



Don't put all your eggs in one basket

BALANCING RISK

If you're like most investors, your goal is to accumulate enough wealth during your working years to allow you to enjoy the lifestyle you want in retirement, while still enjoying the life that you lead today. If paying constant attention to the financial markets is keeping you from enjoying your everyday life, while thoughts of falling short of your financial goals have you worried about your long-term financial future, determining and implementing an appropriate asset allocation strategy may be just the solution for you.

Asset allocation simply refers to a long-term investment strategy that focuses on allocating investments across different types of assets to optimize your risk/reward tradeoff, and is the practical example of the old phrase, "Don't put all your eggs in one basket."

Though a very simple concept, it is widely believed by many investment experts that asset allocation is the single greatest determinant of long-term investment performance, with more than 90 per cent of the variation in portfolio returns explained by differences in long-term asset mix decisions¹.

The theory is that, by having your money invested in a variety of asset classes which respond differently to changing market conditions, you are more likely to maximize long-term investment growth while minimizing the overall effects of the inevitable ups and downs of the financial markets on your investment portfolio. Figure 1 shows how there is no consistent asset class that outperforms, making it difficult to pick tomorrow's winner.



ASSET CLASS PERFORMANCE: CAN YOU PICK THE NEXT WINNER?²

1970-74	1975-79	1980-84	1985-89	1990-94	1995-99	2000-03
5.4	23.3	17.6	33.0	12.9	29.3	3.1
(-0.1)	22.3	14.0	17.2	8.2	17.0	0.8
(-0.3)	18.6	13.2	14.2	5.8	13.8	(-6.2)
(-3.9)	8.8	10.3	9.9	4.5	5.0	(-6.5)
Colour legend			Canadian Equity	US Equity	International Equity	Cash

Figure 1

How much you invest in each asset class largely depends on which asset allocation strategy you employ, which, in turn, will depend on things such as your investment personality, financial goals, and risk tolerance. If you are young and many years away from retirement, you are probably interested in the maximum growth of your portfolio over the long term. On the other hand, if retirement isn't as far off as it once was, you may be more interested in starting to protect the wealth that you have worked so long and hard to accumulate. Though your tolerance for risk should generally decrease as your remaining working years dwindle, some growth-oriented assets should still be maintained in order to ensure adequate inflation protection, as well as to provide income and capital for what is hopefully a long and enjoyable retirement.

FACTORS TO CONSIDER WHEN DECIDING UPON AN ASSET ALLOCATION STRATEGY:

- Time Horizon(s)
- Risk Tolerance
- Liquidity Issues
- Tax Concerns
- Legal Constraints
- Unique Circumstances
- Investment Reporting/Analysis Capabilities

Your best asset allocation approach should begin with a visit to your financial advisor, whose expertise and experience will be invaluable to you as you decide on your own asset allocation strategy. Once your ideal



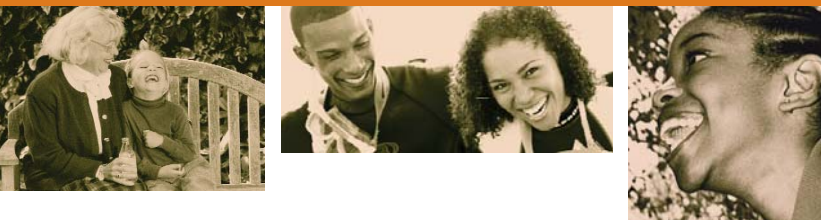


strategy has been determined, your financial advisor should be able to assist you in finding an investment fund that practises asset allocation according to your chosen strategy, or he/she may help you select from a variety of funds to create your own asset allocation portfolio. In either case, the following are some things you should consider as you choose and subsequently review your investments:

1. How much risk must I assume to achieve reasonable growth?
2. If my investments are in a taxable account, is my asset allocation strategy going to provide me with the highest after-tax returns?
3. If my investments are in a tax-deferred account, does my asset allocation strategy deal effectively with foreign content restrictions while still investing in a diversified array of investments appropriate to my risk tolerance?
4. Was the asset allocation strategy tested and modelled under different scenarios?
5. Are the investments underlying the asset allocation strategy from more than one fund company, and are the individual managers true specialists in the areas that they invest?
6. Do the investments underlying the asset allocation strategy accurately reflect my desired asset classes and proportions (types of stocks, bonds, etc.)?

7. Is the asset allocation strategy congruent with my time horizon(s)?

Once your asset allocation strategy has been adopted and implemented, regular portfolio rebalancing should be undertaken. When asset allocation portfolios are not periodically or systematically rebalanced, their risk and return characteristics can change, which can significantly decrease their overall effectiveness. Figure 2, which outlines historical asset-class shifts to a hypothetical balanced portfolio [initially consisting of 60 per cent large-cap stocks and 40 per cent fixed-income (split 30 per cent bonds and 10 per cent T-Bills)], illustrates this point. As you can see, without regular rebalancing, one is taking on needless and potentially serious allocation risk that can lead to a significant impact on portfolio performance over time.



