Asset Allocation Determination

IN this brief we offer a discussion on a practical method of how asset allocation can be used to accomplish an investor's attempt to satisfy stability and opportunity within an investment portfolio. It is our objective to create a solid basis for understanding changes in allocations when considering objectives, risks and market characteristics.

In this brief, there are six major sections and ten sub-sections. The major sections start with a global view and then continue to refine our focus until the allocation is focused exclusively on domestic sectors. At the end of the brief there is a special section where consideration is given to portfolios that are concentrated in a single particular sector and how to adjust a portfolio to reduce the concentration impact.

This version of the Asset Allocation is our initial view as the new year starts and may change as world market conditions change. If conditions change throughout the year such that our view warrants a major review, we will publish a revision and clearly identify the revised allocations.

Throughout the year there will be minor adjustments to the relative allocations, especially sectors. As sectors become increasingly overvalued or undervalued on a relative basis, the sector asset allocation will be adjusted. A through explanation of this process is provided in the section titled "Asset Allocation – U.S. Sector.

Each section of the report addresses asset allocation to three major asset classifications: cash, bonds (debt) and stocks (equity). Bonds are further segmented into eight additional asset areas. These asset areas are identified in columns one and three of Figure 1. The second column shows a market ticker of an index security that is considered a widely-accepted representation of the specific market area. For example, Corporate bonds are represented by the corporate bond ETF identified as "LQD". Each asset area has a representative security.

In the third column, the asset area common name is stated in an slightly abbreviated style. The areas represent 17 domestic and 10 international markets. The domestic areas

	Ticker	Name
Cash		
Bonds		
	SHY	US Govt
	MBB	MBS
	LQD	Corp/Pfd
	HYG	HY Corp
	IBND	Intnl Corp
	MUB	Muni
	IGOV	Sov Mkt
	EMB	Emerg Mkt
Stocks		
Domestic Large Cap	IVV	
	XLY	Consumer Discretion
	XLP	Consumer Staples
	XLE	Energy
	XLF	Financial
	XLV	Healthcare
	XLI	Industrials
	XLK	Technology
	XLB	Materials
	XLK	Telecom
	XLU	Utility
Midcap	IJH	
Smallcap	IFR	
International	EFA	
	EWU	UK
	EZU	Europe
	EPP	Pacific
	EWJ	Japan
	FXI	China
	EZA	Africa
	EEM	Emerging Markets
Real Estate		
Commodities		

Figure 1: Asset Allocation Classifications

are: U.S. Government [SHY], Mortgage Backed Securities [MBS], Corporate/Preferreds [LQD], High-Yield Corporates [HYG], and Municipal [MUB], 10 domestic sectors, mid cap and small cap markets.

Corporate bonds include preferred securities because this type of security many times has the same characteristics of a 30 year corporate bond.

The municipal area includes both tax-exempt and taxable securities. As a general rule, we are very concerned over the high debt levels incurred by state and local governments. As the lines between tax-exempt and taxable municipal bonds becomes increasingly vague, limited availability and with possible future treatment of municipal tax status, we have combined the category.

Stocks are segmented into two major categories: Domestic and International and then each major category is further refined. Domestic is segmented into Large, Mid and Small capitalization areas. The Large cap area is refined into ten sectors that focus on specific parts of the market. The ten sectors are identified in column three by name and their representative SPDR security identifier in column two. Each of these 10 sectors is discussed in detail in section "Asset Allocation – U.S. Sector".

Mid and Small capitalization portions of the market are identified in column one and the respective security ticker in column two.

International markets are identified as a group with the combined designation "EFA" representing the majority of "developed" non-American markets. It has traditionally been referred to as EAFE. There are seven asset areas under an international classification that are as mutually exclusive as possible, but not perfectly exclusive.

There are three major single markets: United Kingdom (UK), Japan and China. China is also represented in the Emerging Markets index along with many other secondary markets. This is an example of less than perfect mutual exclusiveness that has been part of global asset allocation since the beginning of investing. The reason we give China a separate representation is that China is now the #2 economy in the world. We can adjust the allocation to Emerging Markets to accommodate the separation of China from the collective. Europe covers continental Europe and Pacific includes countries in the region while excluding one of the largest economies, Japan. Africa has also been segmented because it has been identified as the next great global area of growth.

Allocation values are provided in columns four through nine. The first of these columns, column four provides what we have labeled Value Weights. Each of the values starts with a market capitalization weight that we identify as market neutral. If there were no under or overvalued positions in the world's markets we would have an asset allocation that would be a market neutral position. Since the occurrence of a pure market neutral condition is very rare, each of the allocations reflects the current classification relative to the market's relative valuation.

Across columns five through nine are allocations that represent the tradeoff between stability on one side and future opportunity on the other. These are not necessarily mutually exclusive, and they are not necessarily mutually obtainable. Historically, investments that provide potential for future increases in value (opportunity) are more speculative and experience higher variations in pricing over time. It is not the same as saying these investments experience a higher risk of default or failure. It simply translates to more variations in portfolio values over any period of time.

