

## Understanding Asset Allocation and Hedging

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  - Certified Financial Planner
  - Registered Investment Advisor
  - SEA Benefit Provider Since 1999
- Federal Times' "Money Matters" Columnist
- "Ask the Experts" Panelist at [www.federaltimes.com](http://www.federaltimes.com)

# Fundamentals of Investing for Retirement Income

1. Success and Failure in Retirement Investing
2. Defining Retirement Resources, Goals and Constraints
3. Understanding Investment Risk and Return
4. How Diversification Really Works
5. Asset Classes and Types – Diversification and Concentration
- 6. Understanding Asset Allocation and Hedging**
7. Setting Investment Performance Expectations
8. Managing Investment Costs
9. The Case for Index Investing
10. Accounting for Inflation in Retirement Planning
11. Managing Portfolio Liquidity
12. Organizing Your Portfolio

# SEA Member Benefits

- Free Hour of Consulting / Analysis
  - \$250 Vantage Discount
- Email Questions to me at [mmiles@variplan.com](mailto:mmiles@variplan.com)

# Asset Classes and Types – Diversification and Concentration

# Asset Classes

Stocks

Bonds

Cash

Fractions of asset classes and anything else

# Asset Types

Sector Funds

Commodities / Resources

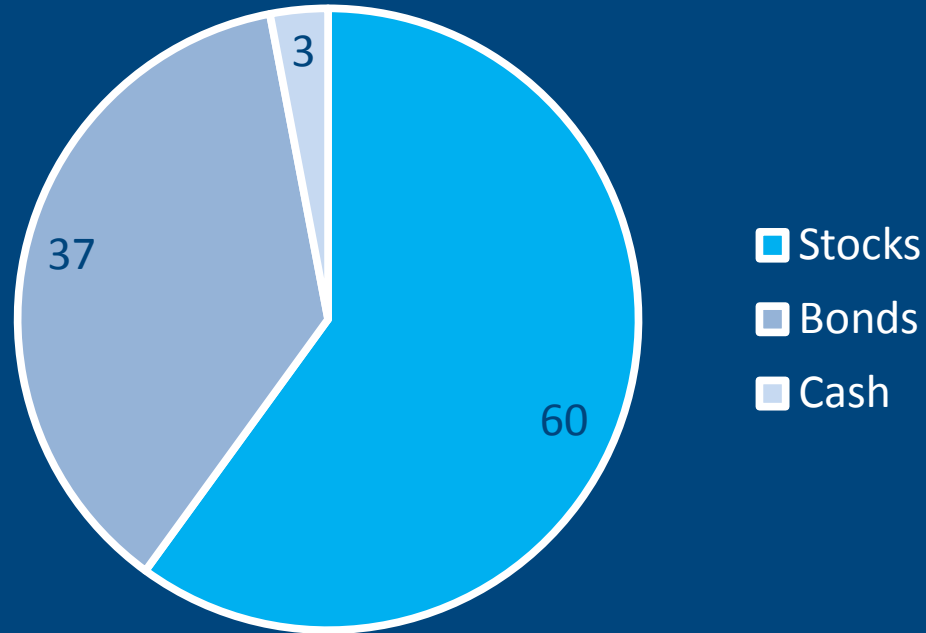
REITS

Derivatives

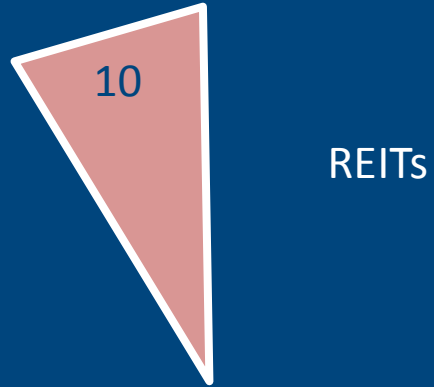
Foreign Funds



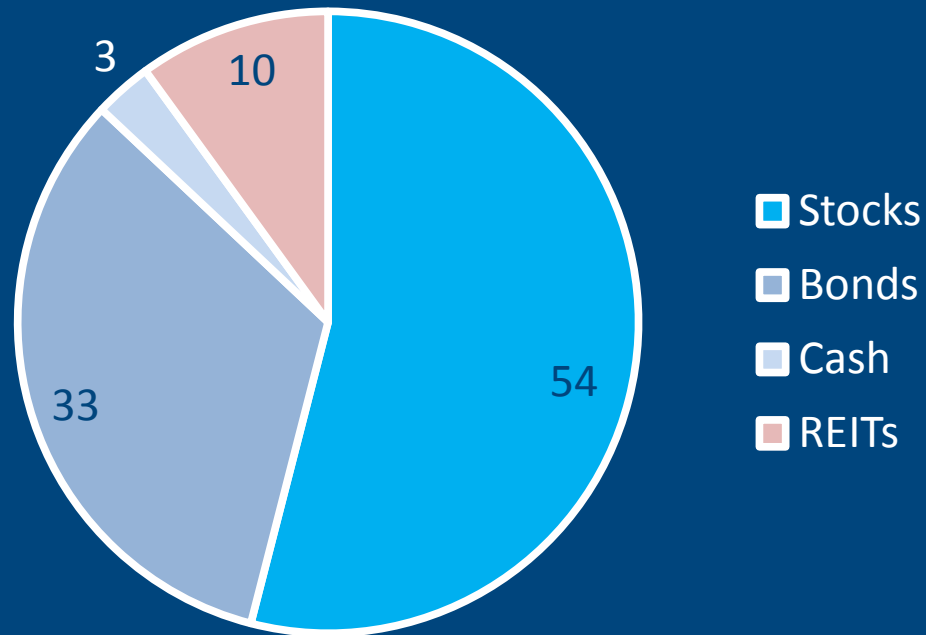
# Simple Moderate Portfolio



# How About Adding REITs to the Allocation?



# Compromising REITs Into the Allocation



# REITs vs. Asset Classes

Asset	Expected ROR	Standard Deviation	Change in EROR	Change in SD
Stocks	13%	19%	-39%	-21%
Bonds	5%	5%	+60%	+200%
Cash	4%	3%	+100%	+400%
REITs	8%	15%	-	-

