VITAL SIGNS: VOLATILITY

# Conversations about diversification.

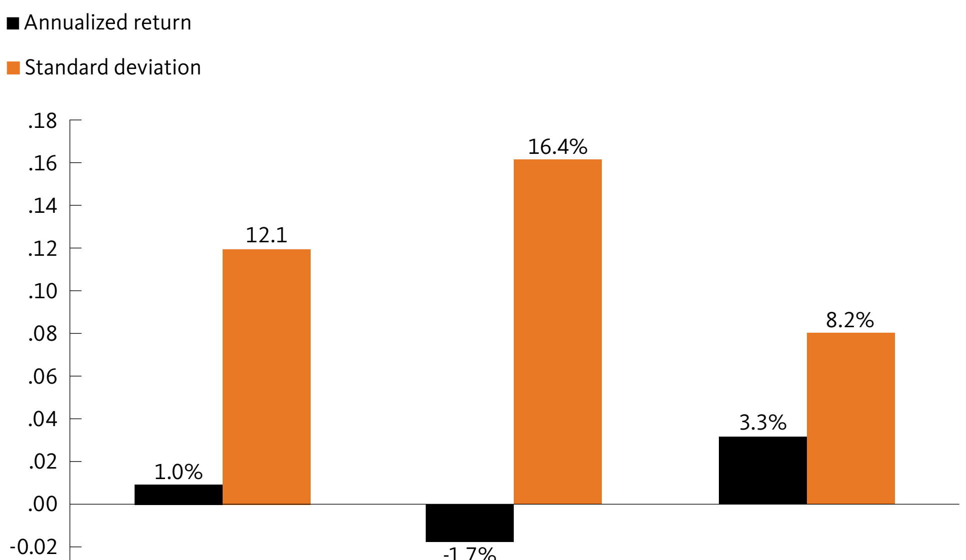
There's a good reason why Nobel Prize laureate Harry Markowitz is famously credited with saying: "Diversification is the only free lunch."

## Don’t doubt diversification

Maintaining a diversified portfolio cannot guarantee against loss, but investing broadly across asset types, investment styles, holding periods, and geographies can be one of the best methods to manage the risk of an overall investment portfolio. Investors tend to chase last year’s winners or put too much money in a single stock or asset class. This all-too-familiar scenario often causes emotional investment decisions that can potentially undermine long-term goals.

Over the long haul, a diversified portfolio may offer better returns with less risk, especially compared to an investor making common mistakes. This is illustrated in the simplified hypothetical portfolio comparisons below.

### Diversification is likely to win over time




**Return-chaser**
Each year, the strategy invests only in the prior year’s top-performing asset class.

**Contrarian**
Each year, the strategy invests in the prior year’s worst-performing asset class.

**Diversifier**
The diversified strategy simply holds equal amounts of all available asset classes year in and year out.

Standard deviation: A common measure of investment risk, whereby lower is deemed less risky.

Annual returns from 2012 (to establish best- and worst-performing asset classes going into 2013) through 2022. At the start of each year, the hypothetical Return-chaser strategy invests 100% in the best-performing asset class of the prior year; the hypothetical Contrarian strategy invests 100% in the worst-performing asset class of the prior year; and the hypothetical naive or 1/N Diversifier strategy invests equally in all asset classes each year. Asset-class returns are based on the same indexes as indicated on the preceding page.

Index returns are for illustrative purposes only and do not represent actual investment performance. Index returns do not reflect any management fees, transaction costs, or expenses. Indexes are unmanaged and one cannot invest directly in an index.

Sources: FactSet, Index providers, SEI. The performance data quoted represents past performance. Past performance does not guarantee future results.

**MIND OVER MATTER**

Diversification helps smooth the ride.

Spreading risk broadly ensures that all your investments aren’t in the worst-performing asset class. It also increases the likelihood that part of your portfolio is allocated to better-performing assets in any given year.

Remember, years like 2022, when both fixed income and equities declined in tandem, are an anomaly.

