

# understanding a portfolio approach to investing

## INTRODUCTION

Portfolios provide an efficient and rigorous way of implementing your investment decision, by combining a number of investments in a robust and logical manner. A good portfolio will include a wide range of asset types and fund managers. This not only provides diversification benefits, but also access to a range of managers with sound track records.

## RISK MANAGEMENT IS IMPORTANT

Portfolio construction is really about risk management. A portfolio should not seek the highest return possible, at any cost. Rather, a portfolio should achieve the highest return for a given amount of risk, by seeking the optimum risk/return trade-off. Risk should be thought of as the probability and frequency of losing money and the expected volatility of the portfolio. Good portfolio construction provides investment discipline and risk management to ensure that your portfolio has a high probability of delivering its investment target while remaining within an acceptable level of risk.

## ASSET ALLOCATION

Asset allocation determines the riskiness of the portfolio and its long term returns, but not necessarily its short term returns. It is important to have the right mix of assets to ensure that the portfolio can reasonably deliver returns at an acceptable level of risk. This process of calculating the asset mix is known as asset allocation. The asset allocation for each of our portfolios is based on the long term risk-return characteristics for each asset class. Those asset classes with the more favourable risk-return outlook will have a higher allocation in the portfolio than those with less favourable risk-return profiles. Superior returns are the outcome of disciplined long term investment strategies.

## MANAGER SELECTION

The investments used in our portfolios are all selected from the SFG Approved Product List. Investment merit is the principal criteria for manager selection, with the selected fund managers being able to demonstrate superior performance for the level of risk that they take.

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Managers within a single asset type are usually highly correlated with each other. Simply adding more funds of the same type does not necessarily improve diversification, but tends to increase costs and reduce potential returns. The number of investment funds in a portfolio should be kept to the minimum required to do the job. Indeed, the use of too many investments in a portfolio may lead to below average outcomes.

## KEEPING UP TO DATE

Value is best added through long term investment. Frequent changes in asset allocation and fund managers create a drag on performance from capital gains tax and entry and exit fees and should be minimised. However, asset classes do experience periods of exceptionally strong (or weak) performance. This results in a drift away from the target asset allocation, thereby changing the riskiness of the portfolio. It is good practice to have your adviser review your portfolio at least annually and re-balance the asset allocations when necessary. This process ensures that the portfolios are neither over nor underexposed to one particular asset due to short-term fluctuations in the markets or investment managers' performance.



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