The Importance of Diversification

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TOPICS OF DISCUSSION

- Defining Diversification
- Diversification Topics

ASSET ALLOCATION	ASSET/SECURITY CONCENTRATION	REBALANCING

- Putting it All Together – Why Diversification Matters

DIVERSIFICATION

- Don’t Put All of Your Eggs in One Basket

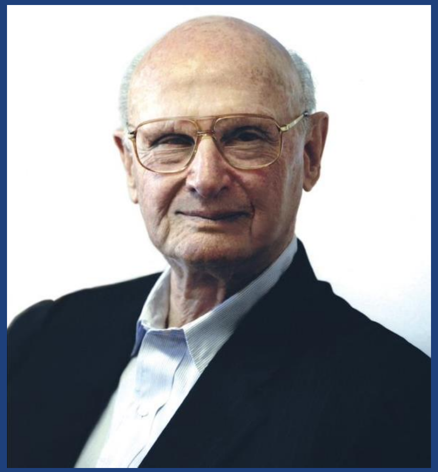
DIVERSIFICATION

- The sum is greater than the parts

BENEFITS OF DIVERSIFICATION

Diversification is the only free lunch in finance.

Harry Markowitz,
Nobel Laureate in Economics



- Reduce risk while sacrificing little in expected returns

OR

- Enhance returns without a meaningful increase in risk

WHEN DOES IT WORK?

- Over time, not every time

Periodic Table

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
Best	Small-Cap Stocks 38.8	Real Estate Securities 31.8	Real Estate Securities 4.2	Small-Cap Stocks 21.3	Emrg-Mkt Stocks 37.3	Cash Equivalents 1.8	Large Cap Stocks 31.5	Small-Cap Stocks 20.0	Real Estate Securities 46.2	Commodities 16.1
	Mid Cap Stocks 34.8	Large Cap Stocks 13.7	Large Cap Stocks 1.4	High Yield Bonds 17.1	International Stocks 25.0	Inv-Grade Bonds 0.0	Mid Cap Stocks 30.5	Large Cap Stocks 18.4	Large Cap Stocks 28.7	Cash Equivalents 1.5
	Large Cap Stocks 32.4	Mid Cap Stocks 13.2	Inv-Grade Bonds 0.5	Mid Cap Stocks 13.8	Large Cap Stocks 21.8	High Yield Bonds -2.1	Real Estate Securities 25.8	Emrg-Mkt Stocks 18.3	Commodities 27.1	High Yield Bonds -11.2
	International Stocks 22.8	Inv-Grade Bonds 6.0	Cash Equivalents 0.0	Large Cap Stocks 12.0	Mid Cap Stocks 18.5	Large Cap Stocks -4.4	Small-Cap Stocks 25.5	Mid Cap Stocks 17.1	Mid Cap Stocks 22.6	Diversified Portfolio -12.4
	Diversified Portfolio 12.4	Small-Cap Stocks 4.9	International Stocks -0.8	Commodities 11.8	Small-Cap Stocks 14.6	Real Estate Securities -4.8	International Stocks 22.0	Diversified Portfolio 8.6	Diversified Portfolio 15.2	Inv-Grade Bonds -13.0
	High Yield Bonds 7.4	Diversified Portfolio 4.8	Mid Cap Stocks -2.4	Emrg-Mkt Stocks 11.2	Diversified Portfolio 13.5	Diversified Portfolio -6.9	Diversified Portfolio 18.7	International Stocks 7.8	Small-Cap Stocks 14.8	International Stocks -14.5
	Real Estate Securities 1.9	High Yield Bonds 2.5	Small-Cap Stocks -4.4	Diversified Portfolio 9.8	High Yield Bonds 7.5	Mid Cap Stocks -9.1	Emrg-Mkt Stocks 18.4	Inv-Grade Bonds 7.5	International Stocks 11.3	Mid Cap Stocks -17.3
	Cash Equivalents 0.0	Cash Equivalents 0.0	High Yield Bonds -4.5	Real Estate Securities 7.2	Real Estate Securities 4.2	Small-Cap Stocks -11.0	High Yield Bonds 14.3	High Yield Bonds 7.1	High Yield Bonds 5.3	Large Cap Stocks -18.1
	Inv-Grade Bonds -2.0	Emrg-Mkt Stocks -2.2	Diversified Portfolio -4.6	Inv-Grade Bonds 2.6	Inv-Grade Bonds 3.5	Commodities -11.2	Inv-Grade Bonds 8.7	Cash Equivalents 0.5	Cash Equivalents 0.0	Emrg-Mkt Stocks -20.1
	Emrg-Mkt Stocks -2.6	International Stocks -4.9	Emrg-Mkt Stocks -14.9	International Stocks 1.0	Commodities 1.7	International Stocks -13.8	Commodities 7.7	Commodities -3.1	Inv-Grade Bonds -1.5	Small-Cap Stocks -20.4
Worst	Commodities -9.5	Commodities -17.0	Commodities -24.7	Cash Equivalents 0.3	Cash Equivalents 0.8	Emrg-Mkt Stocks -14.6	Cash Equivalents 2.2	Real Estate Securities -7.9	Emrg-Mkt Stocks -2.5	Real Estate Securities -26.8

