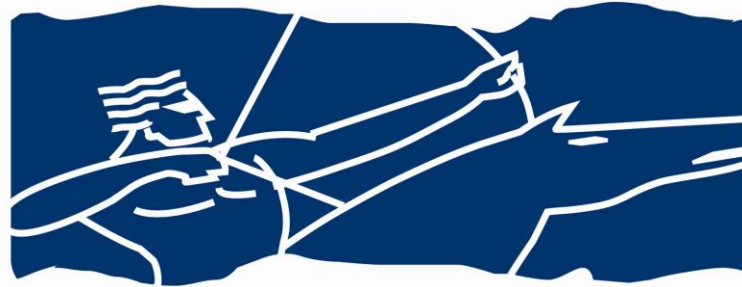


TODD-VEREDUS



ASSET MANAGEMENT LLC

# INTRODUCTION TO ASSET ALLOCATION

PAPERS Conference

May 25, 2011

Jack White, CFA

Todd-Veredus Asset Management

# WHAT IS ASSET ALLOCATION

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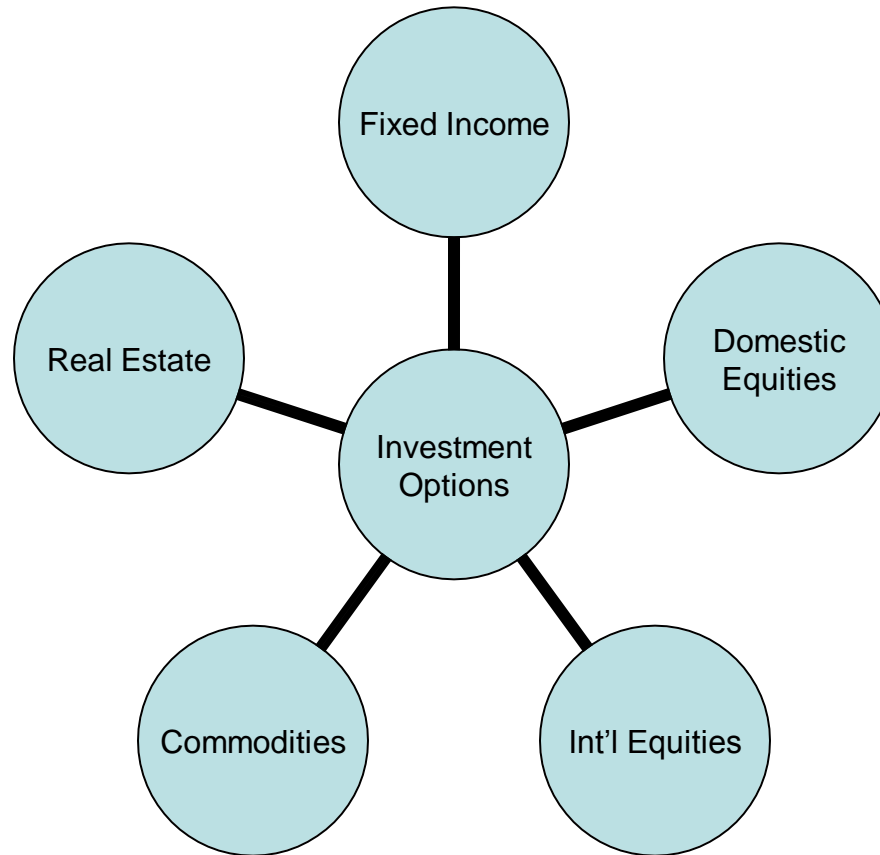
Asset allocation is the way investors diversify their portfolio among different investment options.

