



**PVG Asset Management**  
LOSS AVERSE INVESTING

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# **TACTICAL ASSET ALLOCATION GUIDE TO INVESTING**

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# ASSET ALLOCATION EXPLAINED

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Asset allocation is an investment strategy that attempts to balance risk and reward by apportioning a portfolio's assets according to the investor's risk tolerance, goals, and investment time frame. There are three main asset classes: stocks, bonds, and cash and equivalents. Asset allocation is based on the principal that different asset classes perform differently in different markets and economic conditions.

The theory behind asset allocation is the expectation that different asset classes offer returns that are not significantly correlated with each other, hence diversification reduces the overall risk in terms of the variability of returns for a given level of expected return.

There are multiple categories of asset allocation, strategic or systemic, and tactical. Both approaches have their merits, the primary goal of strategic asset allocation is to create a blended portfolio of multiple asset classes that will provide an optimal balance between expected risk and return for a long term investment horizon.

Generally, strategic asset allocation relies on historical relationships between asset classes, while tactical asset allocation is focused on taking a more active approach of positioning a portfolio into asset classes or sub-categories of asset classes that have the most potential for gains.

The issue with traditional strategic asset allocation is that it is based on statistical data like correlations, variance, and historical returns of each asset class that existed over a specific period of time. The traditional asset allocation concept is based on past relationships between asset classes and the belief that returns similar to historical returns will continue in the future. *This is seldom the case.* In other words, when backward looking approaches are used to forecast future returns or risks using the traditional mean variance optimization of Modern Portfolio Theory (which is no longer modern), this method of asset allocation, is predicting future risks and returns based on history.

The traditional asset classes are:

**Stocks** – there are multiple categories such as growth or value, large cap, mid cap, small cap, domestic, international, or emerging markets.

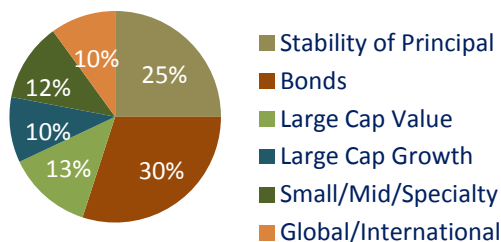
**Bonds** - debt instruments that are either government issued or issued by corporations and can vary greatly in terms of quality and duration.

**Cash and cash equivalents** - short term in nature with generally very low risk such as money market funds.

See Page 9 and 11 for more information on asset classes.

An example of a traditional asset allocation, commonly referred to as balanced, is generally for a moderate risk investor having a mix of roughly 60% in stocks and 40% in bonds.

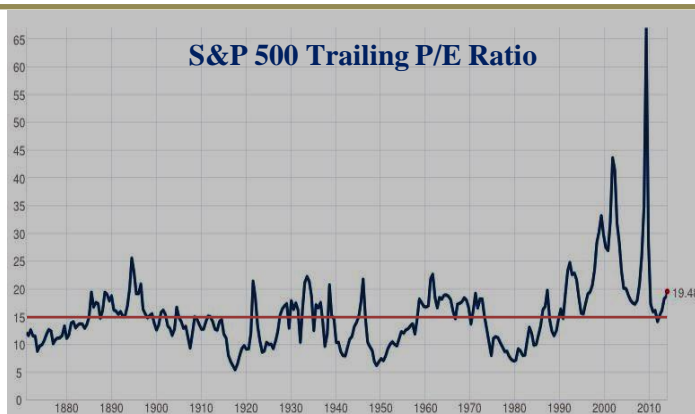
#### STRATEGIC MODERATE CONSERVATIVE PORTFOLIO



The issue with both the strategic and tactical asset allocation is that neither work when both stocks and bonds fall at the same time unless the investor is completely in cash, which is not a likely scenario. There are times that it is critical to avoid both stocks and bonds like the financial crisis in 2008, or having any stock exposure in 2000-2002.