The two ends of the spectrum are lower variations in portfolio values, and an increased level of stability, versus lower stability in values, but greater potential in the future. Neither end of the spectrum in our asset allocation are to the extreme of absolute stability (zero-variation) and wild swings in pricing levels. The range is between an investor seeking greater levels of stability in valuations through low fluctuations in pricing, and the trade off with future potential valuations. The stable side is not cash and the opportunity side is not venture capital. It is a gradual tilting of the allocation, left or right, to gradually increase stability or increase future potential. There are some general themes throughout the process as allocation moves from stability to

Global Asset Allocation

	Ticker	Name	Value Sector Weights	Stable Target	Stability Preferred Target	Balanced Target	Opportunity Preferred Target	Opportunity Target
Cash			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Bonds			100.0%	90.0%	75.0%	50.0%	25.0%	10.0%
	SHY	US Govt	39.0%	35.1%	29.3%	19.5%	9.8%	3.9%
	MBB	MBS	29.0%	26.1%	21.8%	14.5%	7.3%	2.9%
	LQD	Corp/Pfd	13.0%	11.7%	9.8%	6.5%	3.3%	1.3%
	HYG	HY Corp	10.0%	9.0%	7.5%	5.0%	2.5%	1.0%
	IBND	Intnl Corp	3.0%	2.7%	2.3%	1.5%	0.8%	0.3%
	MUB	Muni	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	IGOV	Sov Mkt	3.0%	2.7%	2.3%	1.5%	0.8%	0.3%
	EMB	Emerg Mkt	3.0%	2.7%	2.3%	1.5%	0.8%	0.3%
Stocks			100.0%	10.0%	25.0%	50.0%	75.0%	90.0%
Domestic Large Cap	IVV		75.7%	7.6%	18.9%	37.8%	56.8%	68.1%
	XLY	Consumer Discretion	9.3%	0.9%	2.3%	4.7%	7.0%	8.4%
	XLP	Consumer Staples	7.9%	0.8%	2.0%	4.0%	6.0%	7.1%
	XLE	Energy	5.1%	0.5%	1.3%	2.5%	3.8%	4.6%
	XLF	Financial	11.8%	1.2%	3.0%	5.9%	8.9%	10.7%
	XLV	Healthcare	11.4%	1.1%	2.8%	5.7%	8.5%	10.2%
	XLI	Industrials	7.3%	0.7%	1.8%	3.7%	5.5%	6.6%
	XLK	Technology	16.2%	1.6%	4.1%	8.1%	12.2%	14.6%
	XLB	Materials	2.1%	0.2%	0.5%	1.1%	1.6%	1.9%
	XLK	Telecom	2.3%	0.2%	0.6%	1.2%	1.7%	2.1%
	XLU	Utility	2.2%	0.2%	0.5%	1.1%	1.6%	2.0%
Midcap	IJH		6.4%	0.6%	1.6%	3.2%	4.8%	5.8%
Smallcap	IFR		2.9%	0.3%	0.7%	1.4%	2.2%	2.6%
International	EFA		15.0%	1.5%	3.8%	7.5%	11.3%	13.5%
	EWU	UK	2.8%	0.3%	0.7%	1.4%	2.1%	2.5%
	EZU	Europe	6.1%	0.6%	1.5%	3.0%	4.6%	5.5%
	EPP	Pacific	2.3%	0.2%	0.6%	1.1%	1.7%	2.1%
	EWJ	Japan	3.2%	0.3%	0.8%	1.6%	2.4%	2.9%
	FXI	China	0.3%	0.0%	0.1%	0.1%	0.2%	0.3%
	EZA	Africa	0.1%	0.0%	0.0%	0.1%	0.1%	0.1%
	EEM	Emerging Markets	0.1%	0.0%	0.0%	0.1%	0.1%	0.1%
Real Estate			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Commodities			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Figure 2: Global Asset Allocation - Example

opportunity. First, fixed income securities are more prevalent in stability enhancing portfolios now that interest rates are headed in a positive direction. Prior to now, many bond securities presented a negative return over time. In our opinion, there was no benefit in investing in instruments that provided a negative return, no matter how statistically stable. Now that normal interest rates (3%) are on the horizon, allocations to bond securities can contribute to reaching stability enhancing objectives. Stock investments increase as you move toward opportunity enhancing allocations.

There is also an increase in corporate bond allocations and international bond areas as opportunity is sought. Since both the domestic economy and global currencies influence these two security areas, fluctuation in values becomes less stable than a pure U.S. treasury bond. However, each of these areas offers greater opportunity in value than domestic government based securities.

International allocations also increase during most, but not all time periods when moving from stability to opportunity. This type of allocation offers greater opportunity many times throughout history, but they also experience increased fluctuations as global currencies change. Also, within the foreign markets there is a slight increase in allocations to Africa and Emerging Markets. Future long-term growth will occur in these markets, but the timing is uncertain. It could occur in 12 months or 120 months, but an increase in future value is almost certain. Investment in these areas does not provide a regular income such that which comes from bond interest payments, but it does recognize the future potential of economic growth around the world.

Markets are always attempting to estimate future values. Historical experiences are valuable in estimating future values, but not guaranteed. Every investor must make some hopefully, intelligent estimate, about future values. These collective estimates create a pricing structure that may or may not accurately reflect what is considered a fair valuation. It is not usual for markets to be overly optimistic or too pessimistic when estimating the future. When this occurs, periods of miss-valuation occur on both sides and at many levels. Valuations can become tilted within a major asset classification (stocks, bonds, cash), capitalization level (large, mid, small), domestic and international markets, domestic sectors and between industry groups. When these valuation misalignments occur asset allocations can be tilted to benefit a portfolio. The most recent example of misalignments occurred in Energy. When oil prices were dropping rapidly, energy became the most undervalued sector in the world. Once this temporary condition stabilized, numerous opportunities erupted from the energy sector to become one of the best performing sectors.

Asset allocation adjustments will move assets to undervalued areas and away from overvalued areas based on the degree of over/under valuation. The further the distance current valuations are above fair value, the lower the allocation will be for the asset area from market neutral. The further distance current valuations are below fair value, the higher the allocation will be for the asset area from market neutral.

We start our asset allocation analysis by looking at the globe and then gradually focus our allocation as we evaluate specific industry concentrations.