# Correlation Coefficients

	Stocks	Bonds	Cash	REITs
Stocks	1.00	0.14	0.06	0.51
Bonds		1.00	0.23	0.18
Cash			1.00	-0.05
REITs				1.00

# Adding REITs to the Portfolio

Portfolio	Expected ROR	Standard Deviation	Change in EROR	Change in SD
a. Moderate 60/37/3	10.1%	12.0%	-	-
b. Moderate w/ 10% REITs	9.9%	11.7%	-2.0%	-2.5%
c. 57/40/3 Variant	9.9%	11.5%	-	-1.7%
d. Moderate w/ 20% REITs	9.6%	11.3%	-5.0%	-5.8%
e. 53/44/3 Variant	9.6%	10.9%	-	-3.5%

# How Much Inter-Market Diversification is Too Much?

Cost–Benefit Analysis

# Considerations

- Time
- Skill
- Method
- Expense
- Access
- Performance



# Example: Asset Types Menu

SIMPLE ←		→ COMPLEX	
Stocks	Domestic	Large	Value
			Growth
		Medium	Value
		Growth	
		Small	Value
		Growth	
	Foreign	Developed	Blend
		Emerging	Blend
Real Estate	Domestic	Diversified	REIT
Metals	Global		Gold
Cash	Cash	Cash	Cash
Bonds	Domestic	Government	Short
			Medium
			Long
			TIPS
		Commercial	Invest Grade
			High Yield
	Foreign	Government	Diversified

# Example: Securities Menu

COMPLEX ←			→ SIMPLE
IVE	IVE	IVE	IVV
IVW	IVW	IVW	
IJJ	IJJ	IJJ	
IJK	IJK	IJK	
IJS	IJS	IJS	IJR
IJT	IJT	IJT	
EFA	EFA	EFA	EFA
EEM	EEM		
IYR			
IAU			
Cash	Cash	Cash	Cash
SHY	SHY	SHY	AGG
IEF	IEF	IEF	
TLT	TLT	TLT	
TIP	TIP		
LQD	LQD	LQD	
HYG	HYG		
IGOV			

## Understanding Asset Allocation and Hedging

# Financial Planning and Management



- Wants
- Needs

- **Guaranteed**
  - Annuities
  - Insurance
- **At Risk**
  - **Liquid Assets**
    - Cash
    - Marketable Securities
  - **Illiquid Assets**
    - Real Estate
    - Business Interests

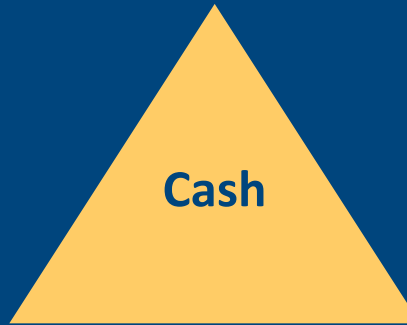
- **Action**
  - Constraints
- **Decisions**
- **Analysis**
  - Assumptions
  - Experience
  - Probabilities
  - Estimates