The bursting of financial bubbles is not something that strategic allocations can effectively protect portfolios. It is especially important to protect portfolios when asset prices are significantly out of line with their underlying fundamentals, such as in 2008, when both stocks and corporate bonds both fell significantly.

We are currently in a very unusual market environment where we have very low interest rates and now expensive stock valuations. Generally at the bottom of economic cycles like in early 2009, interest rates are significantly lower than they are towards the peak (such as now). Interest rates are lower now due to Federal Reserve policy. This is odd to occur at this point in the cycle.



The graph of the S&P 500 Trailing P/E Ratio shows generally 15 times earnings or lower represents attractive periods for owning stocks. Above a 15 P/E ratio represents higher risk periods. It should be noted that there are periods during recessions when earnings fall to very low levels and should not be used to assess the value of the stock market for these purposes like in 2008 and 2009.



The yield of the 10 Year Treasury Note generally trends around the nominal GDP growth rate. For instance, real GDP growth of 3% plus inflation rate of 3% plus a risk premium, gets an expected yield on the 10 Year Treasury of 6-7%. When the bond yields are more than 8% it generally represents good value, and below 4% has a high degree of risk.

The major risk to portfolios is the systemic risk or market risk, and there are times that the systematic risk of owning either stocks or bonds or both must be taken out of the portfolio. The chart above shows that both stocks and bonds are overvalued. There are managers that manage portfolios that can replace traditional asset classes or sub-categories that do not have the same systemic or market risk as traditional managers.

The management firms that specialize in managing stocks, bonds, or a combination of both in a tactical manner, which reduce or eliminate the systemic risk, can also be known as absolute return managers. PVG has coined the phrase, “Loss Averse Investing” instead of tactical, to best describe their approach of preserving capital during negative markets.

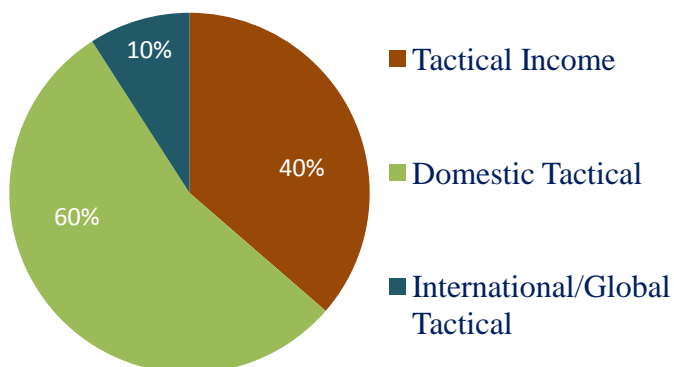
There are varying degrees of Tactical Strategies. Some Tactical Strategies are designed to have more correlation with the financial markets, and others have very low correlation with the stock or bond market.

These nontraditional approaches to managing stocks or bonds are commonly referred to as absolute return portfolios, rather than the traditional relative return portfolios that may benchmark against an index like the S&P 500 or the Barclays Aggregate Bond Index. Absolute return portfolios focus on positive returns rather than trying to beat an index. Therefore, they do not have the same risks, correlation, or variances as traditional portfolios in bear markets.

Traditional asset allocation is critical in helping avoid unnecessary risk, but it does not help during very critical periods of negative market declines, when most investors expect their portfolios to be protected.

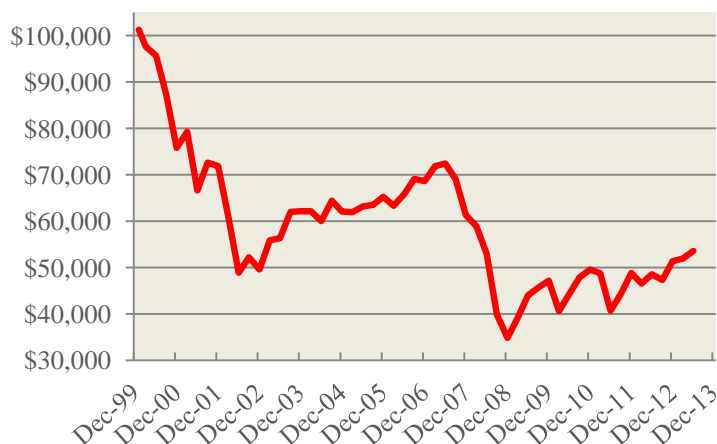
Using tactical managers to replace traditional managers in an asset class can significantly reduce the systemic risk and protect portfolios when it matters most. *(an example of a tactical portfolio is below)*