Asset Allocation – Global

Our global asset allocation is the broadest view of the world markets and includes every major part of the regular investment universe. By regular, we mean that which is available to all investors in a reasonable manner without using special securities, contracts or structures. We have not included private equity or other similar investments because many times these are faddish, restricted to investors that must meet specific criteria or harbor inclusion restrictions.

On the most stable side of the view we start with 90% allocated to bonds and 10% allocated to stocks. The largest portion of the bond allocation is with the most stable, government bonds, but includes a small allocation to emerging markets even at this high stability seeking level. As can be seen from Figure 3, the allocation to less stable bonds is small at 2.7%. Just because an investor seeks stability does not mean they give up all opportunity. Just remember, America was once an emerging market and not too long ago. This allocation is predominately weighted to the more stable side of the bond allocation favoring domestic government, mortgage backed and corporate bonds.

Each of these asset allocations is reduced as the overall asset allocation moves from Stable to Opportunity. When the allocation reaches a dominate position of Opportunity, the debt allocation is reduced to 10% creating greater opportunity from higher equity positions.

Stock allocations work in the opposite direction from bonds with allocations moving from 10% on the most stable side to 90% when attempting to maximize opportunity. Domestic stocks hold the highest weight in the allocation for two reasons. First, because the allocation in this brief is from a US$ base currency view and second, it is the largest

Global Asset Allocation	Ticker	Name	Value Sector Weights	Stable Target	Stability Preferred Target	Balanced Target	Opportunity Preferred Target	Opportunity Target
Cash			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Bonds			100.0%	90.0%	75.0%	50.0%	25.0%	10.0%
	SHY	US Govt	39.0%	35.1%	29.3%	19.5%	9.8%	3.9%
	MBB	MBS	29.0%	26.1%	21.8%	14.5%	7.3%	2.9%
	LQD	Corp/Pfd	13.0%	11.7%	9.8%	6.5%	3.3%	1.3%
	HYG	HY Corp	10.0%	9.0%	7.5%	5.0%	2.5%	1.0%
	IBND	Intnl Corp	3.0%	2.7%	2.3%	1.5%	0.8%	0.3%
	MUB	Muni	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	IGOV	Sov Mkt	3.0%	2.7%	2.3%	1.5%	0.8%	0.3%
	EMB	Emerg Mkt	3.0%	2.7%	2.3%	1.5%	0.8%	0.3%
Stocks			100.0%	10.0%	25.0%	50.0%	75.0%	90.0%
Domestic Large Cap	IVV		75.7%	7.6%	18.9%	37.8%	56.8%	68.1%
	XLY	Consumer Discretion	9.3%	0.9%	2.3%	4.7%	7.0%	8.4%
	XLP	Consumer Staples	7.9%	0.8%	2.0%	4.0%	6.0%	7.1%
	XLE	Energy	5.1%	0.5%	1.3%	2.5%	3.8%	4.6%
	XLF	Financial	11.8%	1.2%	3.0%	5.9%	8.9%	10.7%
	XLV	Healthcare	11.4%	1.1%	2.8%	5.7%	8.5%	10.2%
	XLI	Industrials	7.3%	0.7%	1.8%	3.7%	5.5%	6.6%
	XLK	Technology	16.2%	1.6%	4.1%	8.1%	12.2%	14.6%
	XLB	Materials	2.1%	0.2%	0.5%	1.1%	1.6%	1.9%
	XLK	Telecom	2.3%	0.2%	0.6%	1.2%	1.7%	2.1%
	XLU	Utility	2.2%	0.2%	0.5%	1.1%	1.6%	2.0%
Midcap	IJH		6.4%	0.6%	1.6%	3.2%	4.8%	5.8%
Smallcap	IFR		2.9%	0.3%	0.7%	1.4%	2.2%	2.6%
International	EFA		15.0%	1.5%	3.8%	7.5%	11.3%	13.5%
	EWU	UK	2.8%	0.3%	0.7%	1.4%	2.1%	2.5%
	EZU	Europe	6.1%	0.6%	1.5%	3.0%	4.6%	5.5%
	EPP	Pacific	2.3%	0.2%	0.6%	1.1%	1.7%	2.1%
	EWJ	Japan	3.2%	0.3%	0.8%	1.6%	2.4%	2.9%
	FXI	China	0.3%	0.0%	0.1%	0.1%	0.2%	0.3%
	EZA	Africa	0.1%	0.0%	0.0%	0.1%	0.1%	0.1%
	EEM	Emerging Markets	0.1%	0.0%	0.0%	0.1%	0.1%	0.1%
Real Estate			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Commodities			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Figure 3: Global Asset Allocation

equity market in the world. The complete U.S. stock allocation moves from 8.5% in the most stable allocation, to 76.5% in the most opportunistic. International stock allocation ranges from a low of 1.5% and a high of 13.5%, respectively to the direction mentioned earlier.

Large Cap stock allocation represents the majority of the stock allocation starting at 7.6% climbing to 68.1%. There is a similar increase in both Mid and Small Cap allocations that range from 0.6% at the Stable level for Mid Cap and 5.8% at the Opportunity level. Small Cap experiences the same rate of growth starting at 0.3% climbing to 2.5% when it reaches Opportunity levels.

Asset Allocation – U.S.

