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What are the best investment options:

Portfolio of Exchange Traded Funds
Or
Portfolio of individual stocks and some fixed income ETF's

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This is the question that most investors deal with on a regular basis. Supposed industry advisers encourage us to take the safer approach and buy only ETF's.

But is a portfolio of ETF's really safer than a portfolio of individual stocks? Is your adviser objective enough to provide you with the best strategy?

The majority of advisers are compensated principally by the dollar value of assets under management and not by investment performance. Consequently, their opinions are biased at best.

Over the last several years portfolio volatility was considerably lower than its normal range. Investors were spoiled into believing that simply investing in an index ETF or fund was the only investment decision they needed to make. In an environment with very low interest rates and inflation, equity valuations kept rising without a lot of downside volatility.

Portfolio volatility has returned to more normal long-term averages in 2018 and investors are getting spooked by their dismal returns.

As a result of this increased volatility, many investors are of the belief that the end of the long-term bull market is imminent.

But maybe it is not the end of the bull market but the resurgence of stock picking over passive index strategies. I firmly believe this is the case. Many current advisers are simply not trained and equipped to be stock pickers.

My Income and Growth sample portfolios consist of 60 and 75 individual stocks plus some ETF's respectively. Both portfolios are very well diversified by asset class, equity sectors and by individual companies. Despite the number of names, my objective is to pick the best companies in each sector. This is far more important than simply buying an index ETF.

Active strategies like my portfolios tend to do better with more price volatility like we have today.

The combination of stock picking, active equity sector and asset mix strategies tend to produce better returns over time. In addition, the well diversified sample portfolios that my site offers provide more than sufficient portfolio risk reduction to minimize overall price volatility.

Let's take the Consumer Discretionary area in the US as an example. There has been a very wide divergence in investment returns over the last year. Amazon and Kohl's have sharply outperformed their peers with total returns of 67% and 71% respectively. Home Depot registered 22% over the same period, while Lowes only performed slightly better than zero. Stanley Works produced a 5% return despite its recent price decline. The PowerShares S&P 500 Consumer Discretionary ETF RCD delivered a return of 7.93% over the past year. Investing in the RCD ETF would have produced much lower returns than simply picking individual stocks as my sample portfolios have done.

Take the Canadian REIT sector as another example. The BMO equal weight REIT ETF ZRE produced a total return of 8.73% over the last twelve months, while the iUnits XRE rose 5.34%. Taking an average of my four REIT holdings, Chartwell, Canadian Apartment, InterRent and Sienna Living would have delivered a superior 13.8% over the same period despite Chartwell having a poor year.

Furthermore, there is a definite lack of transparency investing in an ETF as opposed to an individual company. While you can see the top holdings in an ETF, these can change anytime. When you purchase an index ETF you really are not in the driver's seat.

Many investors falsely believe that ETF investing is much safer and involves minimal risk relative to picking individual securities. Financial firms promote this belief that is in many cases simply not true. Today there are more ETF's than individual securities and companies try to differentiate themselves by offering sector, actively managed and double leveraged ETF's that are clearly much riskier than my diversified portfolio approach. There are sector ETF's investing only in marijuana stocks and in crypto-currency. These are very clearly much riskier investments than a well thought out portfolio of individual names.

In my past life as a portfolio manager, I inherited many client portfolios that were all invested in sector ETF's that were performing very poorly. The clients had all been informed by their former advisers that these investments were all high quality, low risk ones. I am not really sure how gullible people can be, but promotional statements like that should always be questioned.

Conclusion

I recommend that every investor spend more time understanding exactly what they are invested in, even if you have limited financial knowledge. In many instances that limited knowledge is far more than what your adviser has.

Try to keep an open mind in regards to investing in individual securities. Take some of your capital and sell all your ETF's in that account. I would make sure that this account has at least $50,000 before investing in individual securities. Use the proceeds to gradually invest in individual companies across all sectors.

Ensure that you do not invest too much in any one security or sector. This involves making a whole bunch of small bets rather than one or two large ones. Over time you will see better investment performance with the overall portfolio risk the same or in many cases much less.

Once the portfolio of individual securities is set up, there will be lower fees on an ongoing basis than an ETF portfolio. In addition, you can manage the investments to meet your income needs more effectively and ensure that your investments minimize taxable capital gains.

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