Source: Morningstar. Returns are total returns, as of December 31, 2020. For “Diversification Effect”, REITs are represented by the Wilshire US REIT TR USD; Emerging Market Stocks are MSCI EM NR USD; International Stocks are MSCI EAFE NR USD; Mid Cap Stocks are Russell Mid Cap TR USD, Small Cap Stocks are Russell 2000 TR USD; High Yield Bonds are Bloomberg US Corporate High Yield TR USD; Large Cap Stocks are S&P 500 TR USD; Commodities are Bloomberg Commodity TR USD; Investment Grade Bonds are Bloomberg US Agg Bond TR USD; Cash Equivalents are Bloomberg US Treasury Bill 1-3 Mon TR USD. Diversified Portfolio is an equal-weighted blend of the aforementioned. For additional information, please see disclosure page.

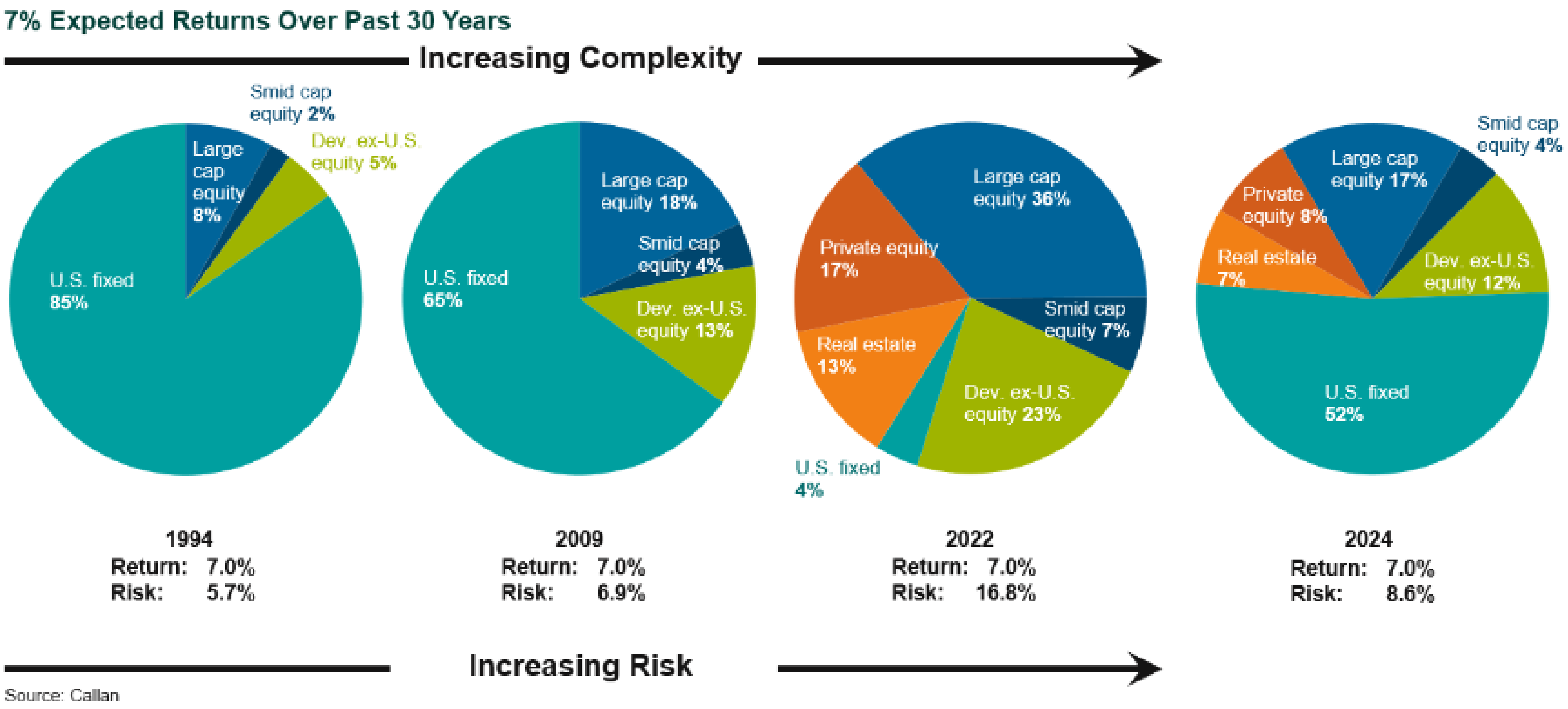
MANAGER OR ALLOCATION?