**MIND OVER MATTER**

Over the past decade, the Return-Chaser would have beaten the other strategies 40% of the time, while the Contrarian would have won 50% of the time.

The Diversifier would have come out on top in only one of those ten years.

However, over the long term, the Diversifier would have achieved better returns with less volatility and risk.

## Asset class performance varies and leadership rotates often

Annual returns for key indices (2012–2022) ranked in order of performance (best to worst)

| 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|---|
| Emerging Markets Equity **18.63%** | Small Cap Growth **43.30%** | REIT Index **32.00%** | Large Cap Growth **5.67%** | Small Cap Value **31.74%** | Emerging Markets Equity **37.75%** | International Fixed Income **3.49%** | Large Cap Growth **36.39%** | Large Cap Growth **38.49%** | REIT Index **45.91%** | Large Cap Value **-7.54%** |
| Emerging Market Debt **18.54%** | Small Cap Value **34.52%** | Large Cap Value **13.45%** | REIT Index **4.48%** | High Yield Bond **17.49%** | Large Cap Growth **30.21%** | Core Fixed Income **0.01%** | Large Cap Core **31.43%** | Small Cap Growth **34.63%** | Small Cap Value **28.27%** | High Yield Bond **-11.21%** |
| Small Cap Value **18.05%** | Large Cap Growth **33.48%** | Large Cap Core **13.24%** | International Fixed Income **1.55%** | Large Cap Value **17.34%** | International Equity **25.62%** | Large Cap Growth **-1.51%** | Small Cap Growth **28.48%** | Large Cap Core **20.96%** | Large Cap Growth **27.60%** | Core Fixed Income **-13.01%** |
| International Equity **17.90%** | Large Cap Core **33.11%** | Large Cap Growth **13.05%** | Emerging Market Debt **1.23%** | Large Cap Core **12.05%** | Small Cap Growth **22.17%** | High Yield Bond **-2.27%** | Large Cap Value **26.54%** | Emerging Markets Equity **18.31%** | Large Cap Core **26.45%** | International Fixed Income **-13.10%** |
| Large Cap Value **17.51%** | Large Cap Value **32.53%** | International Fixed Income **9.77%** | Large Cap Core **0.92%** | Emerging Markets Equity **11.60%** | Large Cap Core **21.69%** | REIT Index **-4.22%** | REIT Index **23.10%** | 60/40 Diversified Portfolio **14.72%** | Large Cap Value **25.16%** | International Equity **-14.01%** |
| REIT Index **17.12%** | International Equity **23.29%** | 60/40 Diversified Portfolio **7.55%** | Core Fixed Income **0.55%** | Small Cap Growth **11.32%** | 60/40 Diversified Portfolio **15.68%** | 60/40 Diversified Portfolio **-4.60%** | Small Cap Value **22.39%** | International Equity **7.82%** | 60/40 Diversified Portfolio **12.01%** | Small Cap Value **-14.48%** |
| Large Cap Core **16.42%** | 60/40 Diversified Portfolio **16.52%** | Core Fixed Income **5.97%** | 60/40 Diversified Portfolio **-0.24%** | Emerging Market Debt **10.19%** | Large Cap Value **13.66%** | Emerging Market Debt **-4.61%** | International Equity **22.01%** | Core Fixed Income **7.51%** | International Equity **11.26%** | 60/40 Diversi-fied Portfolio **-15.86%** |
| High Yield Bond **15.55%** | High Yield Bond **7.41%** | Small Cap Growth **5.60%** | International Equity **-0.39%** | 60/40 Diversified Portfolio **8.77%** | Emerging Market Debt **9.32%** | Large Cap Core **-4.78%** | 60/40 Diversified Portfolio **20.97%** | High Yield Bond **6.07%** | High Yield Bond **5.35%** | Emerging Market Debt -16.45% |
| Large Cap Growth **15.26%** | International Fixed Income **1.42%** | Emerging Market Debt **5.53%** | Small Cap Growth **-1.38%** | Large Cap Growth **7.08%** | Small Cap Value **7.84%** | Large Cap Value **-8.27%** | Emerging Markets Equity **18.42%** | Emerging Market Debt **5.88%** | Small Cap Growth **2.83%** | Large Cap Core **-19.13%** |
| Small Cap Growth **14.59%** | REIT Index **1.22%** | Small Cap Value **4.22%** | Large Cap Value **-3.83%** | REIT Index **6.68%** | High Yield Bond **7.48%** | Small Cap Growth **-9.31%** | Emerging Market Debt **14.42%** | International Fixed Income **4.67%** | Emerging Markets Debt **-1.51%** | Emerging Markets Equity **-19.74%** |
| 60/40 Diversified Portfolio **13.41%** | Core Fixed Income **-2.02%** | High Yield Bond **2.51%** | High Yield Bond **-4.61%** | International Fixed Income **5.13%** | REIT Index **3.76%** | Small Cap Value **-12.86%** | High Yield Bond **14.41%** | Small Cap Value **4.63%** | Core Fixed Income **-1.54%** | REIT Index **-25.35%** |
| International Fixed Income **5.51%** | Emerging Markets Equity **-2.27%** | Emerging Markets Equity **-1.82%** | Small Cap Value **-7.47%** | Core Fixed Income **2.65%** | Core Fixed Income **3.54%** | International Equity **-13.79%** | Core Fixed Income **8.72%** | Large Cap Value **2.80%** | International Fixed Income **-2.35%** | Small Cap Growth **-26.35%** |
| Core Fixed Income **4.21%** | Emerging Market Debt **-6.58%** | International Equity **-4.48%** | Emerging Markets Equity **-14.6%** | International Equity **1.51%** | International Fixed Income **2.06%** | Emerging Markets Equity **-14.58%** | International Fixed Income **8.02%** | REIT Index **-11.20%** | Emerging Markets Equity **-2.54%** | Large Cap Growth **-29.14%** |

