

THE EVOLUTION OF ASSET ALLOCATION



PlanMember Securities Corporation
Planning your future...today.®

THE EVOLUTION OF ASSET ALLOCATION

Over the past fifty years the idea of asset allocation in a securities portfolio has been evolving due to the development of modern portfolio theory and sophisticated analytical tools. As a result, investors can seek out a mix of securities with different return and risk characteristics that are expected to achieve their investment objectives. Until recently, a visual presentation of this asset allocation was relegated to a “pie” chart with the slices of the pie equating to a specific asset class weighting.

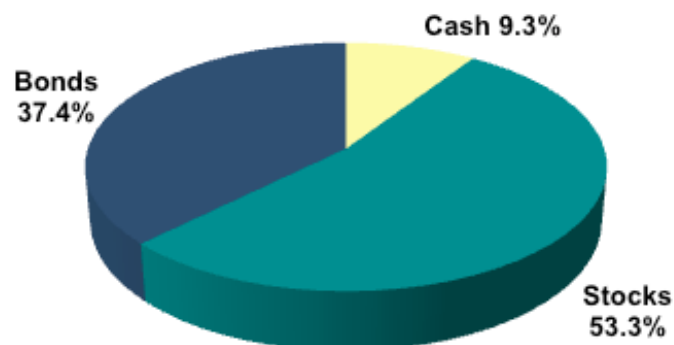
PlanMember has designed a revolutionary technique for depicting a portfolio’s asset class weightings and approved ranges. This innovation graphically depicts a portfolio’s investable universe as well as its current asset class weighting. In addition, historical allocations can be added to illustrate the changes in PlanMember’s investment strategy over various time periods. This simple visual representation provides an excellent, comprehensive picture of a portfolio’s current and historic investment characteristics.

Determining the mix and types of securities or asset classes in an investment portfolio is an important aspect of most investment plans. The type and weight of these asset classes is known as asset allocation and consists of investing in different types of securities in order to develop a portfolio that will be characterized by specific risk/return objectives. Traditional portfolio management encompasses three primary asset classes: common stocks, bonds, and cash equivalents. Each asset class has different levels of risk and return, and therefore will produce different returns over time.

Prudent investing is a hallmark of traditional investment management. The definition of a prudent investment has changed dramatically over the years especially for large pension plans. The Prudent Man Rule established in 1830 laid the framework for legally acceptable investments,

and portfolios subject to this regulation were invested solely in fixed-income securities. The notion of asset allocation among alternate asset classes lay dormant until equity markets began providing much higher relative returns and investors sought to gain exposure to the potential growth opportunities of these securities. At the same time, academic research reinforced the notion that risk and return would be influenced by portfolio asset weightings. Gradual changes in the laws governing prudent investments led to the establishment of the Uniform Prudent Investor Act of 1992. This law opened the door for the use of common stocks and other “risky” assets in retirement plans in well-diversified portfolios.

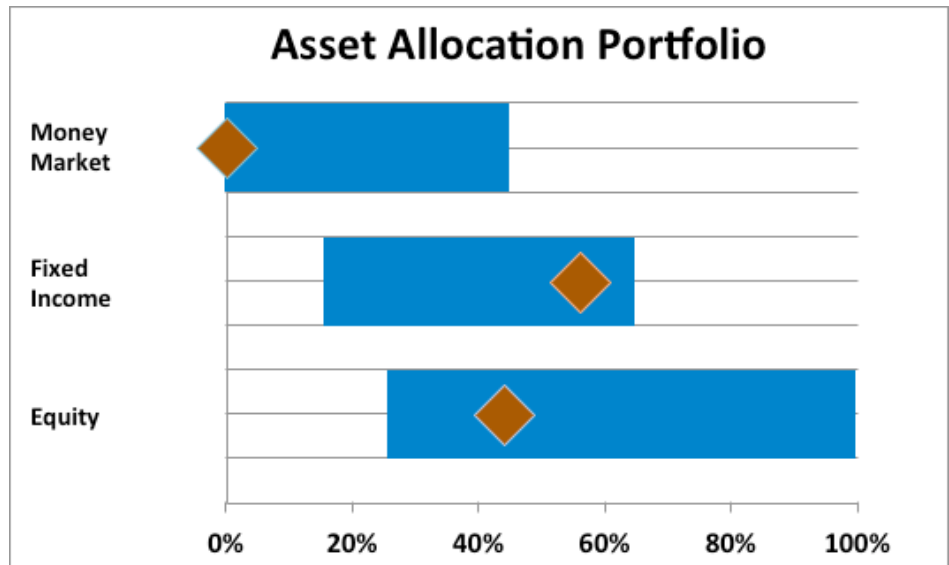
Historically, a heavier representation of the stock portion of a portfolio suggested a higher return and higher risk profile, while increasing



the bond weighting led to the inverse. Cash was viewed as the ultimate stabilizer with little or no risk to principal.