Many investors wish to examine the allocation decision exclusively in terms of a domestic decision. This section of the asset allocation report, Asset Allocation – U.S., addresses this view. The titles of the report that pertain to international investment have been lightened in Figure 5 and zero values have been blanked out to simplify the table

Overall, bond security allocations have remained the same at the highest level starting at 90.0% in the Stable allocation level dropping to 10.0% by the time they reach the Opportunity level. The allocation begins to change slightly in the other five categories due to zero allocations in international markets. The adjustments range from an

U.S. Asset Allocation

	Ticker	Name	Value Sector Weights	Stable Target	Stability Preferred Target	Balanced Target	Opportunity Preferred Target	Opportunity Target
Cash			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Bonds			100.0%	90.0%	75.0%	50.0%	25.0%	10.0%
	SHY	US Govt	42.9%	38.6%	32.1%	21.4%	10.7%	4.3%
	MBB	MBS	31.9%	28.7%	23.9%	15.9%	8.0%	3.2%
	LQD	Corp/Pfd	14.3%	12.9%	10.7%	7.1%	3.6%	1.4%
	HYG	HY Corp	11.0%	9.9%	8.2%	5.5%	2.7%	1.1%
	IBND	Intnl Corp						
	MUB	Muni	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	IGOV	Sov Mkt						
	EMB	Emerg Mkt						
Stocks			100.0%	10.0%	25.0%	50.0%	75.0%	90.0%
Domestic Large Cap	IVV		89.1%	8.9%	22.3%	44.5%	66.8%	80.1%
	XLY	Consumer Discretion	10.9%	1.1%	2.7%	5.5%	8.2%	9.8%
	XLP	Consumer Staples	9.3%	0.9%	2.3%	4.7%	7.0%	8.4%
	XLE	Energy	6.0%	0.6%	1.5%	3.0%	4.5%	5.4%
	XLF	Financial	13.9%	1.4%	3.5%	7.0%	10.4%	12.5%
	XLV	Healthcare	13.4%	1.3%	3.3%	6.7%	10.0%	12.0%
	XLI	Industrials	8.6%	0.9%	2.2%	4.3%	6.5%	7.8%
	XLK	Technology	19.1%	1.9%	4.8%	9.5%	14.3%	17.2%
	XLB	Materials	2.5%	0.2%	0.6%	1.2%	1.9%	2.2%
	XLK	Telecom	2.7%	0.3%	0.7%	1.4%	2.1%	2.5%
	XLU	Utility	2.6%	0.3%	0.6%	1.3%	1.9%	2.3%
Midcap	IJH		7.6%	0.8%	1.9%	3.8%	5.7%	6.8%
Smallcap	IFR		3.4%	0.3%	0.8%	1.7%	2.5%	3.0%
International	EFA							
	EWU	UK						
	EZU	Europe						
	EPP	Pacific						
	EWJ	Japan						
	FXI	China						
	EZA	Africa						
	EEM	Emerging Markets						
Real Estate								
Commodities								

Figure 4: U.S. Asset Allocation - Domestic Market Only Original

increase in U.S. government bonds by 3.5% to 38.6% in the Stable category to 0.0% in the Opportunity category which remains unchanged at 10.0%.

The stock allocation remains predominately in Large Cap. On the Stable side, starting at 8.9% increasing progressively to 80.1%. Information Technology remains the most important sector throughout each of the classifications ranging from a low of 1.9% in the Stable allocation increasing to 17.2% in the Opportunity allocation.

Asset Allocation – Stock Only (No bonds)

When the central banks around the world started dropping interest rates to zero eight years ago, and some eventually moved into negative deposit rates, investors began to question the value of including debt based securities in a portfolio that was supposed to

STOCK ONLY Asset Allocation

	Ticker	Name	Value Sector Weights	Stable Target	Stability Preferred Target	Balanced Target	Opportunity Preferred Target	Opportunity Target
Cash			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Bonds			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	SHY	US Govt						
	MBB	MBS						
	LQD	Corp/Pfd						
	HYG	HY Corp						
	IBND	Intnl Corp						
	MUB	Muni						
	IGOV	Sov Mkt						
	EMB	Emerg Mkt						
Stocks			100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Domestic Large Cap	IVV		75.8%	98.1%	93.6%	89.1%	84.7%	80.2%
	XLY	Consumer Discretion	9.3%	9.1%	8.5%	7.6%	6.4%	5.2%
	XLP	Consumer Staples	8.0%	7.8%	7.3%	6.5%	5.5%	4.4%
	XLE	Energy	5.1%	5.0%	4.7%	4.2%	3.5%	2.8%
	XLF	Financial	11.9%	11.6%	10.9%	9.7%	8.2%	6.6%
	XLV	Healthcare	11.4%	11.2%	10.5%	9.3%	7.9%	6.3%
	XLI	Industrials	7.3%	7.2%	6.7%	6.0%	5.1%	4.1%
	XLK	Technology	16.2%	15.9%	14.9%	13.3%	11.2%	9.0%
	XLB	Materials	2.1%	2.1%	1.9%	1.7%	1.5%	1.2%
	XLK	Telecom	2.3%	2.2%	2.1%	1.9%	1.6%	1.3%
	XLU	Utility	2.2%	2.1%	2.0%	1.8%	1.5%	1.2%
Midcap	IJH		6.4%	1.3%	4.4%	7.5%	10.6%	13.7%
Smallcap	IFR		2.8%	0.6%	2.0%	3.4%	4.7%	6.1%
International	EFA		15.0%	1.9%	6.4%	10.9%	15.3%	19.8%
	EWU	UK	2.8%	0.4%	1.2%	2.0%	2.9%	3.7%
	EZU	Europe	6.1%	0.8%	2.6%	4.4%	6.2%	8.0%
	EPP	Pacific	2.3%	0.3%	1.0%	1.7%	2.3%	3.0%
	EWJ	Japan	3.2%	0.4%	1.4%	2.3%	3.3%	4.3%
	FXI	China	0.3%	0.0%	0.1%	0.2%	0.3%	0.4%
	EZA	Africa	0.1%	0.0%	0.1%	0.1%	0.1%	0.2%
	EEM	Emerging Markets	0.1%	0.0%	0.1%	0.1%	0.1%	0.2%
Real Estate								
Commodities								

Figure 5: U.S. Asset Allocation – Global Stock Market Only

gain in value. Traditionally, bonds provided an average of 4% annualized return; now the return could be zero or worse.