AVOID THE RISK OF NOT REBALANCING⁴

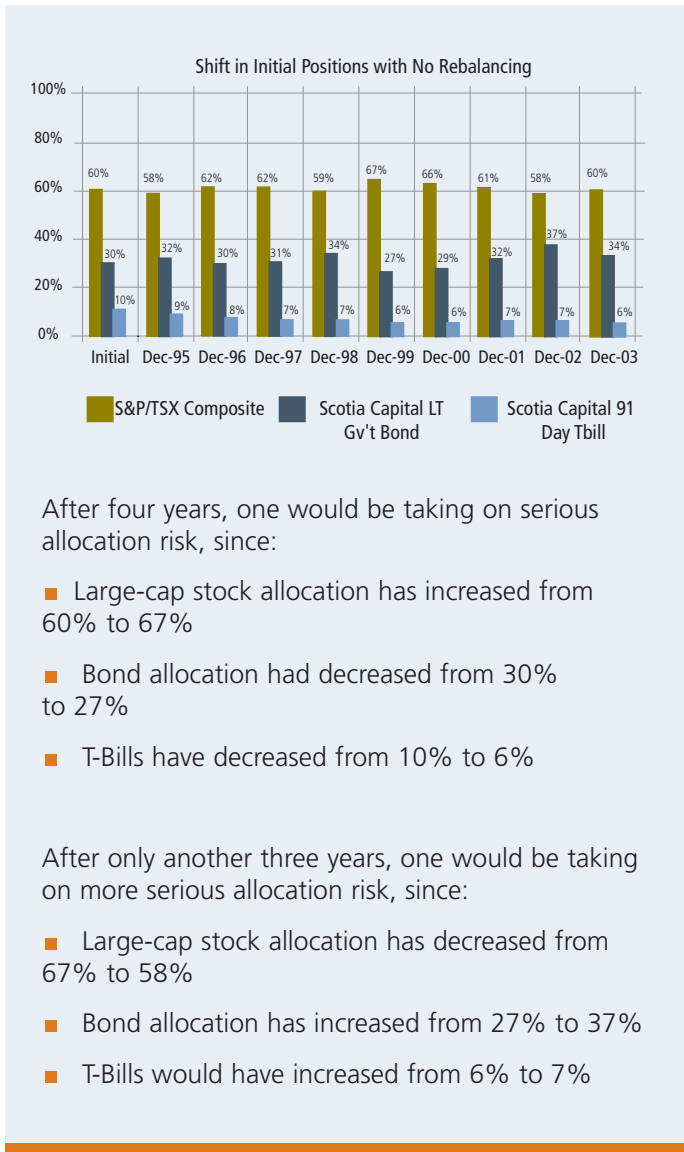


Figure 2

In addition to rebalancing, remixing is an important asset allocation service offered by some investment providers that must also be considered. Remixing involves the regular re-running and tweaking of portfolio models as new investment data becomes available, thus ensuring that the most efficient asset allocations are continuously employed.

In addition to regular rebalancing and remixing, periodic reviews of the asset allocation strategy and portfolio should be undertaken to determine if changes in your desired approach are warranted. Life changes and unplanned events can render existing asset allocation strategies outdated, while long-term views about the relative attractiveness of certain asset classes and managers may also change over time. Periodic reviews done on at least an annual basis are an excellent way to ensure the current portfolio is reflective of your long-term needs and outlook, while also addressing any short or mid-term goals.

At any risk tolerance level, asset allocation strategies are designed to balance individual portfolios while providing consistent, stable growth. When properly designed and managed, investors can take advantage of such time-proven and (Nobel) prize-winning³ strategies to meet their financial goals of the future, while also enjoying their lives of today!





SOME THINGS TO CONSIDER:

- 1 Talk to your advisor to determine if there is an asset allocation strategy and/or portfolio that is appropriate for you.
- 2 Consider pre-packaged asset allocation funds for all or part of your investment portfolio and financial goals.
- 3 Consider implementing a rebalancing strategy or investing in asset allocation portfolios from providers that offer automatic rebalancing and remixing services.
- 4 Review your individual funds in detail to make sure you get what you are expecting. Consider using a “manager of managers” service such as Manulife’s proprietary i-Watch⁵ program to ensure that the funds and managers you include in part of your asset allocation portfolio stay true to their asset class and investment mandates.
- 5 Review your investment portfolio on a regular basis to ensure it is reflective of your short- and long-term lifestyle goals.

1 Source: Brinson, Hood and Beebower, “Determinants of Portfolio Performance”, Financial Analysts Journal, July /August 1986. This 1986 study (repeated and published again in 1991) analyzed investment performance of 91 U.S. pension funds over a 10-year period and found that greater than 90 per cent of the variation in quarterly performance returns were explained by long-term asset mix policy.

2 Ibbotson Associates, MFC Global Investment Management

3 Harry Markowitz and William Sharpe won the 1990 Nobel Prize in Economic Sciences for their work on the Modern Portfolio Theory, in which they concluded that only portfolios with multiple asset classes can achieve the highest return for a given level of risk.

4 Source: Ibbotson Associates, MFC Global Investment Management

5 i-Watch is Manulife’s proprietary process for selecting and monitoring the funds offered. Similar to processes used by Canada’s top consulting firms for large institutional investors, i-Watch subjects funds and fund managers to stringent selection and monitoring criteria.

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