- **Risk**
- **Return**

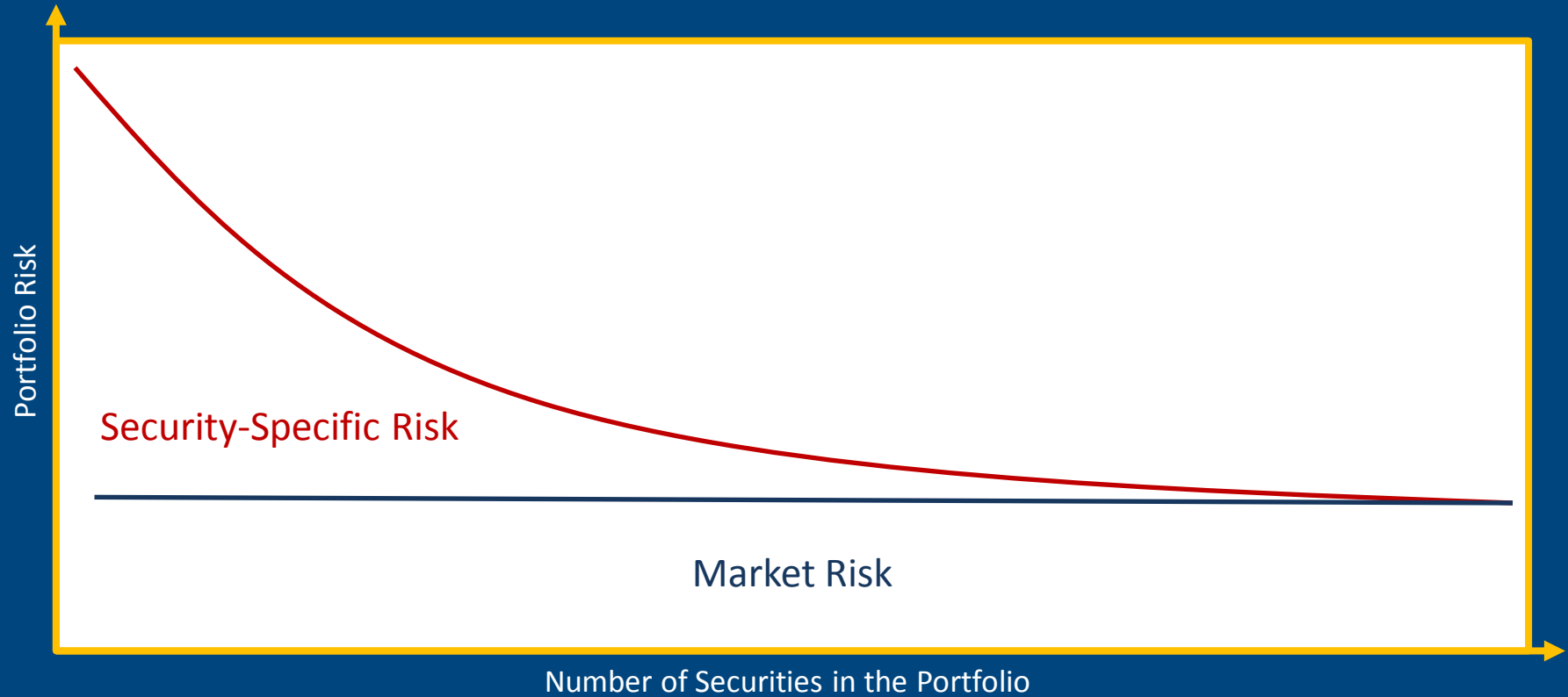
- Cash Flow
- Wealth

Inflation & Taxes

# Portfolio Building Blocks



# Intra-Market Diversification



# Portfolio Building Blocks



- Inflation Risk

