

Asset Allocation Strategies using Index Funds



There have been studies done to demonstrate the effectiveness of including sectors in an asset allocation program. Evidence shows that it is worthwhile to include indices in an asset allocation scheme because different sectors vary negatively or have a negative correlation to other investments and may be combined to achieve lower portfolio risk. This is shown in several ways:

1. International sector funds when viewed alone are riskier than small-cap stock funds. Nevertheless, because of their negative correlation with money market funds, they may be combined with money market funds to achieve lower portfolio risk than could be attained with a single investment.
2. A combination of international, growth, and money market indices can achieve 35% less risk while providing a similar return to small-stock indices taken alone.
3. A different combination of international, growth, and money market funds can achieve 29% less risk while providing a similar return to growth indices taken alone.
4. A combination of international, domestic corporate bond and money markets can achieve 85% less risk while providing a similar return to Treasury indices taken alone.
5. The same combination of international, domestic corporate bond and money markets can achieve 77% less risk while providing more than 1% greater total return than corporate bond indices taken alone.
6. A portfolio of 4 indices can achieve 78% less risk than the risk of the average index category taken alone. (AIG Research)

Are you concerned about the risk in your current portfolio? Call us for a proposal.