The value of bond stability received intense reviews and many concluded that bonds no longer served a purpose in portfolios designed to generate income. Bonds came under further criticism as many stocks provided similar stability results if the selection process was narrowed to "core" only securities that paid dividends greater than the long-term average of the domestic stock market.

Additionally, many investors do not require stability within a portfolio because the ratio between income requirements and total asset wealth does not warrant such extreme protection. Other investors do not wish to give up long-term opportunity for short-term stability and seek a higher longer term investment potential.

In these cases, investors eliminate debt obligations from the portfolio and focus on stock based securities that provide both income potential and long-term appreciation; a stock only portfolio.

The allocation table in Figure 6 displays such an allocation. It is global in nature, but only includes stock securities. For an American investor, domestic stocks are considered more stable than international stocks, especially emerging markets. This is due to the investor base currency, US$. In this U.S. view, domestic large cap stocks dominate in the Stable category at 98.1% and then are reduced to 89.1% in the balanced category and drop to 80.2% when the Opportunity category is reached.

Just as domestic large cap is being reduced there are corresponding increases in domestic Mid cap and domestic Small cap stocks. Mid cap stocks start off at 1.3% and reach 13.7% in the Opportunity category. International stocks are also an increasing part of the asset allocation as opportunity becomes more important to the overall allocation process. Foreign stocks start at a small allocation, 1.9% concentrated in four major markets: UK, Continental Europe, Pacific and Japan. As opportunity is sought, the allocations start to include China, Africa and Emerging Markets. These three markets never exceed 1% and offer a small long-term exposure for the investor. If a higher allocation to these three markets is desired, it would be best to determine the investment based on a thematic approach across the world rather than a country concentration. In these markets, geopolitical influences can sometimes overwhelm rational decision making. This is where thematic investing such as drinkable water, medicine, energy, or food become more powerful than geographic lines on a map. Too many times the lines on the map change or in some cases disappear.

Asset Allocation – U.S. Stock Only

When an American investor does not wish to take on the uncertainties of foreign currencies, engage in predicting international politics or just finds investing in a home country more comfortable, the U.S. Stock Only in Figure 7, allocation would be appropriate. This allocation is also useful for the investor that has other investments around the world and wishes to focus on domestic allocations. There are any number of reasons that a domestic stock only allocation would be appropriate; not everyone desires to be a global investor. After all, nearly 50% of revenue generated by stocks held

U.S. STOCK ONLY Asset Allocation									
	Ticker	Name	Value Sector Weights	Stable Target	Stability Preferred Target	Balanced Target	Opportunity Preferred Target	Opportunity Target
Cash			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Bonds			0.0%	0.0%	0.0%	0.0%	0.0%	10.0%
	SHY	US Govt						
	MBB	MBS						
	LQD	Corp/Pfd						
	HYG	HY Corp						
	IBND	Intnl Corp						
	MUB	Muni						
	IGOV	Sov Mkt						
	EMB	Emerg Mkt						
Stocks			100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Domestic Large Cap	IVV		89.1%	98.1%	93.6%	89.1%	84.7%	80.2%
	XLY	Consumer Discretion	9.3%	9.1%	8.7%	8.3%	7.9%	7.5%
	XLP	Consumer Staples	8.0%	7.8%	7.5%	7.1%	6.8%	6.4%
	XLE	Energy	5.1%	5.0%	4.8%	4.5%	4.3%	4.1%
	XLF	Financial	11.9%	11.6%	11.1%	10.6%	10.1%	9.5%
	XLV	Healthcare	11.4%	11.2%	10.7%	10.2%	9.7%	9.2%
	XLI	Industrials	7.3%	7.2%	6.9%	6.5%	6.2%	5.9%
	XLK	Technology	16.2%	15.9%	15.2%	14.5%	13.7%	13.0%
	XLB	Materials	2.1%	2.1%	2.0%	1.9%	1.8%	1.7%
	XLK	Telecom	2.3%	2.2%	2.1%	2.0%	1.9%	1.8%
	XLU	Utility	2.2%	2.1%	2.0%	1.9%	1.8%	1.7%
Midcap	IJH		6.4%	1.5%	4.4%	7.5%	10.6%	13.7%
Smallcap	IFR		2.8%	0.7%	2.0%	3.4%	4.7%	6.1%
International	EFA							
	EWU	UK						
	EZU	Europe						
	EPP	Pacific						
	EWJ	Japan						
	FXI	China						
	EZA	Africa						
	EEM	Emerging Markets						
Real Estate								
Commodities								

Figure 6: Asset Allocation - U.S. Stock Only

on the NYSE come from international operations. Just by being a domestic large cap stock investor, you are investing globally.

The U.S. Stock Only allocation includes the three market capitalization categories: Large. Mid and Small cap. Large cap is further divided into the 10 sectors used across all three market capitalization categories. Recently, S&P separated out Real Estate from the Financials sector because they believed it was deserving of its own sector designation. Unfortunately, they have not yet completed the task and created the same for the Mid and Small cap categories. In an effort to maintain continuity between all three capitalization categories, we have retained real estate within the financials sector.