# Portfolio Building Blocks



- Interest Rate Risk
- Default Risk
- Valuation Risk



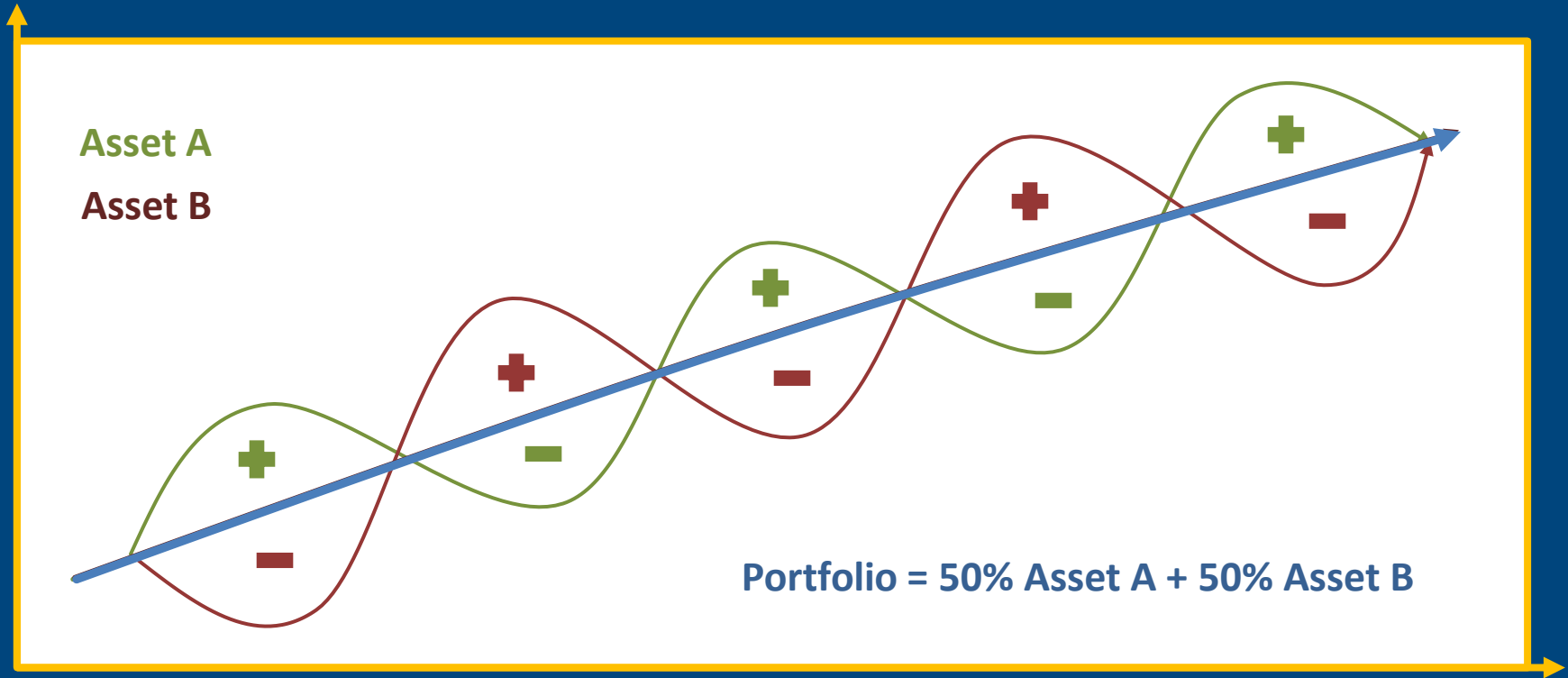
# Portfolio Building Blocks