Best

Worst

- **Large Cap Core** = Russell® 1000 Index
- **International Equity** = MSCI EAFE Index (Gross)
- **Emerging Markets Equity** = MSCI Emerging Markets Index (Gross)
- **Core Fixed Income** = Bloomberg Barclays U.S. Aggregate Bond Index
- **REIT Index** = Dow Jones U.S. Select REIT Index
- **High Yield Bond** = ICE BofA U.S. High Yield Constrained Index
- **Emerging Market Debt** = J.P. Morgan EMBI Global Index
- **Large Cap Growth** = Russell® 1000 Growth Index
- **Large Cap Value** = Russell® 1000 Value Index
- **Small Cap Value** = Russell® 2000 Value Index
- **Small Cap Growth** = Russell® 2000 Growth Index
- **International Fixed Income** = Citigroup Bond WGBI Non-U.S. Hedged Index
- **60/40 Diversified Portfolio** = Annual returns for the 60/40 diversified portfolio are based on 24% Bloomberg Barclays U.S. Aggregate Bond Index, 19% Russell 1000 Growth Index, 18% Russell 1000 Value Index, 12% MSCI EAFE Index, 6% MSCI Emerging Markets Index (Gross), 6% Citigroup WGBI, Non-U.S. Hedged, 4% ICE BofA U.S. High Yield Constrained Index, 4% J.P. Morgan GBI Emerging Markets Global Diversified Index, 3% Russell 2000 Growth Index, 2% Russell 2000 Value, and 2% Dow Jones U.S. Select REIT Index

**Source:** Ibbotson Associates. **This material has been obtained from sources generally considered reliable.** No guarantee can be made as to its accuracy. Not intended to represent the performance of any particular investment. Indices are unmanaged and one cannot invest directly in an index.

## Portfolio health check

- Don't be tricked by recency bias (bias that favors recent events over historical events), and; consider your options before chasing last year's best-performing sector. Do spread risk broadly.
- The best- and worst-performing asset classes rotate unexpectedly. A financial advisor can help ensure that you have an asset mix that that helps you meet your goals during volatile times.
- Don't set it and forget it. Revisit your allocation mix regularly with your advisor, and make sure your portfolio is aligned with your risk tolerance and goals.

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