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Insights from Graystone Consulting Green Bay

Importance of Asset Allocation in Portfolio Management

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Introduction

Asset allocation is one of the most important decisions you will make when it comes to investing. It acts as the heartbeat of effective portfolio management, shaping the foundation for a successful investment strategy. In this brief article, we explore the crucial importance of asset allocation in achieving a balanced and resilient investment portfolio.

What is Asset Allocation?

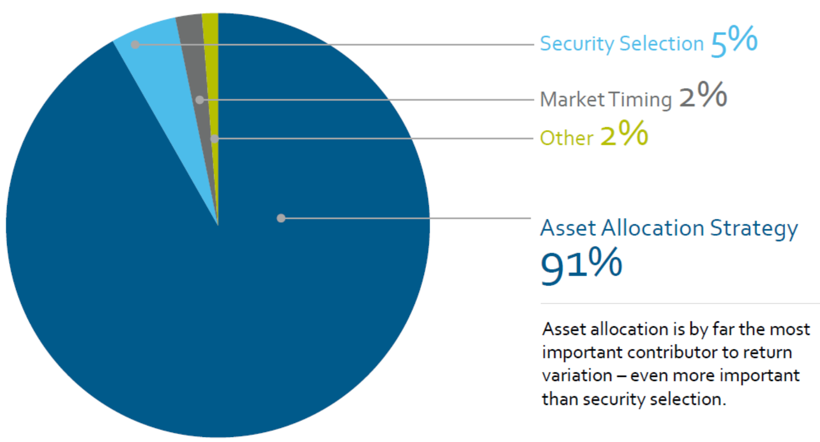
Asset allocation is the decision surrounding what percentage of your investments should be in which asset classes. At a high level, its the choice is between Equities, Fixed Income, Alternative Investments and Cash. Within the broad class of “Equities,” you can opt for a mix of large-cap growth, large-cap value, mid-cap, small-cap, domestic, international, emerging markets and so on. Within the bucket of “Fixed Income,” there are short vs. long-term bonds, government bonds, corporate bonds, mortgage-backed securities and more. Alternative investments are a category of their own and offer a wide-range of risk-mitigating and return-seeking strategies for those qualified to invest in this asset class.

Risk Mitigation Through Diversification

Asset allocation is a key driver of diversification. By spreading investments across different asset classes that are not perfectly correlated you could effectively reduce the volatility of your portfolio. In times of economic uncertainty, a thoughtfully constructed asset allocation strategy can act as a stabilizing force. It helps manage the impact of market downturns and typically provides balance in the overall portfolio. In our opinion, asset class diversification is becoming increasingly important as concentrated market returns can create unwanted exposure to high-momentum growth factors. A poorly diversified portfolio could experience poor performance if markets see a change in sector leadership.

Key Driver of Your Portfolio's Long-Term Returns[1]

Research suggests that more than 90% of a portfolio's long-term return is attributable to its mix of asset classes. Individual stock selection, market timing, and other factors typically account for less than 10% of a diversified portfolio's long-term return. In our experience, asking "What stock should I buy?" is the wrong question. You should be asking "Is my asset allocation strategy aligned with my financial goals, risk tolerance, and time horizon?" Generally long-term goals allow for a "riskier" asset allocation, and vice versa for shorter-term goals.



[1]Source: Roger G. Ibbotson. Does Asset Allocation Policy Explain 10, 90 or 100 Percent of Performance? Financial Analyst Journal, January/February 2000; Brinson, Singer and Beebower. Determination of Performance II: An Update, Financial Analyst Journal, May/June 1991. Based on US pension-fund data from 1977 to 1987. The asset allocation strategy includes broad market exposure.

Professional Guidance and Technology Integration

Seeking advice from a financial professional and leveraging technology-driven tools can elevate the effectiveness of your asset allocation strategy. Advanced analytics and models assist in data-driven decision making, ensuring that allocation strategies remain informed and adaptive to changing market conditions.

Conclusion

At the end of the day, asset allocation emerges as the linchpin of successful portfolio management. Whether mitigating risks, optimizing returns, or aligning with specific financial goals, a strategic approach to asset allocation forms the bedrock of a resilience investment journey. Recognizing its importance can be the key to unlocking the full potential of your portfolio.

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Asset Allocation and diversification do not assure a profit or protect against loss in declining financial markets.

Alternative investments are often speculative and include a high degree of risk. Investors can lose all or a substantial amount of their investment. They may be highly illiquid, can engage in leverage, short-selling and other speculative practices that may increase volatility and the risk of loss, and may be subject to large investment minimums and initial lock-ups. They may involve complex tax structures, tax inefficient investing and delays in distributing important tax information. They may have higher fees and expenses that traditional investments, and such fees and expenses can lower the returns achieved by investors.

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