When looking at the progressive changes made across each allocation, we have created the Balanced allocation as close to the current market fair value allocation as possible. If you were to take the allocation of the entire U.S. domestic stock market it would be very close to having 89% of stock value in the Large cap category, approximately 7.5% in Mid cap stocks and just over 3% in Small cap stocks.

In general, Mid cap and Small cap stocks are less stable than Large cap stocks and we have reduce the allocation as stability is favored. Both, categories drop to around 1% in the most stable category. The reverse is true when opportunity is sought. Mid and Small cap categories move up to 13.7% and 6.1%, respectively.

Asset Allocation – U.S. Enhanced Sector

Just as an investor would consider a U.S. domestic stock allocation, a large cap only sector allocation is also a consideration. This may be the result of a refined investment mandate or the desire to focus on the largest part of the market. We have added an additional parameter to the "sector only" allocation that takes into account each sector's proclivity to possess stocks that exhibit pricing patterns close to the market, less price fluctuations than the market and those that experience greater movement over time. There are three classifications used and each stock is placed in one of the three classifications. The three classifications are: Core, Market and Aspirational. Market stocks move in a similar pattern to the market overall. Stocks classified as Core, exhibit characteristics that are more stable than the market and Aspirational stocks demonstrate a more spirited ride.

Just as in the U.S. stock only allocation, we start with a market neutral position in the Balanced allocation with 89.1% in Large cap, 7.5% in Mid cap and 3.4% in Small cap stocks. The large cap sectors are then weighted according to their market capitalization and stability/opportunity tilt. In the Stability classification, there is an increased allocation to Consumer Staples, Telecommunication Services and Utilities with a

U.S. STOCK SECTOR ONLY Asset Allocation

	Ticker	Name	Value Sector Weights	Stable Target	Stability Preferred Target	Balanced Target	Opportunity Preferred Target	Opportunity Target
Cash			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Bonds			0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	SHY	US Govt						
	MBB	MBS						
	LQD	Corp/Pfd						
	HYG	HY Corp						
	IBND	Intnl Corp						
	MUB	Muni						
	IGOV	Sov Mkt						
	EMB	Emerg Mkt						
Stocks			100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
Domestic Large Cap	IVV		75.8%	98.1%	93.6%	89.1%	84.7%	80.2%
	XLY	Consumer Discretion	9.3%	2.7%	8.2%	13.7%	10.2%	6.7%
	XLP	Consumer Staples	8.0%	25.5%	13.9%	2.3%	1.1%	0.0%
	XLE	Energy	5.1%	0.0%	5.5%	11.0%	22.3%	33.7%
	XLF	Financial	11.9%	5.0%	6.7%	8.3%	4.3%	0.3%
	XLV	Healthcare	11.4%	5.5%	8.2%	11.0%	12.7%	14.5%
	XLI	Industrials	7.3%	4.9%	8.8%	12.7%	9.0%	5.2%
	XLK	Technology	16.2%	0.1%	7.6%	15.1%	11.0%	6.8%
	XLB	Materials	2.1%	1.0%	7.3%	13.7%	13.3%	13.0%
	XLK	Telecom	2.3%	24.2%	12.7%	1.1%	0.6%	0.0%
	XLU	Utility	2.2%	29.1%	14.7%	0.3%	0.2%	0.0%
Midcap	IJH		6.4%	1.3%	4.4%	7.5%	10.6%	13.7%
Smallcap	IFR		2.8%	0.6%	2.0%	3.4%	4.7%	6.1%
International	EFA							
	EWU	UK						
	EZU	Europe						
	EPP	Pacific						
	EWJ	Japan						
	FXI	China						
	EZA	Africa						
	EEM	Emerging Markets						
Real Estate								
Commodities								

Figure 7: U.S. Enhanced Stock Sector Asset Allocation Original

corresponding decreased allocation to Consumer Discretion, Energy, Financials, Health Care and Information Technology. As the investor seeks opportunity over stability there are increases in Energy and Health Care.

Traditionally, as allocations across the various categories move from stability to opportunity, they are adjusted in a linear fashion. The allocation will start off larger on one side and decrease as you move to the other side. The reverse was true as an investor moves from opportunity to stability. The allocation was very two-dimensional. In the U.S. Stock Sector Only allocation we have added consideration for both individual stock and group characteristics. Some have called this a third dimension to asset allocation. It is a simple consideration. Using the Industrial sector as an example we see a stable allocation of 4.9%, market allocation of 12.7% and aspirational allocation of 5.2%. This occurs because the majority of stocks within the Industrials sector exhibit characteristics similar to the market with a smaller universe of stocks within the sector that match stability characteristics as well as fewer stocks on the other end of the scale opportunity. It is not linear. If an investor wished to tilt the portfolio to increase opportunity they would lower the allocation to Industrials from the market. The same is true if the investor were seeking to increase stability. Industrials stocks are concentrated in the classification that describes the market (Market) and that is where they receive the highest allocation.

The enhanced allocation can also be used to focus on individual stocks within a specific sector to move the allocation of the overall portfolio. For example, Energy stocks can be added to an investor's portfolio that wishes to increase opportunity over stability. Even though some of the largest stocks in the market are energy enterprises, over time, they exhibit a pricing activity that is not as similar to the overall market as most expect. Energy stocks would not be considered to improve a portfolios stability.

The Enhanced allocation is for an investor that wishes to select individual stocks within the individual sectors that exhibit Core, Market, or Aspirational characteristics.

Asset Allocation – Sector Neutralized

Many times, investors have high concentrations in a specific stock or part of the market. This can occur for many reasons. An executive may have worked for a single company or within a specific industry for most of their career. It would not be unusual for an individual to have worked for Ford Motor Company for most of their career and within the automotive industry. The same is true for information technology or health care. A successful career can result in high concentrations within a single stock through stock grants, options or stock purchase programs.

