaways, starting early can help investors harness the power of compounding returns and ETFs can make this easy, given minimum investment requirements are generally just the price of a share. When building portfolios, investors may consider diversifying and rebalancing to avoid missing opportunities and attempt to reduce portfolio risk. There are many types of ETFs available, and the right one depends on your unique investment objectives. With goals in place, gather a list of funds aligned with your objectives and consider the items we discussed today to further evaluate the funds. Ask yourself whether the manager has the right experience and expertise, if the structure and exposure is aligned with your goals, and if the total cost helps to reduce the hurdles to success. Thank you for watching.

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Investing involves risk, including possible loss of principal.

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