- ◆ Stocks versus bonds
- ◆ Growth versus value
- ◆ Large cap versus small cap
- ◆ International versus domestic

*Asset Allocation is the Most Important Step in Determining Expected Volatility and Investment Results.*

# COMMON ASSET CLASSES

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**All primary asset classes will fall into one of these groupings, or be derived from them.**

# DIVERSIFICATION- WHY USE A MIX OF ASSETS

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**Diversification theory shows a mix of assets can lower volatility and improve returns for the risk taken.**

- ◆ **Assets have different return and risk characteristics**
- ◆ **Correlation is a key concern**
- ◆ **Goal: Minimizing Correlation while improving returns**
- ◆ **Cycles do occur**

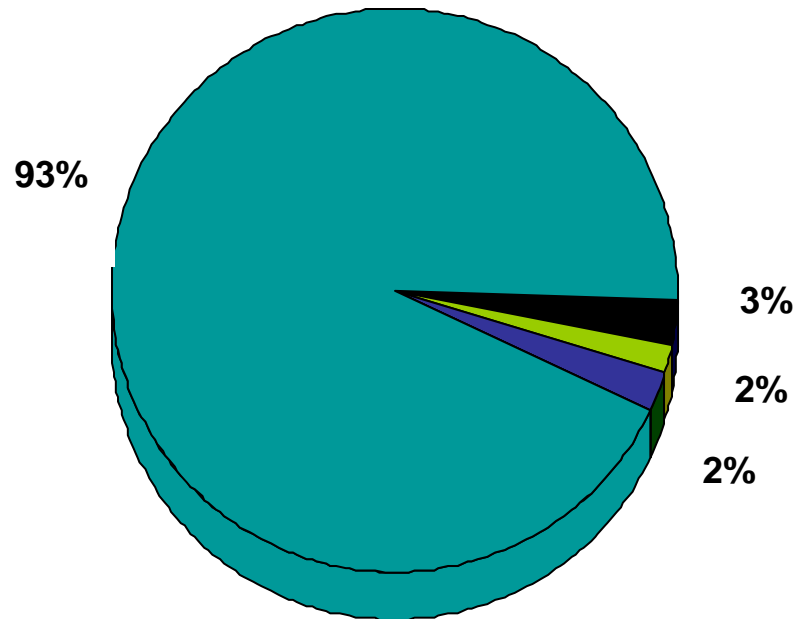
**Improved returns with less volatility are the goals of most pension funds.**

# ASSET ALLOCATION DRIVES RETURNS

## Results – Asset Allocation is Primary Ingredient

- ◆ “93%-95% of difference in return is attributable to asset allocation.”