Inheritance can create concentrations from a relative or parent granting a specific stock. Can you imagine the concentration a portfolio would hold in technology if someone granted 100 shares of Microsoft to their child in 1986 when the stock went to IPO?

In the information technology sector it is not uncommon to find individuals that were involved in the founding or early creation stages of the enterprise to find themselves with high concentrations in the original stock. Mergers, acquisitions, spin-offs, IPOs and many other sorts of corporate creations can result in concentrations.

STOCK SECTOR NEUTRAL Asset Allocation Consumer Discretionary			
	Ticker	Name	Value Sector Weights
Cash			0.0%
Bonds			0.0%
	SHY	US Govt	
	MBB	MBS	
	LQD	Corp/Pfd	
	HYG	HY Corp	
	IBND	Intnl Corp	
	MUB	Muni	
	IGOV	Sov Mkt	
	EMB	Emerg Mkt	
Stocks			
Domestic Large Cap	IVV		100.0%
	XLY	Consumer Discretion	0.0%
	XLP	Consumer Staples	12.0%
	XLE	Energy	7.6%
	XLF	Financial	17.9%
	XLV	Healthcare	17.2%
	XLI	Industrials	11.0%
	XLK	Technology	24.4%
	XLB	Materials	3.2%
	XLK	Telecom	3.4%
	XLU	Utility	3.3%
Midcap	IJH		
Smallcap	IFR		
International	EFA		
	EWU	UK	
	EZU	Europe	
	EPP	Pacific	
	EWJ	Japan	
	FXI	China	
	EZA	Africa	
	EEM	Emerging Markets	
Real Estate			
Commodities			

Figure 8: U.S. Sector Asset Allocation Sector Neutral: Consumer Discretionary

The standard investment industry response is to "diversify" by selling the concentration and reallocating the assets across the global investment universe. It is certainly the simplest approach and makes the compliance and risk officer of the investment firm the happiest. Unfortunately, it may not be the best solution for the investor.

Concentration Position Management (CPM) is not an area that many investment professionals wish to address outside of the simplistic solution – "diversify". There are

STOCK SECTOR NEUTRAL Asset Allocation Consumer Staples			
	Ticker	Name	Value Sector Weights
Cash			0.0%
Bonds			0.0%
	SHY	US Govt	
	MBB	MBS	
	LQD	Corp/Pfd	
	HYG	HY Corp	
	IBND	Intnl Corp	
	MUB	Muni	
	IGOV	Sov Mkt	
	EMB	Emerg Mkt	
Stocks			
Domestic Large Cap	IVV		100.3%
	XLY	Consumer Discretion	13.7%
	XLP	Consumer Staples	0.0%
	XLE	Energy	7.5%
	XLF	Financial	17.5%
	XLV	Healthcare	16.8%
	XLI	Industrials	10.8%
	XLK	Technology	23.9%
	XLB	Materials	3.1%
	XLK	Telecom	3.4%
	XLU	Utility	3.5%
Midcap			
Smallcap			
International			
Real Estate			
Commodities			

Figure 9: U.S. Sector Asset Allocation Sector Neutral: Consumer Staples

volumes of information about the concerns of stock specific risk and under many other terms, but there is a void of information on effective actions to take that work to address these conditions from the investors point of view.

Solutions can be simple but, they can also begin to appear like solutions that resolve problems from quantum mechanics. In the tables that follow, we offer a simple adjustment to domestic asset allocation that can assist the investor in steps to consider neutralizing allocations to specific sectors.

A concentration in a Consumer Discretionary stock can be neutralized by increasing the other nine sectors in proportion to their market allocations and relative fair value. In the case of Consumer Discretionary concentrations, the largest increase is to Information Technology. IT is the largest sector and would naturally receive the highest increase.

Consumer Discretionary stock is the 4th largest sector in terms of market capitalization. If the concentration within the investor's portfolio is large, a complete neutralization to

STOCK SECTOR NEUTRAL Asset Allocation Financials			
	Ticker	Name	Value Sector Weights
Cash			0.0%
Bonds			0.0%
	SHY	US Govt	
	MBB	MBS	
	LQD	Corp/Pfd	
	HYG	HY Corp	
	IBND	Intnl Corp	
	MUB	Muni	
	IGOV	Sov Mkt	
	EMB	Emerg Mkt	
Stocks			
Domestic Large Cap	IVV		100.0%
	XLY	Consumer Discretion	14.5%
	XLP	Consumer Staples	12.5%
	XLE	Energy	8.0%
	XLF	Financial	0.0%
	XLV	Healthcare	17.9%
	XLI	Industrials	11.5%
	XLK	Technology	25.4%
	XLB	Materials	3.3%
	XLK	Telecom	3.6%
	XLU	Utility	3.4%
Midcap			
Smallcap			
International			
Real Estate			
Commodities			

Figure 11: U.S. Asset Allocation Sector Neutral: Financials

STOCK SECTOR NEUTRAL Asset Allocation Energy			
	Ticker	Name	Value Sector Weights
Cash			0.0%
Bonds			0.0%
	SHY	US Govt	
	MBB	MBS	
	LQD	Corp/Pfd	
	HYG	HY Corp	
	IBND	Intnl Corp	
	MUB	Muni	
	IGOV	Sov Mkt	
	EMB	Emerg Mkt	
Stocks			
Domestic Large Cap	IVV		100.0%
	XLY	Consumer Discretion	13.2%
	XLP	Consumer Staples	11.3%
	XLE	Energy	0.0%
	XLF	Financial	16.8%
	XLV	Healthcare	16.1%
	XLI	Industrials	10.4%
	XLK	Technology	22.9%
	XLB	Materials	3.0%
	XLK	Telecom	3.2%
	XLU	Utility	3.1%
Midcap			
Smallcap			
International			
Real Estate			
Commodities			

Figure 10: U.S. Sector Asset Allocation Sector Neutral: Energy

the sector may be appropriate. If it is smaller, each of the allocations can be adjusted in proportion to the overall weight.

