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How to Build an ETF Portfolio: A Step-by-Step Guide

A complete guide to building an ETF portfolio from scratch.

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Exchange-traded funds (ETFs) have revolutionized the way investors build and manage portfolios. They offer diversification, low costs, and flexibility, making them ideal for DIY retail investors, family offices, and high-net-worth individuals.

But with thousands of ETFs available, creating an effective, goal-aligned portfolio can seem daunting.

Here's a step-by-step guide to building an ETF portfolio, including defining your goals, selecting funds, and managing them over time.

Step 1: Define Your Goals, Risk Tolerance, and Time Horizon

Before choosing any ETFs, start with a clear understanding of why you're investing. Your financial goals and personal circumstances should drive your investment decision-making process.

Ask yourself: What am I investing for? (retirement, wealth accumulation, a home purchase, etc.); when will I need the money? (short-term vs. long-term horizon); and how much volatility can I stomach? (risk tolerance).

For example, a 30-year-old saving for retirement can afford higher risk and might allocate more to equities, while someone nearing retirement may prefer a bond-heavy portfolio to preserve capital. Similarly, a family office or high-net-worth individual may elect to take a tax-aware approach to preserve capital in taxable accounts.

Step 2: Determine Your Asset Allocation

Asset allocation—your preferred blend of stocks, bonds, and alternative assets—is the single biggest driver of long-term returns.

But how do you know what balance is right for you? Here's a general framework: An aggressive strategy (80–100% equities) is best-suited for long-term growth; a moderately aggressive strategy (a 70/30 split between equities and bonds) will balance growth with stability; and a conservative, bond-heavy portfolio will focus on capital preservation and a reliable, fixed income.

Within each category, consider alternatives (like REITs, commodities, or gold) for diversification and inflation protection. But keep in mind: your allocation doesn't have to be static. It should evolve as your life goals, market conditions, and risk profile change.

Step 3: Choose a Portfolio Strategy

Once you've set your allocation, decide how to structure your ETF portfolio. Common approaches include:

- **Core & Satellite:** A simple and effective framework. The "core" is made up of broad-market ETFs that track a specific index, while "satellites" are specialized ETFs that hold niche investments (such as artificial intelligence stocks or real estate assets), express tactical views, or add diversification.
- **Equal Weight:** Each ETF holds an equal percentage of the portfolio. This avoids overconcentration but may require more frequent rebalancing.
- **Geographic Exposure:** Consider how much you want in U.S. vs. international markets. Many global investors allocate a minority percentage of their portfolio to non-U.S. markets to capture growth abroad and hedge against domestic economic headwinds.

The key is to choose a structure that's simple enough to maintain, while also aligning with your risk and return objectives.

Step 4: Select ETFs That Support Your Investment Goals

With your structure defined, it's time to choose the actual ETFs that will populate your portfolio. Here are the criteria to focus on:

- **Expense Ratio:** Lower is better, especially for core holdings. Even a 0.10% difference in fees can add up significantly over decades. Actively managed ETFs will cost more, but some investors prefer professional oversight.
- **Liquidity:** Higher trading volume means narrower bid-ask spreads and lower transaction costs. Avoid thinly traded niche ETFs unless you have a strong conviction.
- **Tracking Error:** Compare how closely the ETF tracks its benchmark index. A smaller tracking error means more reliable performance.
- **Issuer Credibility:** Stick to established fund families. They offer strong governance, transparency, and low closure risk.

Step 5: Don't Forget to Rebalance

Even the best portfolio will drift over time as markets move. Rebalancing restores your target asset allocation and helps maintain your desired risk level.

You can do this at fixed intervals, such as annually; when your performance crosses a predetermined threshold; or you can implement a hybrid approach.

Rebalancing can feel counterintuitive, but it establishes discipline and helps lock in gains over time.

Step 6: Watch Out for Common Pitfalls

Even well-constructed ETF portfolios can stumble if you overlook key risks. These include checking holdings for redundancy and overlapping exposure; adding to many specialized ETFs, thus diluting returns with higher fees; rebalancing taxable accounts too often, resulting in tax drag; and an unnecessarily complex array of ETFs that can make monitoring difficult without a professional's help.

Why Choose ETFs?

Building an ETF portfolio requires clarity, discipline, and consistency. But the benefits can be immense.

Remember: Start with your goals, choose an allocation that matches your timeline and risk tolerance, and populate it with diversified, low-cost ETFs from reputable issuers. Review your portfolio regularly, rebalance when needed, and avoid chasing trends.

It's that simple.

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Definitions (as used by Twin Oak):

- 1. Cost-effective ETFs:** As defined compared to hedge funds, which commonly charge a 2% management fee as well as 20% of the profits.
- 2. Institutional Grade:** Investment strategies generally only accessible in private fund formats to accredited investors.
- 3. Tax Alpha:** The amount of a gross return lost to the tax drag of an investment vehicle through realized taxable events.
- 4. Low Cost:** Defined on a case-by-case basis but generally refers to solutions that are cheaper than private funds (2% management fees and 20% carry).

An investor should consider the investment objectives, risks, charges, and expenses of the Fund(s) carefully before investing. The prospectus and the summary prospectus contain this and other information about the Fund(s). You may obtain a prospectus and a summary prospectus by visiting twinoaketfs.com. Please read the prospectus or summary prospectus carefully before investing.

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- 1. New fund risk:** The Fund is a newly organized, management investment company with no operating history.
- 2. Non-diversification risk:** More of the Fund's assets may be invested in the securities of a single issuer than could be invested in the securities of a single issuer by a diversified investment company. This may make the value of the Shares more susceptible to certain risks than shares of a diversified investment company. The Fund has a greater potential to realize losses upon the occurrence of adverse events affecting a particular issuer.
- 3. Counterparty Risk:** Some of the Fund's derivatives contracts are privately negotiated in the over-the-counter market. A counterparty defaulting on its payment obligations to the Fund will cause the value of an investment in the Fund to decrease.
- 4. Derivatives Risk:** The Fund may use derivative contracts which can disproportionately increase losses and reduce opportunities for gains when stock prices, currency rates, or interest rates are changing.
- 5. Illiquid Securities Risk:** The Fund may invest up to 15% of its net assets in illiquid investments which are instruments that the Fund reasonably expects cannot be sold or disposed of in current market conditions within 7 calendar days or less without the sale or disposition significantly changing the market value of the investment.
- 6. Leverage Risk:** The Funds use of options, swaps, or other derivative instruments may result in losses to the Fund or may adversely affect the Fund's NAV or total return, because these instruments are more sensitive to interest rate changes.
- 7. Options Risk:** Purchasing and writing put and call options are highly specialized activities and entail greater than ordinary investment risks from which the Fund may not fully benefit.
- 8. New advisory risk:** This is a newly registered investment advisory and as a result, there is no long-term track record against which an investor may judge the Adviser, and it is possible the Adviser may not achieve the Fund's intended investment objective.

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