	Index Only	Outperformers
Returns	100%	73%
Risk	90%	85%

- Asset Allocation Drives Risk and Return
- Regardless of manager selection, asset allocation drives risk exposure

Sources: Vanguard Group, Great Lakes Advisors

COMPLEXITY OF MODERN PORTFOLIOS



Sources: Callan, Great Lakes Advisors

DIVERSIFICATION TOPICS

- ASSET ALLOCATION
- AVOIDING OVER-CONCENTRATION
- REBALANCING

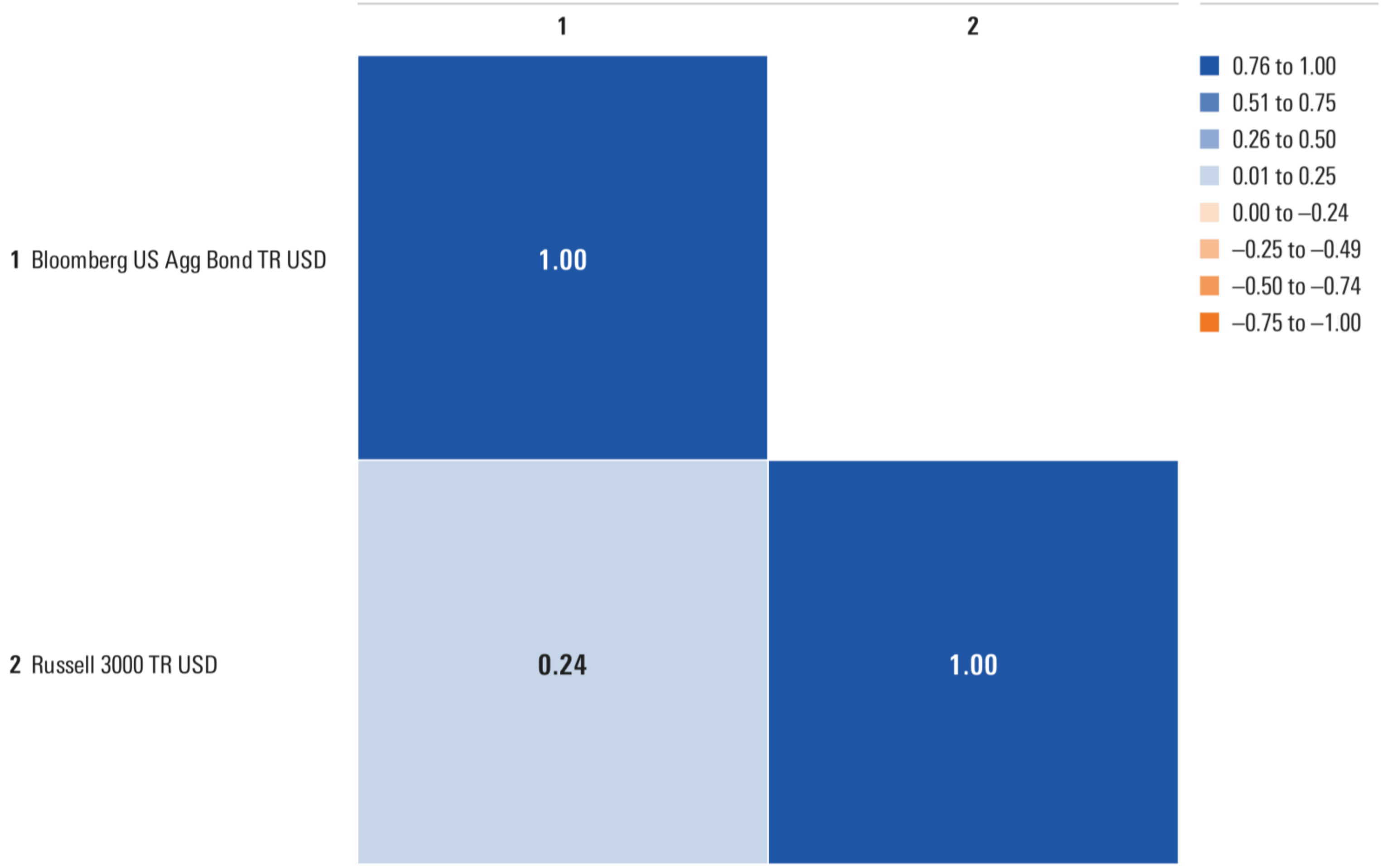
ASSET ALLOCATION

- Different Asset Classes Have Different Risks and Rewards
- Facets of Asset Allocation
  - Asset Type
  - Size
  - Style
  - Geography

Sources: Morningstar, Great Lakes Advisors.

ASSET TYPE

- Not all assets behave the same at the same time



Sources: Morningstar, Great Lakes Advisors. Data as of 6/30/2024.

