

TACTICAL ASSET ALLOCATION

A Proactive Approach to Portfolio Management

WHAT IS ASSET ALLOCATION?

It is well established that more than 90% of portfolio volatility can be attributed to asset allocation, or how an investor chooses to allocate investments among a variety of different asset classes.*

For example, an investor may adjust the amount of his or her portfolio to allocate to growth or value stocks in large-, mid- and small-cap companies — as well as to corporate, municipal and government bonds and cash — based on his or her individual goals, risk tolerance and time horizon. The allocation decision is frequently backward-looking, based on past performance of the asset classes. This approach is often called the investor's strategic asset allocation.

STRATEGIC ASSET ALLOCATION RESPONDS TO MARKET FORCES AFTER THE FACT

Traditionally, strategic asset allocation means to “buy and hold” and then periodically rebalance the portfolio, selling investments in higher performing asset classes and purchasing investments in lower performing asset classes, to bring the portfolio back to its original asset allocation.

TACTICAL ASSET ALLOCATION ANTICIPATES MARKET FORCES — NOW AND FOR THE FUTURE

Tactical asset allocation is a more dynamic, forward-looking form of asset allocation that seeks to adjust asset allocations to expose investors to capital building and to capital preservation opportunities based on macroeconomic and leading indicators for various markets, sectors and asset classes. The effects of globalization, market volatility and rapid economic changes over recent years have created renewed interest in this form of asset allocation.

HOW TACTICAL ASSET ALLOCATION WORKS

Generally speaking, tactical asset allocation strategies attempt to maximize risk-adjusted returns by identifying and taking advantage of relative mispricings across asset classes. To accomplish this, tactical asset allocation uses a variety of measures to evaluate current market status and forecast potential future opportunities and risks. These measures include technical, fundamental and quantitative indicators. Based on these indicators, buy and sell decisions are made based on tested, disciplined and systematic methodologies.

Technical Indicators — Price and volume trends over time may help establish “floor” and “ceiling” values for securities

to help inform buy and sell decisions. These patterns may also provide advanced signals to shift allocation weights from equities to treasuries, or vice versa. For example, a “head and shoulders” pattern in an equity market chart may suggest an opportune time to switch from stocks to T-bills.

Fundamental Indicators — Financial and economic indicators that reflect overall market valuation may help investors choose which sectors or asset classes are more opportune than others. For example, one such measure compares stock dividend yields with bond interest. Stocks are said to be expensive when the market's dividend yield is low relative to that of 10-year notes.

Quantitative Measures — Applying quantitative market measures or variables to predictive models may help identify appropriate trades. For example, a model might be designed to identify potential market pullbacks based on the interplay of stock price movements with the money supply, dividend yields and economic activity.

BENEFITS OF TACTICAL ASSET ALLOCATION

Employing some degree of tactical asset allocation may offer the chance to benefit from — and manage risks from — ever changing opportunities and threats. For example, a strategic asset allocation

of 60% equities may be maintained. However in a tactical move, the ratio of domestic to foreign stock within that 60% equities position may be reallocated based on indicators, measures and the chosen tactical methodology. And instead of selling winners to purchase losers through traditional rebalancing, it may help improve overall portfolio performance.

TAKE AN INTEGRATED APPROACH TO PORTFOLIO MANAGEMENT

The important distinctions between strategic asset allocation and tactical asset allocation mean that many investors are interested in using tactical asset allocation strategies to support their strategic asset allocation goals. Your financial advisor has a variety of resources and a robust set of tools to incorporate tactical asset allocation strategies into a holistic plan to help build and preserve your wealth.

To take advantage of the capital building and preservation opportunities that Tactical Asset Allocation may offer you, contact your financial advisor today.

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