Getting help

Asset allocation, which is driven by complex mathematical models, should not be confused with the much simpler concept of diversification. Asset allocation will not guarantee a profit or protect you from loss. It may, however, provide a hedge against risk and create opportunities in both bull and bear markets.

How many individuals are able to manage their investment portfolios with such a level of sophistication? Probably not many. But these are the tools used by institutional investors and professional portfolio managers.

We help people with their investment and financial management tasks throughout their financial life cycle. The steps needed to achieve financial independence are not always easy to take, but they become easier when you have professional assistance in implementing your plans.

Please give us a call when you need a hand in managing your investment portfolio.

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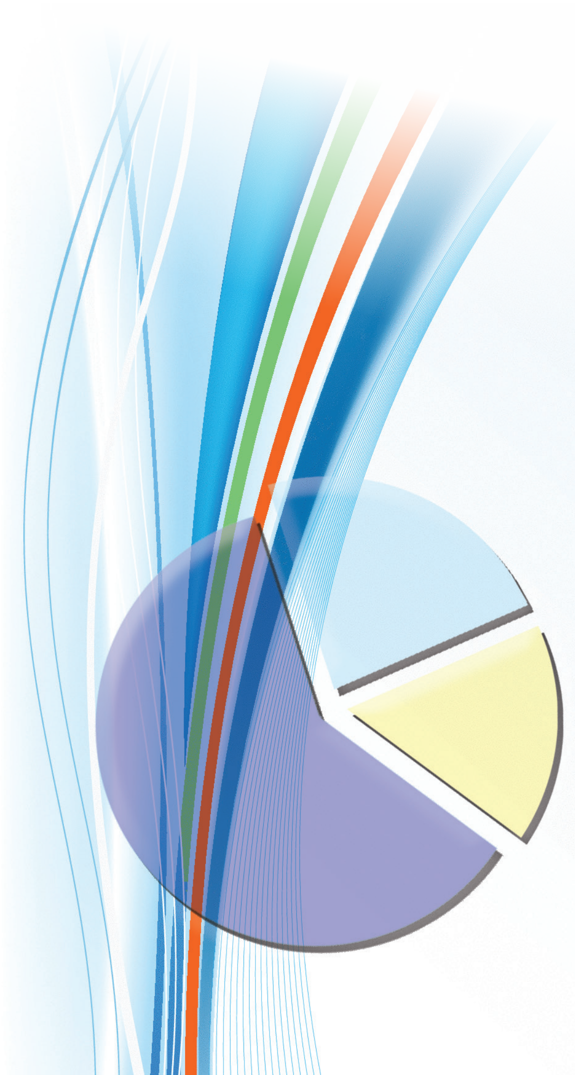
What is Asset Allocation?



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What is “asset allocation”?

The performance of an investment portfolio is affected by many factors, among them:

- **security selection**, the choice of a stock or bond that fits well in the investor’s overall strategy;
- **timing,** the purchase and sale of portfolio assets at the best point in the market cycle (buying low, selling high); and
- **asset allocation**, the choice of relative weight for various asset classes held in the portfolio.

According to academic studies (for example, Roger G. Ibbotson and Paul D. Kaplan, *Does Asset Allocation Policy Explain 40%, 90%, or 100% of Performance?,* in *The Financial Analysts Journal*, of January/February 2000), the third element makes the greatest contribution to portfolio performance. Deciding upon the composition of the portfolio, choosing among various asset classes, and rebalancing the portfolio from time to time all help smooth portfolio volatility for a given targeted return.

Begin with the classes

The various investments in a portfolio may be divided into asset classes. The historical record of each class may be evaluated to determine expected risk and reward characteristics for the class as a whole. Such asset classes may include:

- Large-capitalization growth stocks;
- Large-capitalization value stocks;
- Mid-cap growth stocks;
- Mid-cap value stocks;
- Small-cap growth stocks;
- Small-cap value stocks;
- Commodities;
- Real estate investment trusts;
- International stocks;
- Emerging markets stocks;
- U.S. investment-grade bonds;
- High-yield bonds;
- Foreign bonds;
- Cash.

The different asset classes are subject to different kinds of market risks, so they do not respond to market developments in the same way. To simplify, some years when stocks are up, bonds are down. Some years it’s the reverse. On the other hand, there are times when stocks and bonds do seem to be moving together, up or down. The degree to which each asset class moves together with the other classes can be mathematically determined and is called **correlation.**

A mixture of asset classes may be created to match the investment objectives of a given investor. For example, an investor who is concerned about capital preservation and maximum current income might invest 60% in bonds, 40% in stocks. An investor with a long time horizon, who is willing to accept higher risk in search of maximum capital growth, might choose 100% stocks, including riskier small-cap issues and emerging markets equities. There are countless portfolio variations, each with determinable risk and reward characteristics.

Your Broker-dealer disclosure will appear here.

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Portfolio profiles

Where do you fit in along the risk/reward continuum? Here are some sample portfolio types that may be used in discussing asset allocation models.

Profile	Objectives	Comment
Conservative income	Current income; capital preservation is a secondary objective.	Relatively lower risk
Balanced	Capital preservation and capital growth	Moderate risk
Moderate Growth	Long-term capital gains	Moderate risk
Growth	Long-term capital gains	Riskier assets
Aggressive Growth	High returns	Highest risk

Source: M.A. Co.

Fine-tuning

The historical returns of asset classes are not simply accepted at face value, they must be put into context. The long-term trend for each asset class is identified and compared to the recent trends. If an asset class appears undervalued with this analysis, its weight in the portfolio may be increased; if it is overvalued, decreased.

Once the model for the portfolio is established, specific securities will be selected that conform to it. The portfolio will need to be monitored on an ongoing basis for unexpected deviations from the historical norms. By understanding and using such data, through the process of **portfolio optimization,** the riskiness of a given portfolio may be reduced without sacrificing the potential for reward. Alternatively, one may increase the potential expected return, without increasing risk, through appropriate adjustments among the asset classes.