Asset Allocation: Past, Present and Future

Presented by:
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Evolution of portfolio management theory

- **1900s – 1960s**
  - Concentrated Stock Portfolios
    - Stocks evaluated independently

- **1960s-1980s**
  - Efficient Portfolio Construction
    - Theory of portfolio selection (Markowitz)
  - Strategic Asset Allocation
    - Importance of policy portfolio (Brinson, Beebower, Singer)

- **1980s-1990s**
  - Goals-Based Investing
    - Regime allocation
    - Risk allocation
    - (SEI et al)
  - Active Asset Allocation
    - Investors are not “rational” (Kahneman, Tversky)

- **Today**
  - Asset Allocation
  - Market Timing
  - Securities Selection
  - Other Factors


Asset Allocation does not guarantee a profit or protect against loss in a declining market.
Pitfalls of traditional asset allocation

Estimating Asset Class Returns
- Asset class returns are constantly changing
- Historical returns may reflect secular trends that aren’t expected to persist
- History is a poor predictor

Estimating Asset Class Risk
- Risks constantly change
- Poor market outcomes are rarely consistent with observed standard deviations
- Non-normality is the norm

Estimating Asset Class Correlations
- Correlations among risky assets tend to rise when volatility is high
- Correlations between risky assets and government bonds tend to fall when volatility is high
- Correlations are time variant
Traditionally, demand for higher returns forces investors to move further out on the risk spectrum.

For illustrative purposes only
Traditional asset allocation vs. risk allocation

The traditional “diversified” portfolio is highly concentrated in equity risk…

Traditional asset allocation: The volatility of volatility

Source: SEI
Traditional asset allocation: Correlations and crises

S&P 500 vs. BarCap Aggregate

Source: S&P, BarCap, SEI
Traditional asset allocation and economic regimes

Varying economic regimes and preferred exposures

- **Rising Growth/Falling Inflation**
  - Risk Premiums
  - Equity, Credit…

- **Rising Growth/Rising Inflation**
  - Scarcity Assets
  - Energy, Real Estate…

- **Falling Growth/Falling Inflation**
  - Duration
  - Nominal IG Bonds…

- **Falling Growth/Rising Inflation**
  - Hedges
  - TIPS, Cash…

Source: SEI. Growth = ISM, Inflation = Headline CPI, 25yrs monthly data ended 2011
Overcoming the flaws of traditional asset allocation

Actively managing the strategic asset allocation to take advantage of shorter term market anomalies

• Capturing the collective wisdom of SEI’s platform
• Implementation in accord with client goals & objectives

Continuously evaluating and identifying asset classes with favorable fundamental diversification characteristics

• Inflation beta
• Volatility?
Active asset allocation process

**Top-Down Signals**
- Economic data & analysis
- Market valuations & trends
- Investor sentiment & technicals

SEI Portfolio Strategy Group proprietary modeling & research

**Bottom-Up Signals**
- Manager discussions
- Manager positioning
- Manager trading

SEI Investment Strategy Group proprietary analysis & research

SEI’s Active Allocation
Harnessing the breadth and depth of our platform
Leveraging technology for active asset allocation
Utilizing forward looking risk models for active tilts
### SEI’s approach to active asset allocation

<table>
<thead>
<tr>
<th></th>
<th>Active Asset Allocation</th>
<th>Global Tactical Asset Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investment horizon</strong></td>
<td>Rolling 12 months</td>
<td>Daily</td>
</tr>
<tr>
<td><strong>Trade frequency</strong></td>
<td>Opportunistically</td>
<td>Daily</td>
</tr>
<tr>
<td><strong>Primary objective</strong></td>
<td>Maintaining diversification</td>
<td>Return enhancement</td>
</tr>
<tr>
<td><strong>Summary</strong></td>
<td>An integrated pro-active strategy, rebalancing exposures to best fit client goals over an intermediate time horizon</td>
<td>A stand-alone product seeking high excess returns over cash</td>
</tr>
</tbody>
</table>
Multi-asset inflation

The chart plots the potential combinations of asset classes against return efficiency and inflation beta.

An inflation-sensitive strategy would seek an optimum combination of efficiency and beta.

Source: SEI
Inflation: Allocations and betas

Source: SEI. Data is preliminary and not reflective of an existing investment offering.
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