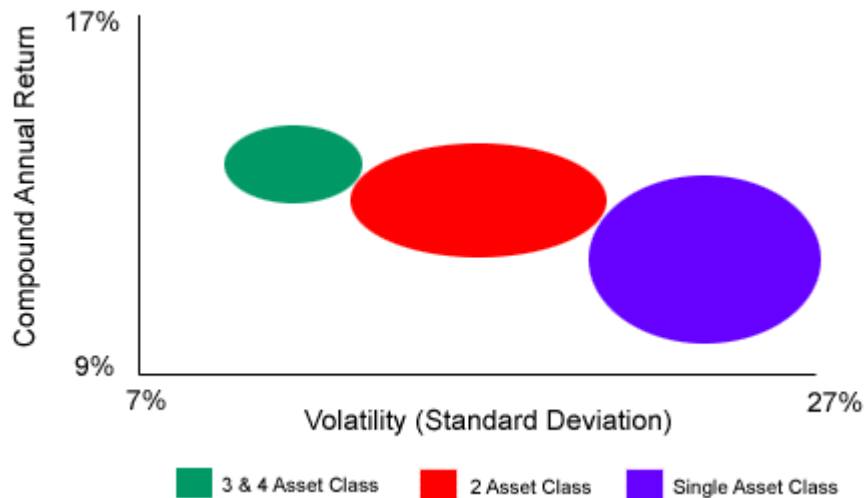


Are you a loser?

Unfortunately many of us are! We're losers on our investments because we don't bother to take advantage of the benefits of having an efficient portfolio. Portfolios that are properly designed with multiple assets deliver superior risk-adjusted returns. Or in layman's language: proper diversification improves returns. Here's a diagram that should illustrate the power of asset allocation.



The rewards of multiple-asset class portfolios

As you can see, the reward of balancing your portfolio with different asset classes can be quite significant in terms of increased returns and lower volatility. So only losers will stick with just one type of equities, or put all their money in a couple of funds.

But if this is such a powerful technique, why isn't everyone doing it? A lot of investors intuitively think that adding new asset classes (especially bonds) can reduce risk but at the expense of reducing returns. But this is not the case – proper asset diversification can reduce volatility and increase returns.

Other reasons include the allure of market timing, the tendency to dismiss assets other than equities as too pedestrian, and simply a widespread ignorance of this technique. Yet it's the same technique that almost all professional money managers will use in some form – and also a theory that won a Nobel prize for economics!

How to get an asset allocation

While asset allocation is powerful is not easy for an individual investor to get a suitable allocation herself. Increasingly independent financial advisers and banks are offering this kind of analysis for their investors. Our investment tune-up is one example. And certainly private banks should.

If your financial advisor does provide such an analysis, it will help you determine if you have the right mix of investments for your personal situation, including investments that you already hold. It may lead to a decision to add new types of investments (or reduce others), in order to change the risk and return of your portfolio. The risk level of the portfolio should match your risk appetite.

A good analysis will provide the following information and forecasts:

- projected overall returns for the portfolio. For example, an average net return of 10.5% pa.
- forecast average value at the end of the investment period. For example, \$244k after 5 years
- proportions of each asset class. For example, 10% in International Bonds, 25% in small company stocks
- 1-year downside, the "losing sleep" factor. For example, an indication that you could lose 15% in any single year in most circumstances
- worst case and best case portfolio values. In other words the range of likely values you will have, rather than to expect (or rely on) average values.
- a backtest of the proposed portfolio, showing you how the portfolio would have performed if you had invested in those proportions and asset classes, over the last 10-15 years.
- forecasts adjusted for product fees (such as unit trust upfront and annual fees). If not the forecasts will be over-optimistic
- ability to adjust for inflation. Nominal values (those not adjusted for inflation) are easy to understand but can be deceptive. For example, a value of \$1m in 15 years could be much less in today's "value" than it might seem. So the analysis will need the option to generate inflation-adjusted forecasts.
- a simple measure of "how good the portfolio is". Sharpe Ratio (a measure of incremental assumed return provided by a portfolio for taking additional risk) is a convenient number to see. Higher values of the Sharpe Ratio are desirable. A low Sharpe Ratio means you are taking risk and not being rewarded for it.