In the 10 tables within this section each sector is neutralized individually and each of the other 9 sectors is adjusted to accommodate the new allocation conditions.

STOCK SECTOR NEUTRAL Asset Allocation Industrials			
	Ticker	Name	Value Sector Weights
Cash			0.0%
Bonds			0.0%
	SHY	US Govt	
	MBB	MBS	
	LQD	Corp/Pfd	
	HYG	HY Corp	
	IBND	Intnl Corp	
	MUB	Muni	
	IGOV	Sov Mkt	
	EMB	Emerg Mkt	
Stocks			
Domestic Large Cap	IVV		100.0%
	XLY	Consumer Discretion	13.6%
	XLP	Consumer Staples	11.7%
	XLE	Energy	7.4%
	XLF	Financial	17.3%
	XLV	Healthcare	16.7%
	XLI	Industrials	0.0%
	XLK	Technology	23.7%
	XLB	Materials	3.1%
	XLK	Telecom	3.3%
	XLU	Utility	3.2%
Midcap			
Smallcap			
International			
Real Estate			
Commodities			

Figure 14: U.S. Asset Allocation Sector Neutral: Industrials

STOCK SECTOR NEUTRAL Asset Allocation Information Technology			
	Ticker	Name	Value Sector Weights
Cash			0.0%
Bonds			0.0%
	SHY	US Govt	
	MBB	MBS	
	LQD	Corp/Pfd	
	HYG	HY Corp	
	IBND	Intnl Corp	
	MUB	Muni	
	IGOV	Sov Mkt	
	EMB	Emerg Mkt	
Stocks			
Domestic Large Cap	IVV		100.0%
	XLY	Consumer Discretion	15.6%
	XLP	Consumer Staples	13.4%
	XLE	Energy	8.5%
	XLF	Financial	19.9%
	XLV	Healthcare	19.2%
	XLI	Industrials	12.3%
	XLK	Technology	0.0%
	XLB	Materials	3.5%
	XLK	Telecom	3.8%
	XLU	Utility	3.7%
Midcap			
Smallcap			
International			
Real Estate			
Commodities			

Figure 12: U.S. Asset Allocation Sector Neutral: Information Technology

STOCK SECTOR NEUTRAL Asset Allocation Materials			
	Ticker	Name	Value Sector Weights
Cash			0.0%
Bonds			0.0%
	SHY	US Govt	
	MBB	MBS	
	LQD	Corp/Pfd	
	HYG	HY Corp	
	IBND	Intnl Corp	
	MUB	Muni	
	IGOV	Sov Mkt	
	EMB	Emerg Mkt	
Stocks			
Domestic Large Cap	IVV		100.0%
	XLY	Consumer Discretion	12.6%
	XLP	Consumer Staples	10.8%
	XLE	Energy	6.9%
	XLF	Financial	16.1%
	XLV	Healthcare	15.4%
	XLI	Industrials	10.0%
	XLK	Technology	22.0%
	XLB	Materials	0.0%
	XLK	Telecom	3.2%
	XLU	Utility	3.0%
Midcap			
Smallcap			
International			
Real Estate			
Commodities			

Figure 16: U.S. Asset Allocation Sector Neutral: Materials

STOCK SECTOR NEUTRAL Asset Allocation Telecommunications Services			
	Ticker	Name	Value Sector Weights
Cash			0.0%
Bonds			0.0%
	SHY	US Govt	
	MBB	MBS	
	LQD	Corp/Pfd	
	HYG	HY Corp	
	IBND	Intnl Corp	
	MUB	Muni	
	IGOV	Sov Mkt	
	EMB	Emerg Mkt	
Stocks			
Domestic Large Cap	IVV		100.0%
	XLY	Consumer Discretion	12.7%
	XLP	Consumer Staples	10.8%
	XLE	Energy	6.9%
	XLF	Financial	16.1%
	XLV	Healthcare	15.5%
	XLI	Industrials	10.0%
	XLK	Technology	22.1%
	XLB	Materials	2.9%
	XLK	Telecom	0.0%
	XLU	Utility	3.0%
Midcap			
Smallcap			
International			
Real Estate			
Commodities			

Figure 15: U.S. Asset Allocation Sector Neutral: Telecommunication Services

STOCK SECTOR NEUTRAL Asset Allocation Utilities			
	Ticker	Name	Value Sector Weights
Cash			0.0%
Bonds			0.0%
	SHY	US Govt	
	MBB	MBS	
	LQD	Corp/Pfd	
	HYG	HY Corp	
	IBND	Intnl Corp	
	MUB	Muni	
	IGOV	Sov Mkt	
	EMB	Emerg Mkt	
Stocks			
Domestic Large Cap	IVV		100.0%
	XLY	Consumer Discretion	12.7%
	XLP	Consumer Staples	10.8%
	XLE	Energy	6.9%
	XLF	Financial	16.1%
	XLV	Healthcare	15.5%
	XLI	Industrials	10.0%
	XLK	Technology	22.1%
	XLB	Materials	2.9%
	XLK	Telecom	3.2%
	XLU	Utility	0.0%
Midcap			
Smallcap			
International			
Real Estate			
Commodities			

Figure 17: U.S. Asset Allocation Sector Neutral: Utilities