Managing Volatility through Diversification

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It's impossible to time the market perfectly or completely avoid market fluctuations, and every year, there is significant rotation on which of the asset classes at right perform well or poorly. So how can long-term investors not only endure market fluctuations but plan for them in their journey to achieve their financial goals?

The way an asset class's performance rises and falls over time is known as volatility. In 1952, Nobel Laureate and 1st Global's strategic advisor Dr. Harry M. Markowitz put forward what is now known as Modern Portfolio Theory, an almost universally accepted approach to long-term investing. By diversifying investments across different asset classes, an investor's portfolio can generate a *reasonable* return without the significant fluctuations of individual asset classes.

The chart below shows the year-by-year returns of several broad-based asset classes since 2008. As you review the chart, note that the returns for the Diversified Portfolio (yellow) tend to land near the middle. Contrast this with the wide swings of specific asset classes, such as international emerging markets equity (purple) and fixed income (light blue) returns. An investor solely invested in international emerging market equity (purple) or fixed income (light blue) would have faced significant volatility over the past ten years, but a diversified investor is better able to weather the ups and downs of individual asset classes.

Talk to your advisor about how to manage volatility through diversification. Your long-term goals may depend on it.

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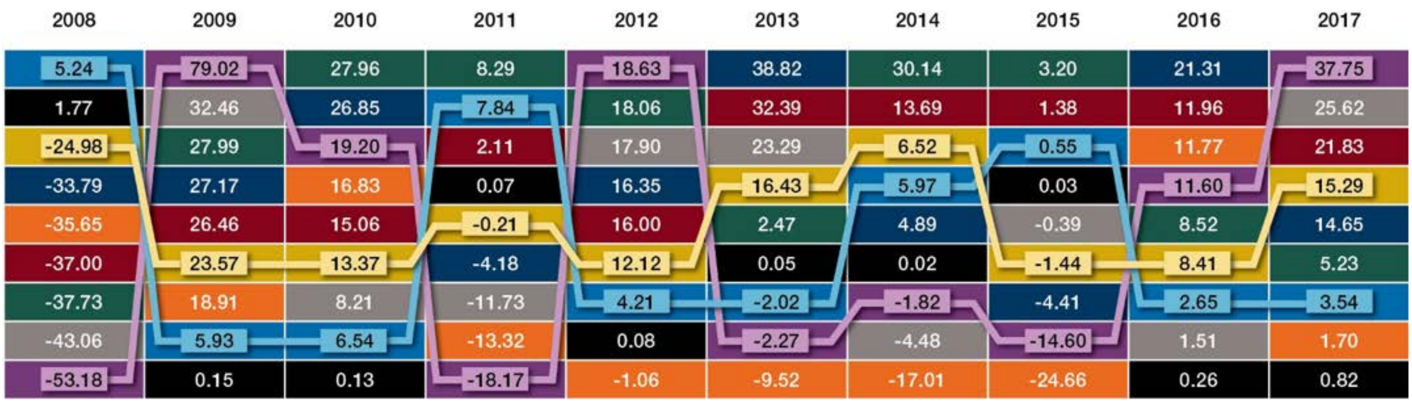

The historical performance of each representative index cited is provided to illustrate market trends; it does not represent the performance of a particular investment product. Past performance does not guarantee future results. Index performance does not reflect the deduction of any investment-related fees and expenses. It is not possible to invest directly in an index. Asset allocation/diversification of your overall investment portfolio does not assure a profit or protect against a loss in declining markets.

Cash is defined as the Bloomberg Barclays 1–3 Month U.S. Treasury Bill Index, which is an unweighted index that measures the performance of one- to three-month maturity of U.S. Treasury bills.

Fixed income is defined as the Bloomberg Barclays U.S. Aggregate Bond TR Index, which covers the U.S. investment-grade fixed-rate bond markets, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. Investing in fixed-income securities involves credit and interest rate risk. When interest rates rise, bond prices generally fall.

Domestic large-cap equity is defined as the S&P 500 TR Index, which is a free-float market capitalization index of the 500 largest publicly held U.S.-based companies, capturing 75-percent coverage of U.S. equities. It is often used as a proxy for the American stock market.

Domestic small-cap equity is defined as the Russell 2000 TR Index, which measures the performance of the smallest 2,000 U.S.-based companies in the Russell 3000 Index and serves as a benchmark for U.S. small-cap stocks. The equity securities of small companies may not be traded as often as equity securities of large companies, so they may be difficult or impossible to sell.

International developed equity is defined as the MSCI EAFE GR Index (Europe, Australasia, Far East), which is a free float-adjusted market capitalization index that is designed to measure the equity performance of 22 developed markets, excluding the U.S. and Canada. The MSCI EAFE Index is commonly used as a benchmark for equities representing the developed world outside of North America. International investing presents certain risks — like currency, custodial, political and transparency risk — not associated with investing solely in the United States.

International emerging market equity is defined as the MSCI Emerging Markets GR Index, which is a free float-adjusted market capitalization index that is designed to measure equity performance in the global emerging markets. Investing in emerging markets involves greater risk than investing in more established markets due to exchange rate changes, political and economic upheaval, and low market liquidity.

Real estate securities is defined as the FTSE NAREIT Equity REIT TR Index, which includes all equity REITs trading on the NYSE, Euronext and the NASDAQ OMX. Equity REITs are defined as firms that own, manage and lease investment-grade commercial real estate. Investing in a non-diversified fund that concentrates holdings into fewer securities or industries involves greater risk than investing in a more diversified fund. Changes in real estate values or economic downturns can have a significant negative effect on issuers in the real estate industry.

Commodities are defined as the Bloomberg Commodity TR Index, which is a diversified benchmark for commodities and is composed of futures contracts on physical commodities. It uses both liquidity data and U.S.-dollar-weighted production data in determining the relative quantities of included commodities. No related group of commodities (e.g., energy, precious metals, livestock or grains) may constitute more than 33 percent of the index.

Diversified portfolios assume annual rebalance at year end. The returns of the asset allocation example assumes an annual rebalancing back to original weights and the linking of monthly returns.

Moderate Allocation Composition

Asset Class	Representative Index	Allocation
Cash	Bloombery Barclays 1–3 Mo. U.S. Treasury Bill	3%
Fixed income	Bloomberg Barclays U.S. Aggregate Bond TR USD	29%
U.S. large-cap equity	S&P 500 TR USD	31%
U.S. small-cap equity	Russell 2000 TR USD	11%
International developed market equity	MSCI EAFE GR USD	13%
International emerging market equity	MSCI EM GR USD	6%
Real estate securities	FTSE NAREIT Equity REITs TR USD	4%
Commodities	Bloomberg Commodity TR USD	3%

The results shown are not the actual performance figures for any particular client.
Source of returns: Morningstar Direct (01/01/08 through 12/31/17)