## TACTICAL MODERATE PORTFOLIO



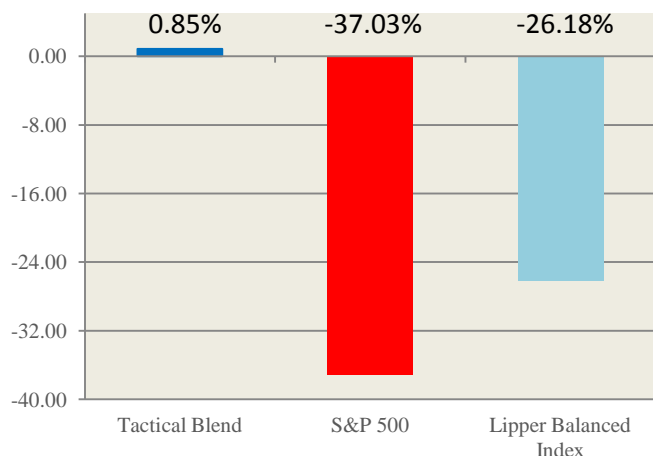
For investors with very long time horizons, 20 to 30 years, asset allocation or protection is less critical than for retired investors or conservative investors. For retired investors or those expecting to retire in a reasonable time, bear markets can be devastating. Withdrawing money during a declining market locks in the low stock or bond prices and leaves investors with a smaller position after markets recover.

## S&P 500 Total Return with 4% Distributions



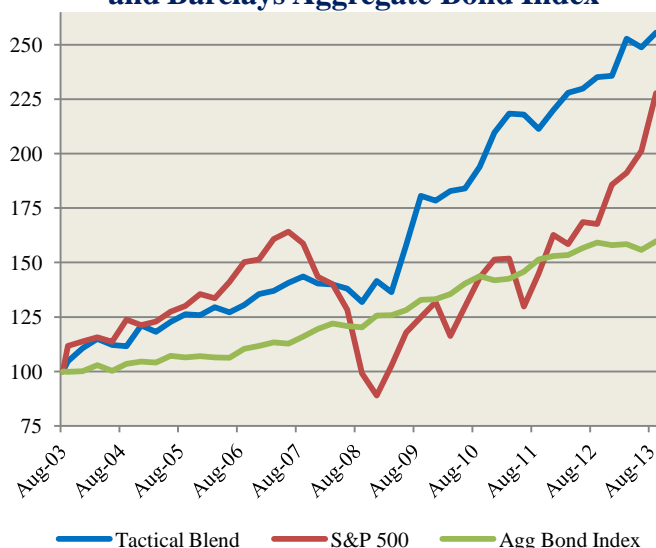
For investors willing to accept more risk in their asset allocation, the traditional aggressive or moderately aggressive investor would normally be very aggressively positioned at market bottoms, such as in 2009. As bull markets naturally mature, the risk in the markets grow as asset prices increase, and the normal economic cycle wanes, like the markets during 2013. In these markets investors should allocate significantly more assets toward tactical managers.

