



BALANCED INVESTMENT STRATEGIES

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## Investor Education Series

### Structure is the Strategy

**Balanced Investment Strategies**

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## The Building Blocks of Your Portfolio

Once you understand the sources of risk and return, the task of putting together a portfolio is a relatively simple one.

First, you decide how much to allocate to growth or defensive assets. Second, you decide on a broad asset class allocation in each of those categories. Third, you break these broad asset classes up into sub-asset classes.

Asset classes are a way of categorising investments with different characteristics in terms of risk and return.

These step-by-step asset allocation decisions make up more than 90% of the difference in returns between portfolios<sup>1</sup>. By contrast, picking the right stocks and getting your timing right have far less influence.

**This is an approach based on science, not guesswork.**

Your key decision is how to combine these asset classes in a diversified portfolio, based on your own risk appetite and goals.

### Step 1: The Growth - Defensive Split

**The broadest asset categories in your portfolio are 'growth' and 'defensive'. Think of growth assets as the sword in your portfolio, and defensive as the shield.**

Growth assets include local and international shares and property. They offer better inflation-adjusted returns over the long haul, but they do tend to be more volatile from year to year.

That's why you normally should not consider investing in these assets unless you have at least a seven-year timeframe.

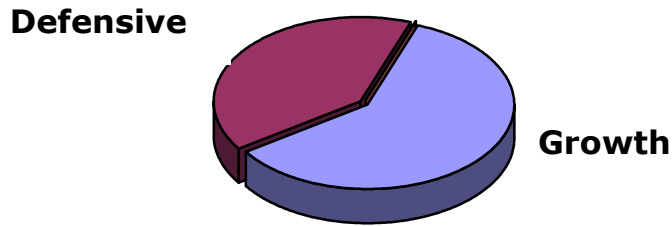
Defensive assets include fixed interest and cash. They are less volatile than growth assets, but the flipside is they offer lower expected returns.

The role of fixed interest in your portfolio is to temper the overall volatility of returns. You shouldn't use these defensive assets to chase high returns. How much you are positioned in growth or defensive assets will depend on your own personal situation, your age, investment goals and risk appetite.

Generally, the younger you are, the greater your growth allocation. That's because you have plenty of time to make up ground if there are a few bad years.

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<sup>1</sup>Source: Study of 91 large pension plans over 10 year period. Gary P. Brinson, L. Randolph Hood and Gilbert L. Beebower, 'Determinants of Portfolio Performance', Financial Analysts Journal, July-August 1986, pp. 39-44; and Gary P. Brinson, Brian D. Singer and Gilbert L. Beebower, 'Revisiting Determinants of Portfolio Performance: An Update', 1990, Working Paper.



**The allocation presented is for illustrative purposes and is not a recommendation**

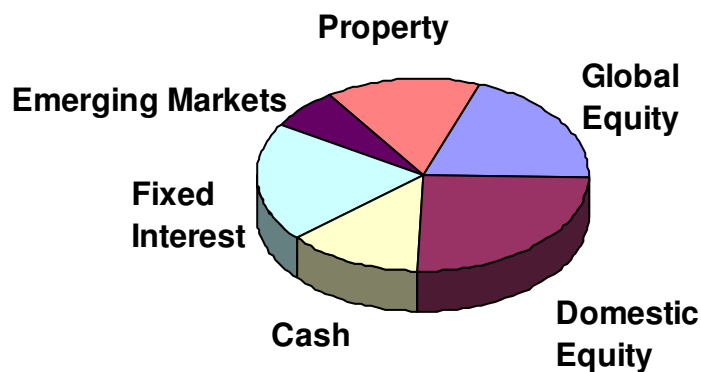
## Step 2: The Broad Asset Classes

**Once you've decided on your growth-defensive split, you can decide how you want to allocate to the broad asset classes in those categories.**

So you can split your defensive portfolio how you like in cash and fixed interest. And you can decide how much of domestic and global shares, emerging markets and property you want in the growth portion.

People are naturally tempted to stick close to home when they are investing. But including global shares and property in your mix of assets adds diversity to your portfolio. And that offers you greater protection when markets are volatile.

Emerging markets are a distinct asset class in that they behave differently to share markets in developed economies. They offer higher expected returns, but they are also riskier. They have a place in a diversified portfolio.



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### Step 3: The Sub Asset Classes

**A lot of people stop at the second step in this process, but much of the additional return to be gained is achieved via the third step.**

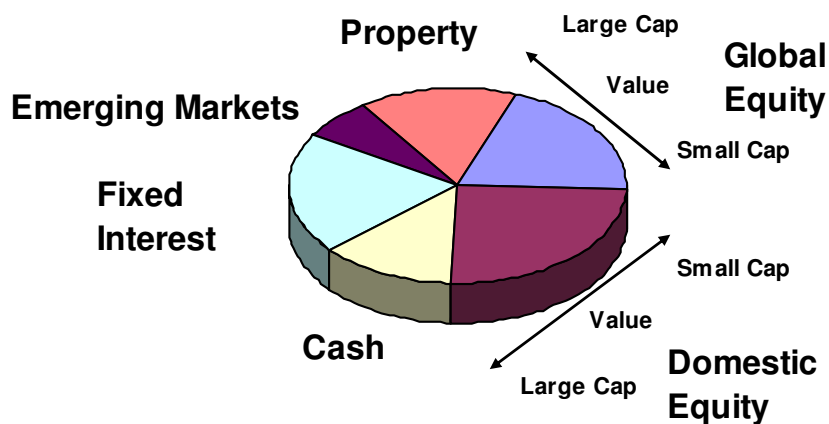
This involves dividing up the global and domestic equity portion of your portfolio into large, value and small stocks.

Generally, the greater the tilt of your portfolio to value and small, the greater the expected return. But remember, with higher returns comes higher risk.

This is a structured approach to investing. It's about earning a return based on your willingness to take risk.

It's not about chance or making forecasts. It's not about the individual stock decisions of a fund manager. It's about working with the market and structuring your portfolio around risks that offer a reliable reward.

That frees you up to concentrate on things you can control.



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