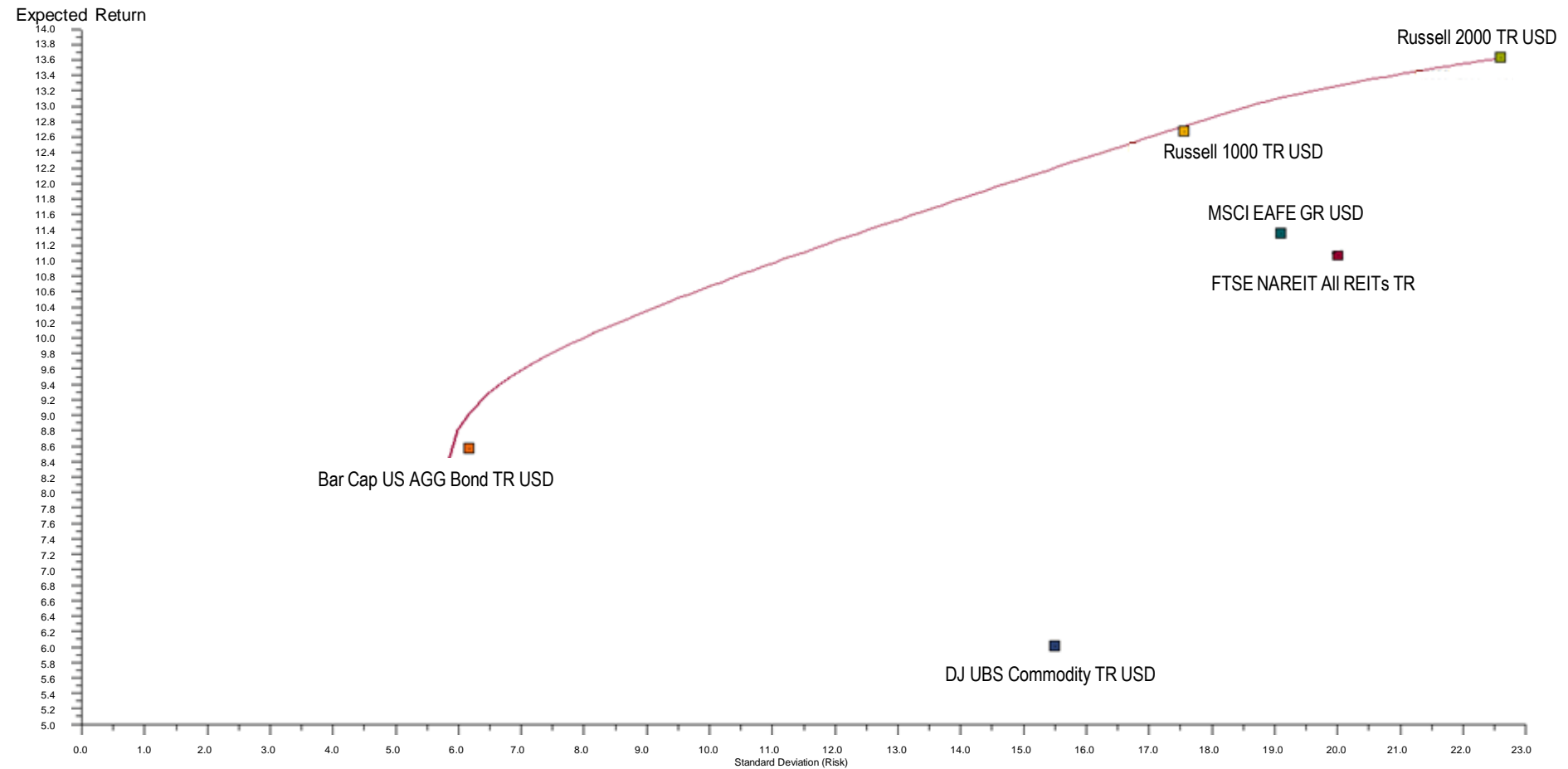
*William F. Sharpe*



Source: Financial Analysts Journal, July-August 1986

# ASSET CLASS RISKS VERSUS RETURNS

## Asset Class Returns and Volatility 1991-2010

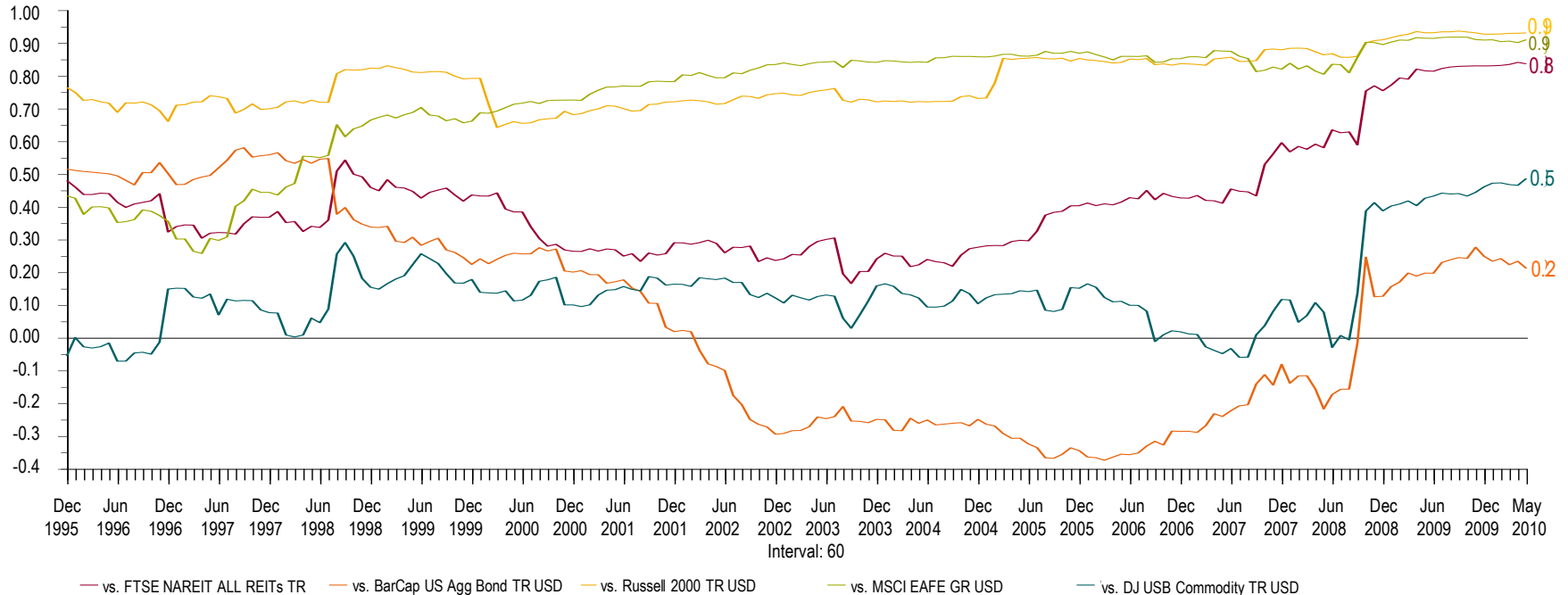


Source: Morningstar

# ASSET CORRELATIONS: WHY THEY MATTER.

## Correlation of Selected Asset Classes to Large Cap Stocks 1995-2010

Correlation Values

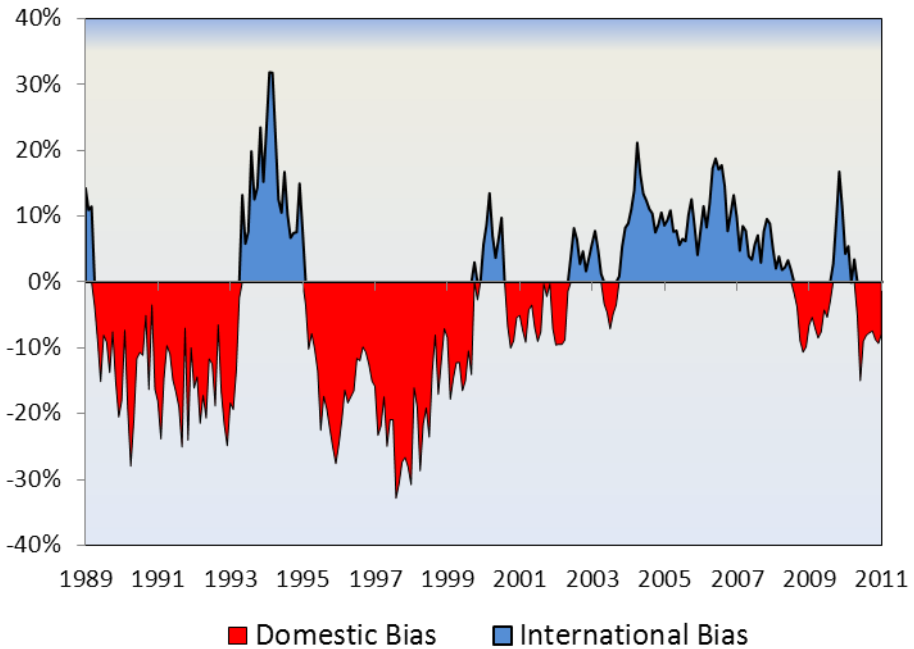


Source: Morningstar

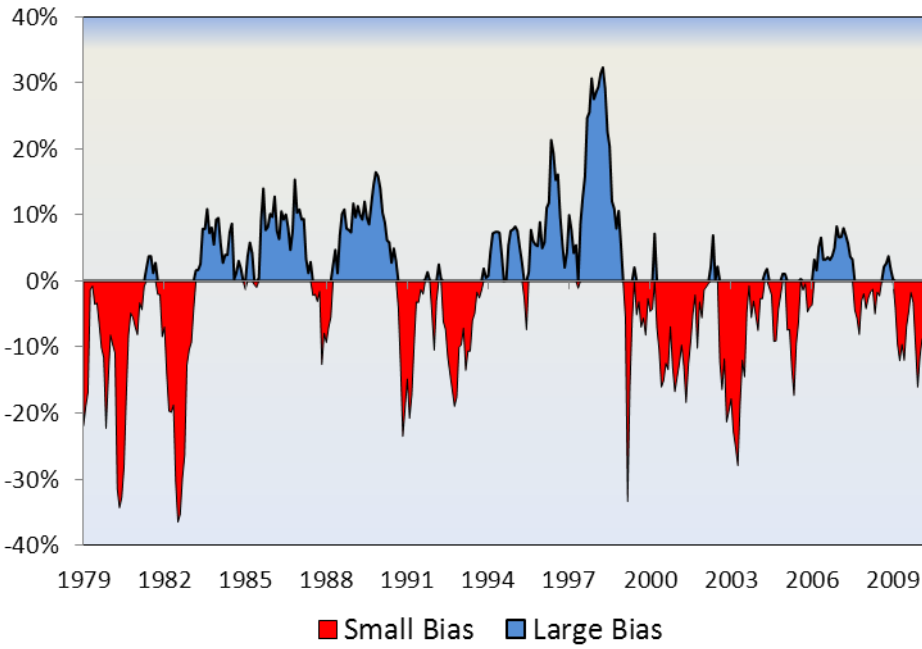
Higher correlations between asset classes dilute diversification benefits.

# PRACTICAL CONSIDERATIONS - CYCLES

12 Month Returns - Rolling Monthly (12/89 - 03/11)