**Tactical Blend vs. S&P 500 Index and Lipper Balanced Index in 2008**



*We have selected three tactical managers with more than a 10 year history to illustrate the potential benefits during certain time periods.*

**Tactical Blend vs. S&P 500 Index and Barclays Aggregate Bond Index**



*The chart above illustrates the growth of \$100,000 from September 1, 2003 to September 30, 2013.*

We hope that the preceding information has been a helpful guide in making more informative investment decisions and to understanding the nuances between Strategic Asset Allocation and Tactical Asset Allocation. In the following pages we have provided a self assessment and guide to assist in finding an appropriate investment allocation as well as explain the differences in each asset class more thoroughly.

## **What is *your* risk profile?**

As an investor that may or may not be concerned with risk, turn to the next page for a guide that helps determine your position on the risk profile spectrum. This will help identify the need for either a Tactical Asset Model or a Strategic Asset Model. Through years of research we have found that implementing these strategies, in accordance to risk appetite, is a more efficient way to find the most suitable investment strategy.

# PROFILE QUESTIONNAIRE

## Risk Assessment Worksheet

Answer the following questions to help determine recommended asset allocation. Total the score and compare it to the values and descriptions listed below.

RISK TOLERANCE	YOUR SCORE
<b>1. Volatility:</b> I can tolerate sharp ups and downs in the short-term value of my investments in return for potential long-term gains. 5. STRONGLY AGREE 4. AGREE 3. DISAGREE 2. STRONGLY DISAGREE	
<b>2. Risk vs. Reward:</b> Hypothetically, I prefer an investment that has a 50 percent chance of losing 15% and a 50 percent chance of gaining 20% in one year, rather than an investment that will assure a 7% return in one year. 5. STRONGLY AGREE 4. AGREE 3. DISAGREE 2. STRONGLY DISAGREE	
<b>3. Decline in value:</b> I am comfortable holding on to an investment even though it drops sharply in value. 5. STRONGLY AGREE 4. AGREE 3. DISAGREE 2. STRONGLY DISAGREE	
<b>4. Equity investing:</b> I am willing to take the risks associated with stocks in order to earn a potential return greater than the rate of inflation. 5. STRONGLY AGREE 4. AGREE 3. DISAGREE 2. STRONGLY DISAGREE	
<b>5. Knowledge of risk:</b> I consider myself knowledgeable about the risks and potential returns associated with investing in stocks and other types of securities. 5. STRONGLY AGREE 4. AGREE 3. DISAGREE 2. STRONGLY DISAGREE	
Total	

If your Risk Tolerance score is:

- **20 or greater;** please complete the questionnaire to determine the appropriate *Strategic Asset Allocation*.
- **Below 20;** please complete the questionnaire to determine the appropriate *Tactical Asset Allocation*.

# PROFILE QUESTIONNAIRE (CONTINUED)

## Risk Assessment Worksheet

Answer the following questions to help determine recommended asset allocation. Total the score and compare it to the values and descriptions listed below.

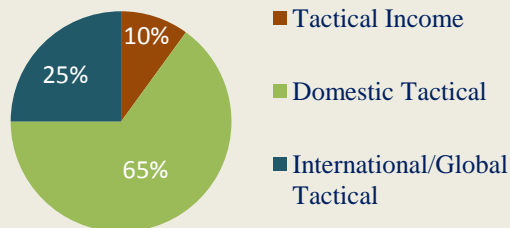
FINANCIAL GOALS					YOUR SCORE
<b>6. Investments:</b> I do not need a high level of current income from my investments. I am more interested in their long-term growth potential.					
5. STRONGLY AGREE 4. AGREE 3. DISAGREE 2. STRONGLY DISAGREE					
<b>7. Large Expenses:</b> I have set aside savings to cover large expenses like purchasing a home, college tuition or a financial emergency.					
5. STRONGLY AGREE 4. AGREE 3. DISAGREE 2. STRONGLY DISAGREE					
<b>8. Inflation:</b> I am concerned about the effects of inflation on my investments.					
5. STRONGLY AGREE 4. AGREE 3. DISAGREE 2. STRONGLY DISAGREE					
TIME HORIZON					
<b>9. Personal timeline:</b> In how many years do you plan to utilize the results of your investment strategy?					
5. MORE THAN 15 YRS 4. MORE THAN 10 YRS 3. MORE THAN 5 YRS 2. LESS THAN 5 YRS					
<b>10. Long-term investing:</b> I am comfortable with an investment that may take 10 years to provide the returns I expect.					
5. STRONGLY AGREE 4. AGREE 3. DISAGREE 2. STRONGLY DISAGREE					
TOTAL SCORE					
If your Total Score is _____, you may be a(n):	<b>45-50</b> Aggressive Investor	<b>39-44</b> Moderately Aggressive Investor	<b>33-38</b> Moderate Investor	<b>27-32</b> Moderately Conservative Investor	<b>20-26</b> Conservative Investor