One method of presenting the concept of asset allocation is to use a circle representing a pie that divides each of the three major asset classes into slices of the pie or the portfolio weightings. The following hypothetical exhibit provides an example of asset allocation among the three major asset class groups (37.4% bonds, 53.3% stocks and 9.3% cash) and their proportional weightings. Other than basic asset allocation, the pie chart provides only a pictorial introduction to the possibilities of portfolio structure.

As investors became aware of the risks associated with different asset classes, there was a desire to provide control mechanisms to limit these risks. Regulators began to focus on appropriate asset allocation for prudent investment decisions by professional asset managers. In response, financial organizations began to limit or control the use and weighting of asset classes in portfolios. To provide control over this asset allocation process, the notion of asset class limitations in the form of maximum and minimum weightings were introduced. One example of such restrictions can be represented by a hypothetical bar chart above that reflects the current weight of an asset class and an assigned range in which each asset class can vary.



This asset allocation range chart provides a dynamic way to view a portfolio. Not only can investors see how a portfolio is allocated among selected asset classes, but they can also see the position of that allocation within potential conservative or aggressive ranges for each asset class. In the example above, an investor can see that the portfolio holds no cash while fixed income securities are over-weighted and equities under-weighted. Since all three weightings fall within the ranges established in this portfolio, the portfolio manager is in compliance with the stated constraints. The graphical representation of minimum and maximum levels for each asset class demonstrates the flexibility afforded to the portfolio manager.

The introduction of lifestyle investing, or the actively managed use of mutual funds in diversified portfolios over a client's lifetime, brought a new perspective to asset

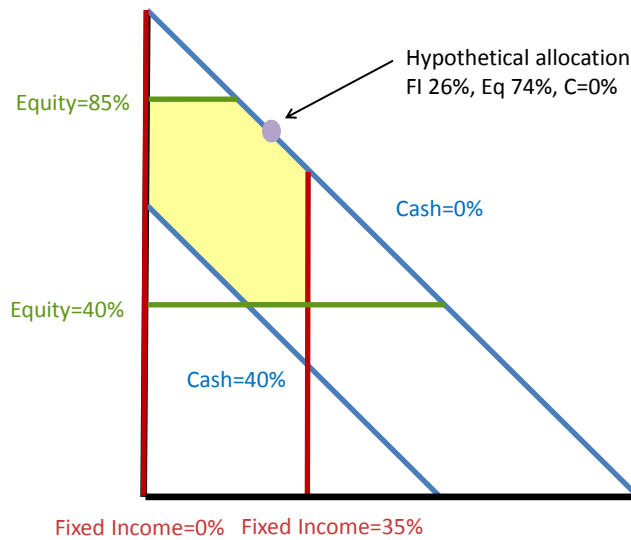
allocation. This lifestyle or lifecycle approach utilizes portfolios of mutual funds in such a way as to achieve a variety of objectives. In some cases, portfolios are rebalanced on a periodic basis in order to maintain a particular asset mix and avoid style drift. In other cases, a manager will change the portfolio's asset allocation mix based on market conditions. For both the manager of the lifestyle funds and the clients, there emerged the need to develop another, more informative visual representation of asset allocation that provides the following:

- Current asset class weighting
- Past portfolio weighting
- Minimum and maximum weighting for each asset class
- Allowable portfolio allocation ranges
- Relative weightings of all portfolios in the lifestyle options