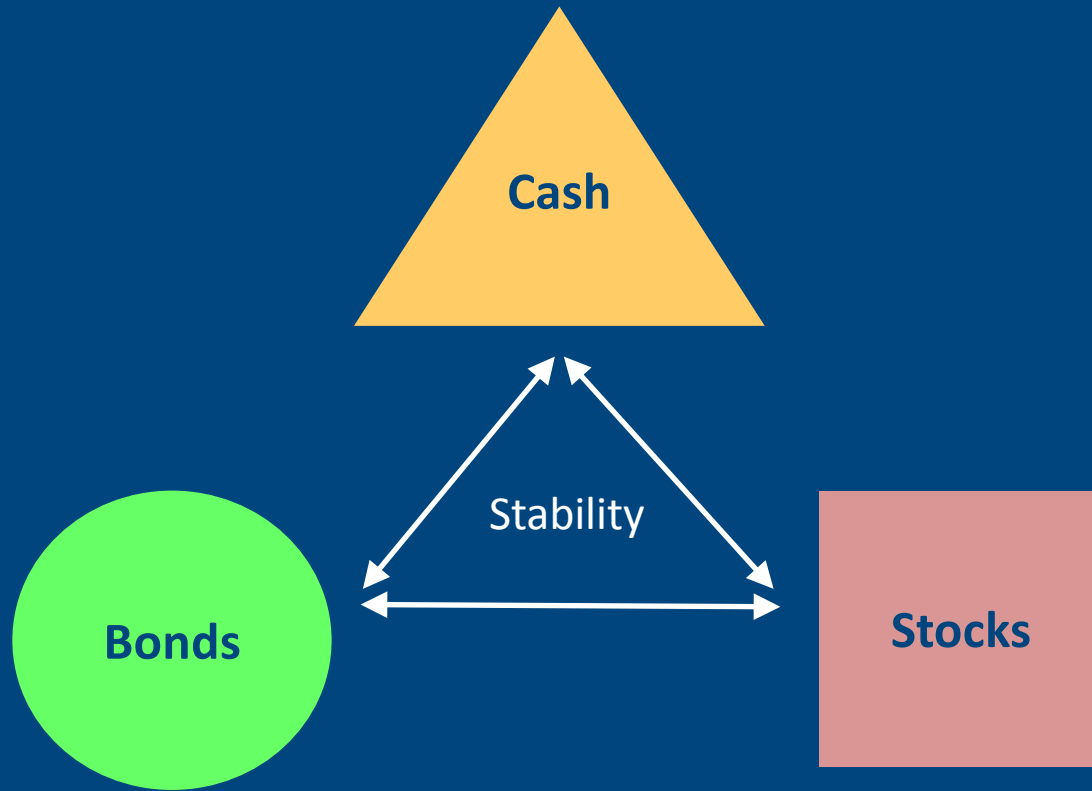
Stocks

- Valuation Risk
- Headline Risk

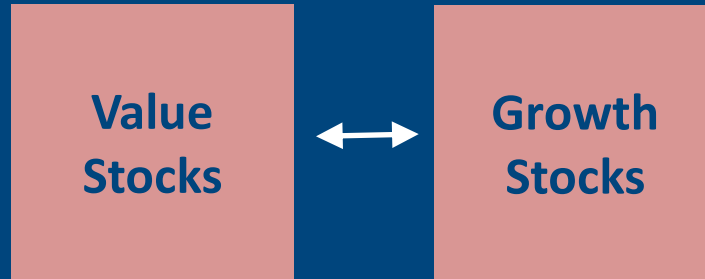
# Inter-Market Diversification



# Hedging



# Hedging



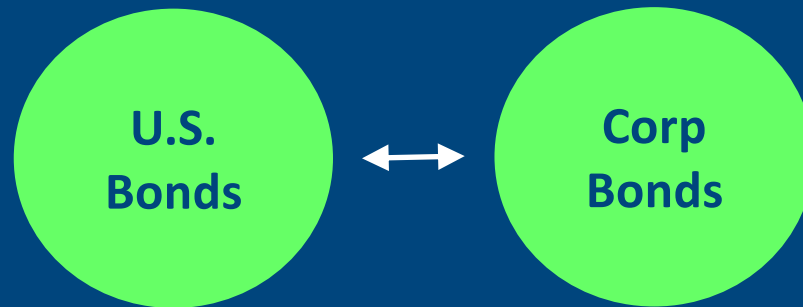