Now that we have created an investment profile, continue to the following pages for more informative asset class analysis, which includes both Tactical and Strategic asset classes. If the Risk Tolerance score is below 20, combine Financial Goals and Time Horizon scores and proceed to page 8. If the Risk Tolerance score is above 20, combine Financial Goals and Time Horizon scores and proceed to page 10.



# TACTICAL ASSET ALLOCATION MODELS

The following model portfolios represent tactical asset allocations for various investor profiles:

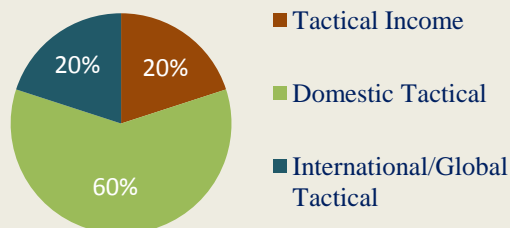


## Aggressive Tactical Portfolio

Emphasis on Tactical Strategies that are seeking high total returns. Generally, there are primarily equities or similar higher risk investments.

### Consider this portfolio if you:

- Have a high total return expectation
- Have a desire to significantly outpace inflation
- Can accept higher degrees of fluctuation

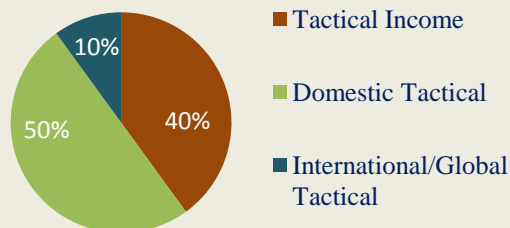


## Moderately Aggressive Tactical Portfolio

80% of this portfolio is focused on seeking high total returns; while also offering income oriented Tactical Income Strategies.

### Consider this portfolio if you:

- Are seeking a higher total return
- Have less desire to protect the portfolio from volatility
- Seeking a total return that will moderately outpace inflation

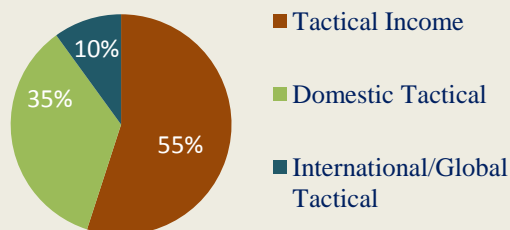


## Moderate Tactical Portfolio

An intermediate risk and return portfolio that provides a blend of Capital Appreciation and Income oriented Tactical Strategies.

### Consider this portfolio if you:

- Have an expectation of moderate total return
- Would like a higher level of diversity
- Would like a hedge against inflation

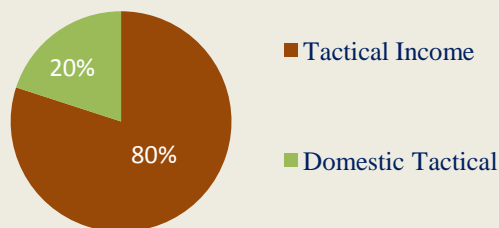


## Moderately Conservative Tactical Portfolio

Portfolio focuses on risk reduction; while maintaining a secondary objective of higher growth potential.