12 Month Returns - Rolling Monthly (12/79 - 03/11)



Source: Todd-Veredus Asset Management, FactSet

**EAFE vs. SPX**

**Russell 1000 vs. Russell 2000**



# TYPES OF ASSET ALLOCATION

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## Two major camps - Strategic vs. Tactical

- **Strategic** – (Static) takes a long-term view and does not change much from year to year. Evolutionary... not revolutionary.
- **Tactical** – (Active) structures portfolios to take advantage of shorter term market inefficiencies. Asset weights vary more from year to year.
  - Tactical Asset Allocation
  - Global Tactical Asset Allocation
  - Dynamic Asset Allocation
  - Market Timing

# ASSET ALLOCATION IMPLEMENTED

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- What is Standard- 60/40? 70/30? Other?
- Benchmarked to an index
- Constrained versus unconstrained
- Class limitations

# OTHER CONSIDERATIONS

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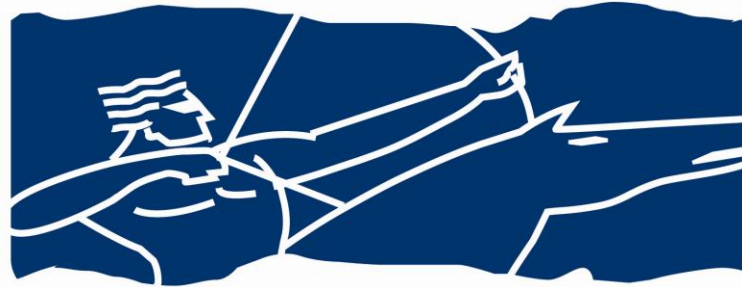
- Rebalancing Frequency
- Implementation- Active or Passive
- Liability Driven Investing
- Glide Path Investing

# BENEFITS OF ASSET ALLOCATION

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- Investors set goals and risk tolerances
- Improves probability of achieving goals
- It provides a benchmark to judge results from

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