
Asset allocation is alive and well

By Editor Test Thu, Jun 14, 2012

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Despite the much-ballyhooed demise of Modern Portfolio Theory pronounced in the wake of the 2008 stock market crash, not everyone has lost the faith. In fact, advisors are split almost evenly over whether asset allocation still works, according to a recent article in the Journal of Financial Planning, "[Going to One: Is Diversification Passé?](#)" by Jim Grote, a CFP and financial writer.

While correlations did soar to +1.0 during the market meltdown, advisors interviewed for the article say that's largely due to panicked selling on the part of investors, and any correlation between +.95 and -1.0 still can offer enough diversification to lower overall portfolio risk. Indeed, some assets, like gold, high-quality bonds and Treasuries did well in 2008 and helped temper some of the volatility.

"What we learned from 2008 was to diversify the 'sources' of our returns," said Joan Malloy, managing director for the Greenway Family Office in St. Louis. "Our clients need to have income derived from real estate rents, master limited partnerships, bond coupon payments, dividends, etc.

"As advisers we need to drill down and analyze the risks that could pose a threat to the return source. We need to diversify in terms of industries and not just asset classes. In addition, the crash should reinforce the need to keep a cushion of liquid assets," she added, noting that when you compare major indices, diversification was vindicated three years after the crash.

Another advisor, Thomas Balcom, founder of 1650 Wealth Management in Boca Raton, Florida, said he finds diversification in alternative investments, such as long-short funds, market-neutral funds, structured notes, and managed futures. Unlike commodities and REITS, these hedging strategies are less likely to become highly correlated because, "everyone is not going to short the same stocks in the same sectors at the same time, thus protecting these [alternatives] to some degree from destructive herd behavior," he said.

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