### Consider this portfolio if you:

- Are seeking a conservative total return
- Have a desire to reduce volatility in your investment portfolio
- Would like some hedge against inflation



## Conservative Tactical Portfolio

Portfolio is designed to provide income with minimal emphasis on capital appreciation.

### Consider this portfolio if you:

- Need income to supplement your cash flow
- Are unwilling to accept risk/volatility
- Are more concerned about current income than outpacing inflation



**T**actical Asset Allocation models are created by combining tactical strategies with varying styles and objectives.

### **Tactical Income**

*These Strategies would substitute for the Stability of Principal and Bond strategic asset classes. They are Tactical Strategies with an Income mandate and an emphasis on Capital Preservation. These Strategies have the flexibility to allocate between stocks or bonds or a combination of both.*

### **Domestic Tactical**

*These Strategies have an objective of Capital Appreciation and have the flexibility to invest in Domestic Large Cap Growth, Small Cap, Mid Cap etc. based on the Manager's outlook, the Manager's process and which Asset Classes they believe will outperform. They also have a secondary objective of Capital Preservation*

### **International/Global Tactical**

*Tactical Strategies that seek Capital Appreciation Globally. The Manager will choose to invest in various Asset Classes that they feel will outperform. These Managers also have a secondary objective of Capital preservation.*

### **What Tactical Managers should I choose?**

By now you might be interested in utilizing tactical managers to help with your wealth management. PVG Wealth Management has researched numerous tactical asset managers and is able to offer guidance of the most appropriate managers.

*Please refer to our Appendix for more information.*

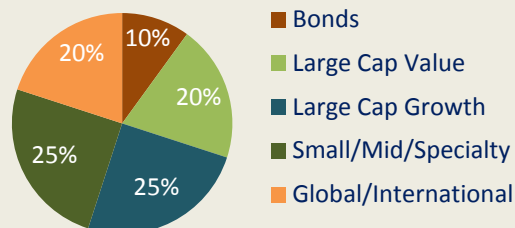
# STRATEGIC ASSET ALLOCATION MODELS

The following model portfolios represent traditional strategic asset allocations for various investor profiles:

## Aggressive Portfolio (Investor Profile Score: 45-50) –

Primarily equities or similar higher risk investments, weighted toward aggressive growth, small company and international investments. Consider this portfolio if you:

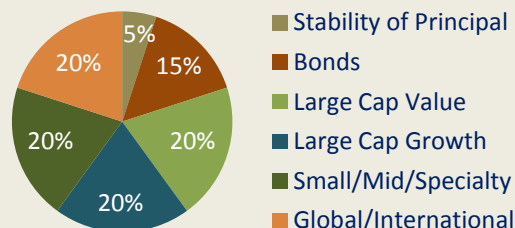
- Have high return expectations for your investments
- Can tolerate higher degrees of fluctuation (sharp, short-term volatility) in the value of your investments
- Are a younger or a more experienced investor and a risk taker
- Desire returns that exceed inflation
- Have 15 years or more before you will need the money from your investments



## Moderately Aggressive Portfolio (Investor Profile Score: 39-44) –

80 percent equities or similar higher risk investments focused on growth, while also offering income-oriented investments. Consider this portfolio if you:

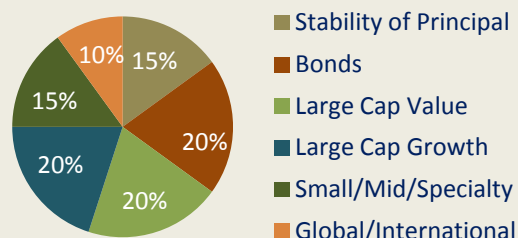
- Have moderately high expectations for a return on your investments
- Can tolerate market downturns and volatility for the possibility of achieving greater long-term gains
- Are an experienced equity investor
- Desire potential returns that moderately outpace inflation
- Have 10 years or more before you will need the money from your investments