# Hedging

Large  
Company  
Stocks

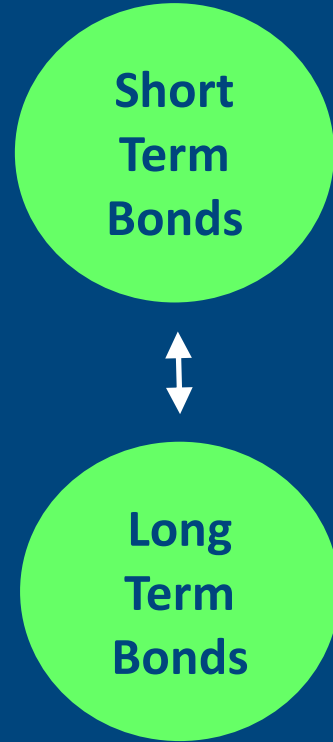


Small  
Company  
Stocks

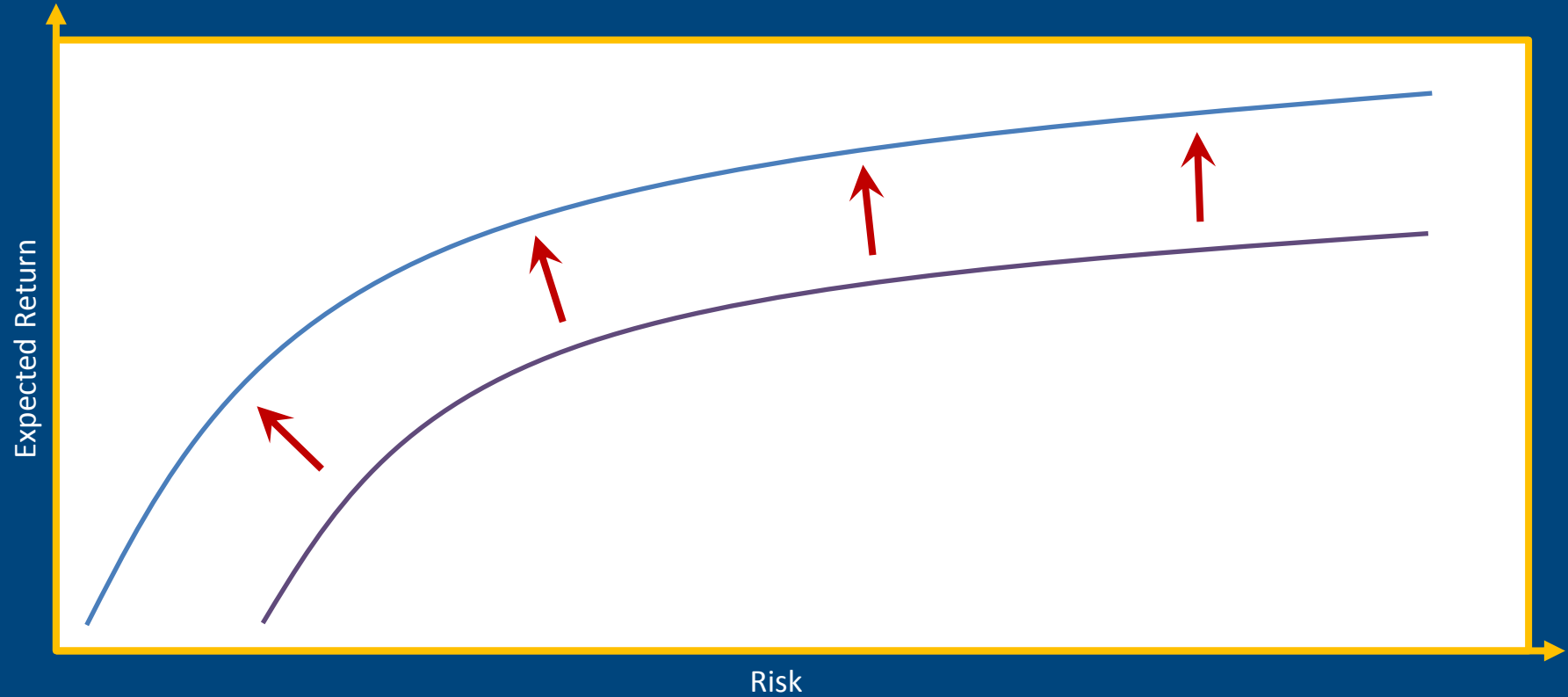
# Hedging



# Hedging