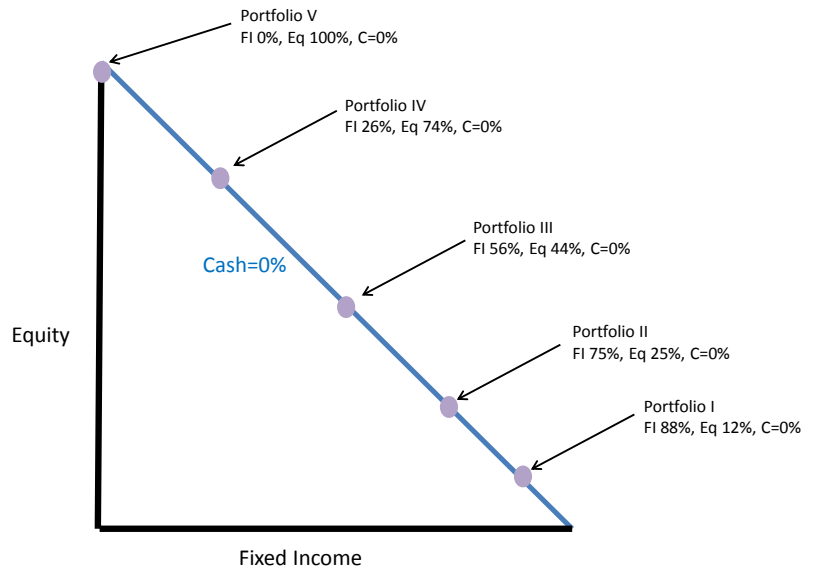
This picture reflects the maximum and minimum ranges for bonds, stocks, and cash for a given portfolio. (For this hypothetical exhibit, portfolio IV is an aggressive portfolio.) The vertical axis represents the range for stocks, the horizontal axis represents the range for bonds, and the diagonal blue line represents cash. As the cash position of the portfolio increases, the plot of that portfolio will fall within the triangle. For example, a theoretical portfolio of 100% cash would be plotted at the origin or the intersection of the vertical and horizontal axes. For a more detailed explanation of how an asset allocation triangle is constructed, please see the appendix.

The lifecycle strategy is based on a long-term investment plan that shifts investments from more growth-oriented to more income-oriented portfolios over time. As such, the following exhibit portrays each of five portfolios and their hypothetical positioning on the hypotenuse (diagonal line) of the triangle. As was previously mentioned, when the allocation to cash is 0% the portfolios will fall on this line. This exhibit provides the investor with a view of asset allocation across all five portfolios and demonstrates the systematic “spacing” among these portfolios. Movements of these portfolios relative to each other can reflect a change in strategy for one portfolio vs. another portfolio.

One visual option is to utilize a right triangle to portray the weighting of three asset classes in a two dimensional space.



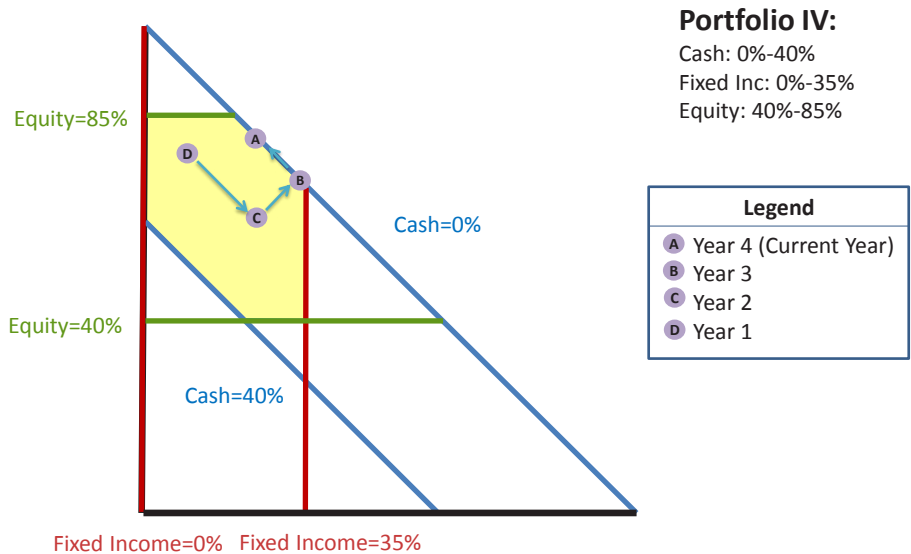
Portfolio IV:
 Cash: 0%-40%
 Fixed Inc: 0%-35%
 Equity: 40%-85%



The triangle plot can also be used to depict the asset allocation movements of a portfolio over time. When there are changes in stock/bond/cash allocations, there will be a change in the portfolio location on the exhibit relative to prior positions. By observing the movements of portfolios over time, the implementation of an investment strategy can be visually identified.

