

Strategic asset allocation

A personalized approach to diversification and risk management



Wealth Management

An investment strategy

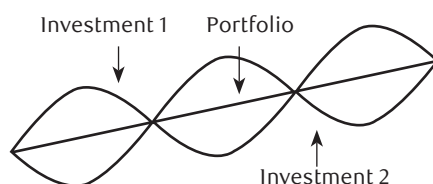
Asset allocation is an approach in which you invest in different asset categories—mainly cash, fixed income and equities. By diversifying your money across and within these asset classes, you can help minimize risk and potentially improve your overall returns.

How you allocate your assets hinges on several factors, including your financial objectives, attitudes toward risk and investing, desired return, age, income and tax bracket, time horizon and even your belief in what the market will do in the near term and long term. Whether you're investing for retirement, a child's college education, or for other goals, asset allocation is an investing strategy.

Diversification: the main principle behind asset allocation

The underlying principle in asset allocation is the documented observation that different categories of investments have varying rates of return and levels of price volatility over time. By diversifying your investments over several asset classes, you may reduce risk and volatility while achieving strong returns.

Optimal diversification assets offset volatility



Generally, downturns in one investment class may be tempered or even offset by favorable returns in another. Just as using different asset categories within a portfolio can help reduce your risk, your choice of individual investments within an asset class may do the same. For example, choosing stocks from different industries (i.e., automotive, retail or utilities) within an asset category can be less risky than investing all of your stock allocation in one industry or company.

Risk tolerance

It is important to determine your risk tolerance before allocating your assets. Different investors react differently to the same market movements because of their different comfort levels with risk. Are you comfortable taking bigger risks in exchange for potentially bigger rewards? Or would you rather “play it safe” with your money?

In general, the higher your risk tolerance, the more comfortable you should feel about owning equities.

The lower your risk tolerance, the more comfortable you should be with bonds or cash and money markets.

Balancing risk and return

Asset allocation can help you balance the risk and return in your portfolio. In addition to their varying advantages and disadvantages, equities, fixed income securities and cash respond differently to the same market conditions. They typically do not move in tandem. For example, when stock prices are rising, bond prices may be falling (and vice-versa).

Effective asset allocation

An effective asset allocation strategy tailored to your individual situation is one key to long-term investment success.

Consider the following:

- Asset allocation is responsible for more than 90% of variations in portfolio performance.
- When assets are invested over time, the key driver of variance of portfolio returns has been the asset allocation decision.
- Ineffective diversification simply adds more securities, without enhancing returns or moderating risk.
- There is no single asset allocation model to fit every investor, or for every stage of life. The asset allocation decision is a personal one.

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Key determinants of variance for portfolio returns



- Strategic asset allocation
- Security selection
- Market timing
- Other

Source: Brinson, Singer and Beebower. *Financial Analyst Journal*, 1991

Time horizon

Each of your goals has a time horizon—the number of years before you’ll need the money you invest. When planning for retirement, it is also wise to consider how long you’ll likely need the money to last once you begin spending it. The longer your investment time horizon, the more volatility risk you may assume. With a longer-term investment horizon, you can ride out several economic cycles, and your highs should generally outweigh the lows. A shorter investment horizon may require a more conservative approach. You may want to allocate investments to a lower volatility mix of asset classes as the time approaches to convert your investments to cash for your particular goal.

Review and rebalancing

The asset allocation you utilize today may not be appropriate for you in the future. This can be the result of economic fluctuations and changes in your investment objectives or your personal or financial circumstances. In addition, any growth or decline within asset classes may cause your asset allocation ratios to shift. For these reasons, it is important to review your asset allocation periodically and rebalance your portfolio from investments in asset classes that have been in favor into investments in lower performing asset classes to ensure your investments remain in a suitable mix.

Contact your financial advisor to discuss the benefits of strategic asset allocation.