## Moderate Portfolio (Investor Profile Score: 33-38) –

An intermediate risk and return portfolio that provides a blend of equities and income-oriented investments. Consider this portfolio if you:

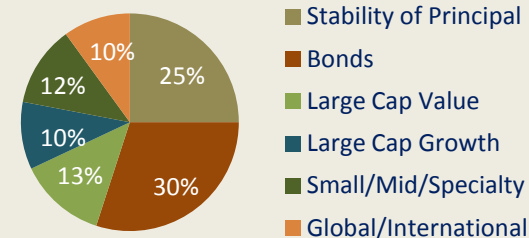
- Have moderate return expectations for your investments
- Want some current income return on your investments
- Are willing and able to accept a moderate level of risk and return
- Are primarily a growth investor but want greater diversification
- Are concerned about inflation
- Have five or more years before you will need the money from your investments



## Moderately Conservative Portfolio (Investor Profile Score: 27-32) –

25 percent invested in stability of principal, 30 percent in income-oriented investments and the remaining 45 percent in equities to provide growth potential. Consider this portfolio if you:

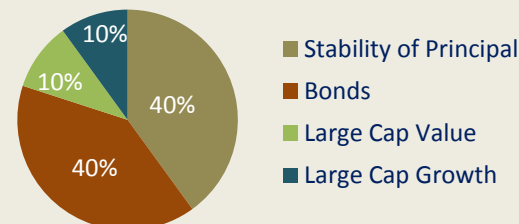
- Need more current income from your investments
- Are willing and able to accept some risk/volatility
- Are a cautious or first-time investor
- Want some potential hedge against inflation
- Have five or fewer years before you will need the money from your investments



## Conservative Portfolio (Investor Profile Score: 20-26) –

Only 20 percent invested in growth and growth and income investments, 40 percent in income-oriented investments and 40 percent in stability of principal. Consider this portfolio if you:

- Need income to supplement your cash flow
- Are unwilling or unable to accept risk/volatility
- Are a cautious investor
- Are more concerned about current income than outpacing inflation
- Have five or fewer years before you will need the money from your investments



**Strategic Model portfolios are traditionally comprised of six different asset classes:**

### **Stability of Principal**

*Seeks to hold – but not necessarily guarantee – the principal value of an investment stable through all market conditions. May credit a stated rate of return or minimum periodic interest rate that may vary. Dividend rates and income levels fluctuate with market conditions and are not guaranteed.*

### **Bonds**

*Seeks income or growth of income, with less emphasis on capital appreciation. May include aggressive: below-investment grade bonds or bonds of foreign issuers; moderate: investment grade corporate bonds, mortgages, government bonds and, to a lesser degree, preferred stock, foreign or convertible bonds; or conservative: Treasury Bills and other highly-rated, short term (e.g., 90-day) securities.*

### **Large Cap Value**

*Seeks long-term growth of capital or a combination of growth and income by investing primarily in stocks of larger, mature companies. Selected for price appreciation and for the value of the current income provided through dividends. Generally exhibit a lower level of price volatility, due to the types of companies favored, such as those able to pay dividends.*

### **Large Cap Growth**

*Seeks long-term growth of capital by investing primarily in stocks of larger U.S. companies. Typically has higher price/earnings ratios and makes little or no dividend payments. Tends to be more established, with lower relative volatility, than more aggressive small and mid-cap stocks.*

### **Small/Mid/Specialty**

*Seeks capital appreciation by investing primarily in stocks of small- and medium-sized companies; also invests in “specialty” or “sector” companies, which include those in a particular industry. Generally, strives to develop new products or markets and has above-average earnings growth potential, but with higher risk and volatility.*

### **Global/International**

*Seeks capital appreciation by investing in foreign stock: stocks of companies outside the United States; world stock: stocks of companies in the United States and developed countries outside the United States; and emerging markets: stocks of developing countries. May provide greater diversification benefits than domestic securities alone, but involves additional risks.*



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