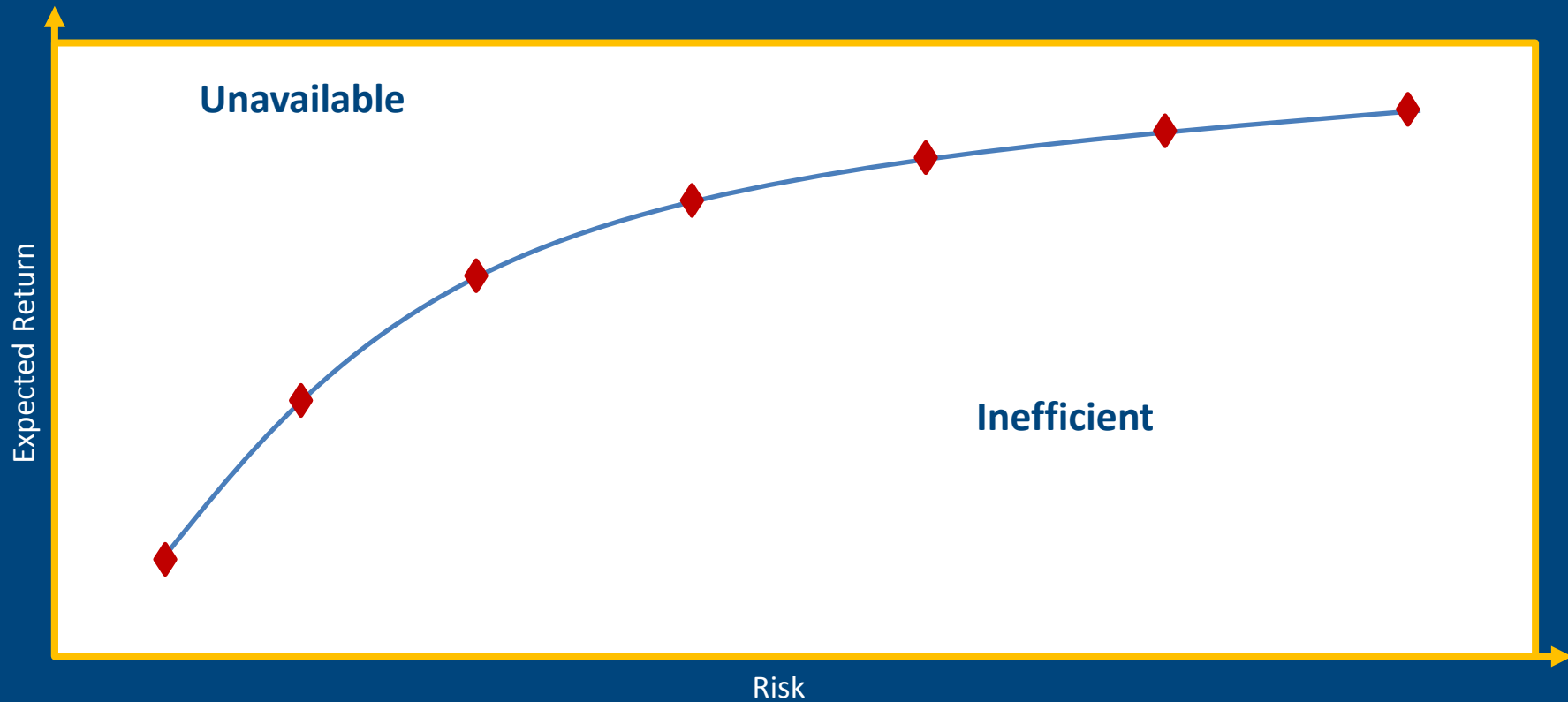


# The Efficient Frontier

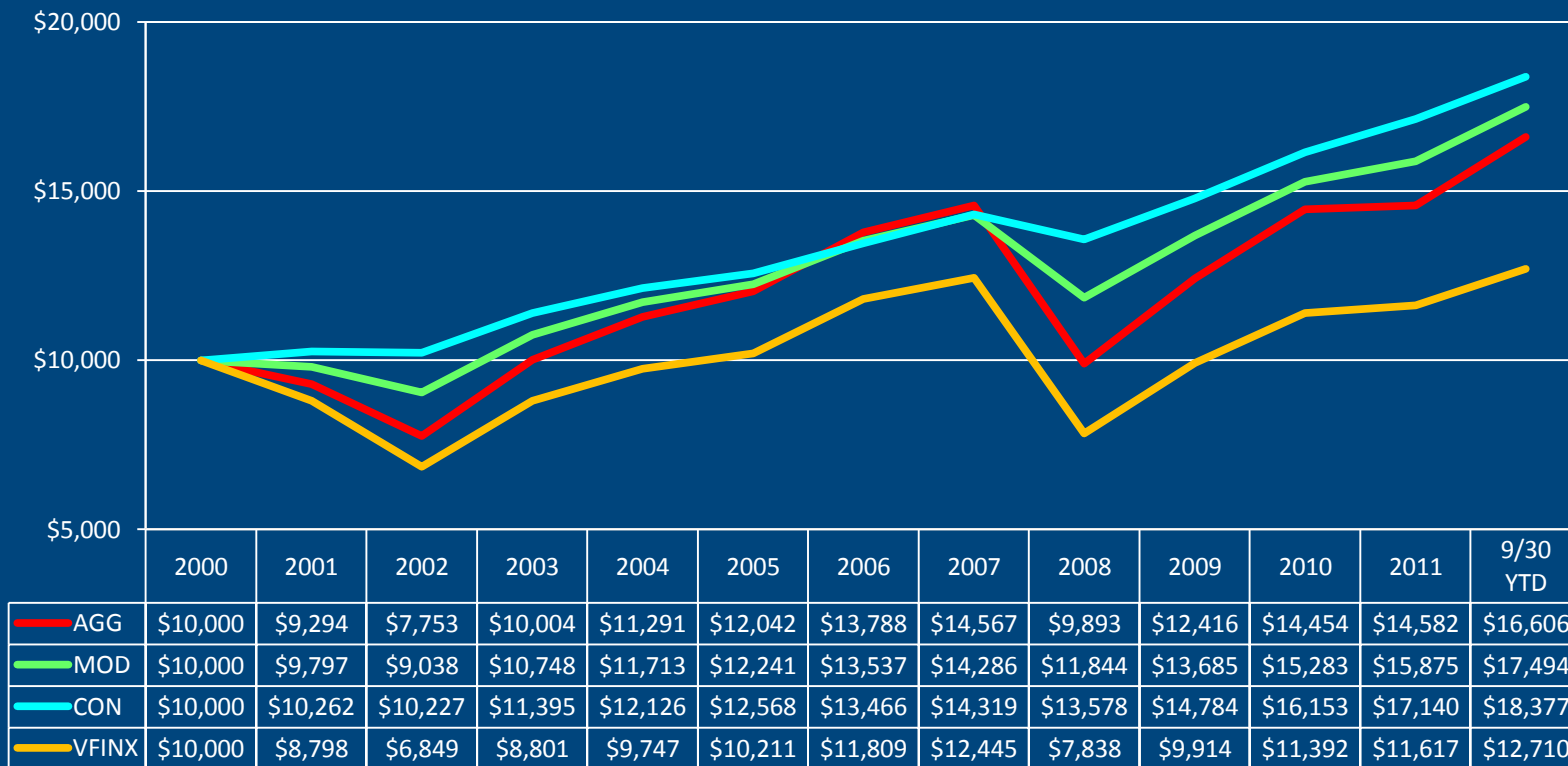




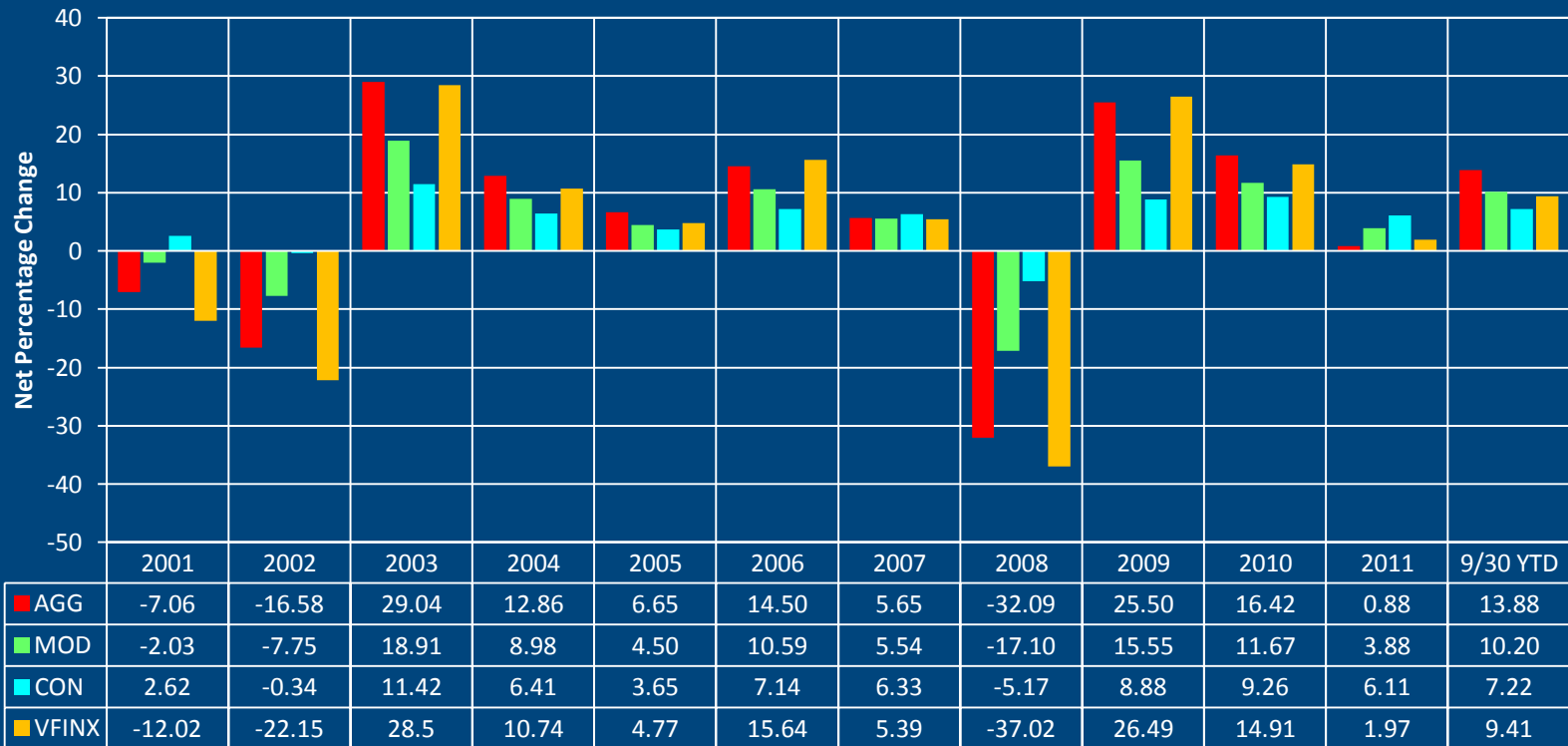
# Designing Efficient Portfolios



# Hedging



# Hedging



# Next Week's Webinar

1. Success and Failure in Retirement Investing
2. Defining Retirement Resources, Goals and Constraints
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