The use of asset allocation triangles is a step forward in providing a useful way to facilitate the communication of investment strategy. Without having to rely on complex mathematical formulas or a series of written data, these exhibits provide relevant information in one succinct exhibit. The triangles are even more effective when discussing the idea of life cycle investing and multiple portfolio structure. This approach to portfolio analysis can go beyond just bond/stock/cash analysis and can be used to drill down to sub-asset classes such as growth and value stock characteristics and bond quality.

Thomas E. Nugent
 Nicholas Escalante, CFA®
 Casey Yokubaitis



Continues on next page

Appendix

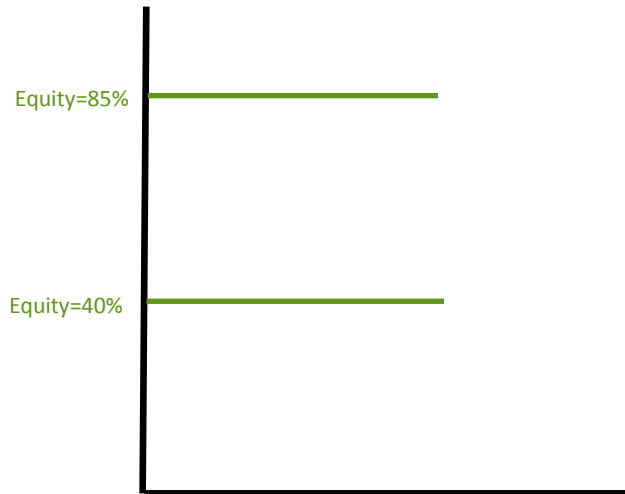
The Creation of an Asset Allocation Triangle

In order to get a better understanding of how an asset allocation triangle is constructed, let us break down each step of the process. We start by constructing two axes, equity on the vertical and fixed-income on the horizontal. These axes range from 0% to 100%. We then input the equity range for the portfolio in question as two horizontal lines extending from the vertical axis. For PlanMember portfolio IV, equity can range from 40% to 85% of the asset allocation mix. Based on our investment policy, our weightings to equity cannot exceed this range for Portfolio IV.

The second step consists of adding two vertical bars to represent the ranges for fixed-income. For Portfolio IV, the fixed-income allocation range is set at 0% to 35%. We can see the resulting graph below (note that the 0% range bar lies on the vertical axis).

The third step involves the creation of a third axis. This axis represents cash holdings in the portfolio and is graphed as a diagonal line. Any asset allocation points lying on this diagonal line (the hypotenuse) will demonstrate 0% cash holding (the minimum for all portfolios).

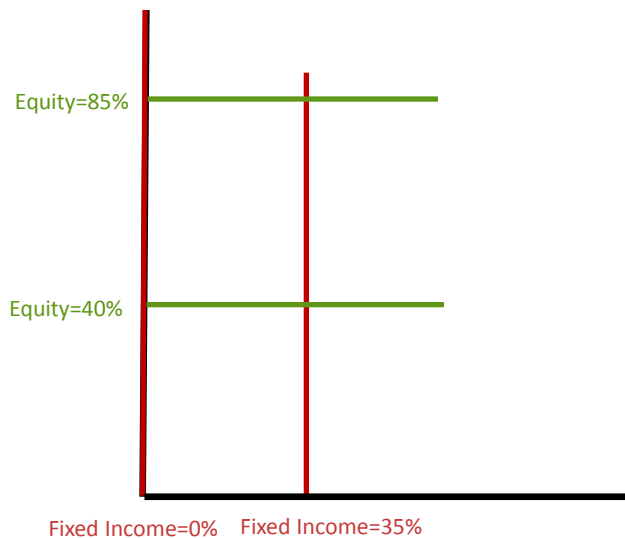
Step 1



Portfolio IV:

Cash: 0%-40%
Fixed Income: 0%-35%
Equity: 40%-85%

Step 2



Portfolio IV:

Cash: 0%-40%
Fixed Income: 0%-35%
Equity: 40%-85%

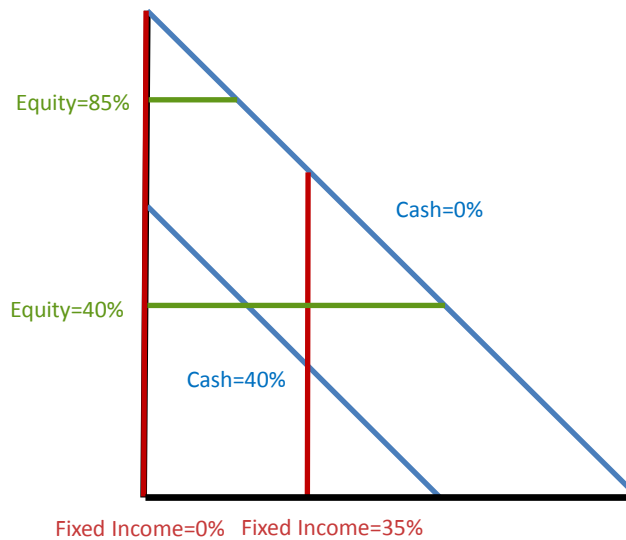
We also add a second vertical line to represent a 40% cash holding (the maximum for all portfolios). Note that as the cash position increases, the diagonal cash line moves inwards towards the origin of the chart.

Now that we have the ranges for the three primary asset classes depicted on the graph, we can determine the available asset allocation weightings for the portfolio as a whole. The yellow shaded area in the graph below shows all possible allocations for Portfolio IV.

Finally, we can add in the current portfolio allocation (represented by the grey point). Such visual representation allows the viewer to quickly determine where the portfolio is positioned relative its allocation constraints. The following exhibit shows PlanMember Portfolio IV with no cash, 74% equity and 26% fixed-income.

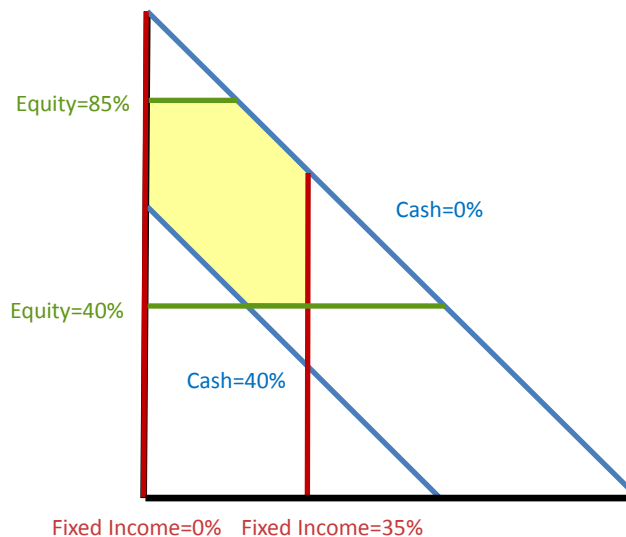
Taking the concept a step further, we can plot historical allocations to show the active management decisions made by PlanMember over any number of years. With a legend depicting the dates of allocation changes, the viewer can see how PlanMember has made strategic allocation changes based on historical events. The following chart shows hypothetical allocations over a four year period.

Step 3



Portfolio IV:
 Cash: 0%-40%
 Fixed Income: 0%-35%
 Equity: 40%-85%

Step 4



Portfolio IV:
 Cash: 0%-40%
 Fixed Income: 0%-35%
 Equity: 40%-85%



PlanMember Securities Corporation

Planning your future...today.®

(800) 874-6910 | www.planmember.com

Before investing, carefully read the prospectus(es) or summary prospectus(es) which contain information about investment objectives, risks, charges, expenses and other information all of which should be carefully considered. For current prospectus(es) call (800) 874-6910. Investing involves risk. The investment return and principal value will fluctuate and, when redeemed, the investment may be worth more or less than the original purchase price. Money market funds are not insured nor guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although money market funds seek to preserve the value at \$1.00 per share, it is possible to lose money by investing in these funds.

Asset allocation or the use of an investment advisor does not ensure a profit nor guarantee against loss.

Foreign securities pose additional risks that are not associated with U.S. domestic issues, such as changes in currency exchange rates and different governmental regulations, economic conditions and accounting standards. High-yield, high-risk bonds generally involve more credit risk. These securities may also be subject to greater market price fluctuations than lower-yielding, higher-rated debt securities. Fixed-income investments are subject to interest rate risk and values may decline in an increasing interest rate environment. Small and mid-cap investments may have additional risk including greater price volatility.

CFA® and Chartered Financial Analyst® are registered trademarks owned by CFA Institute
Representative registered with and offers only securities and advisory services through PlanMember Securities Corporation

A registered broker/dealer, investment advisor and member FINRA / SIPC
6187 Carpinteria Ave. • Carpinteria, CA • 93013 • (800) 874-6910

© 2013 PlanMember Financial Corporation