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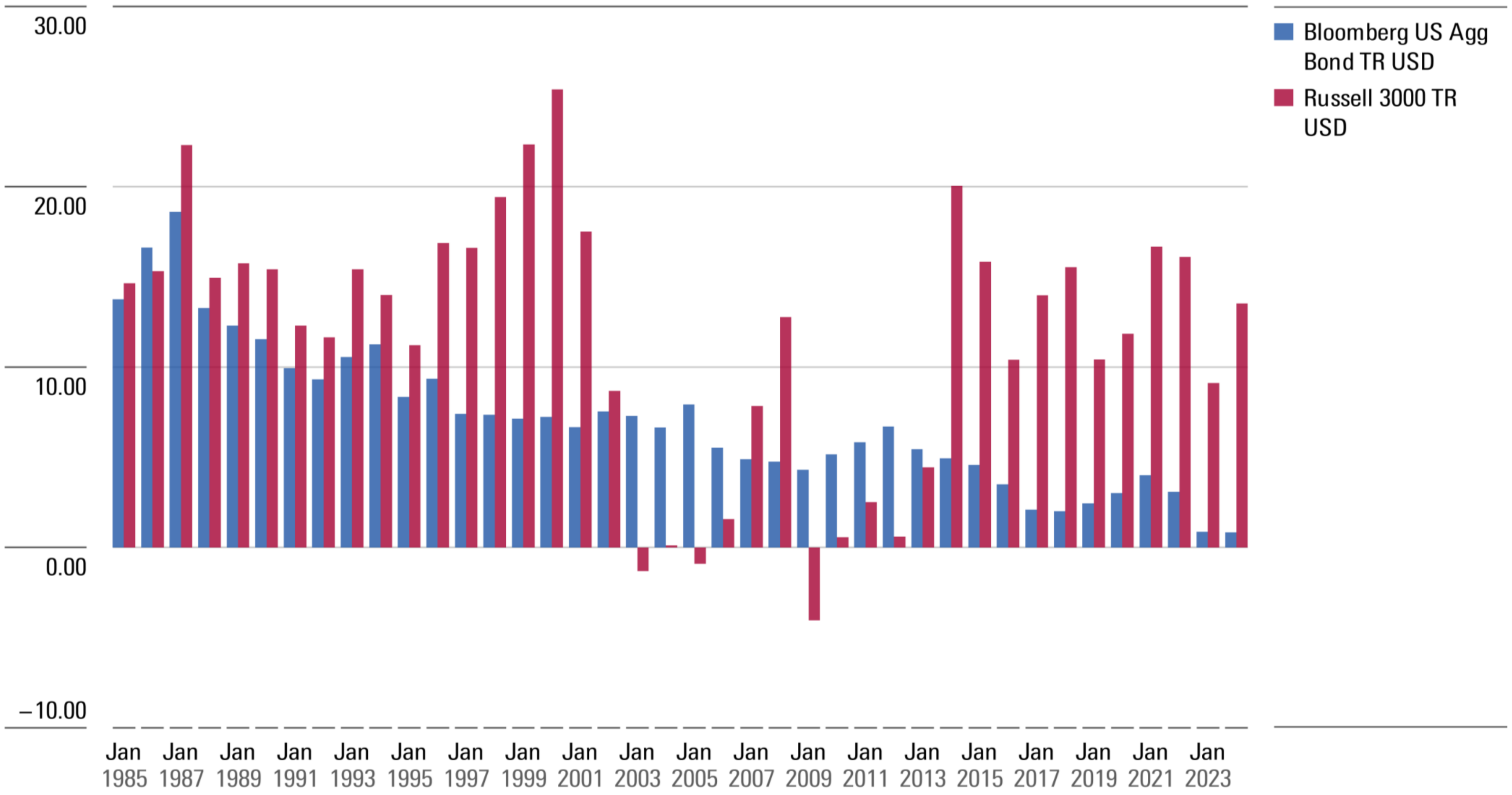
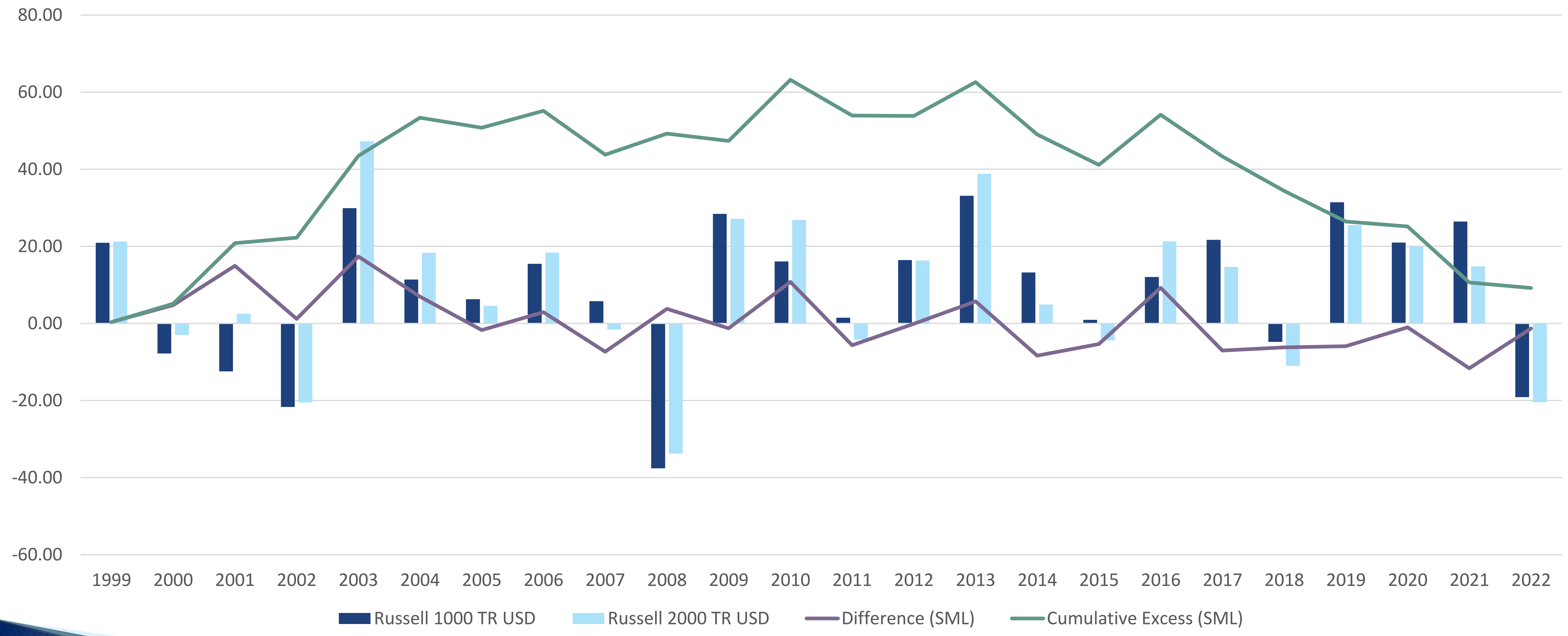


Sources: Morningstar, Great Lakes Advisors. Data as of 6/30/2024.

SIZE: MARKET CAPITALIZATION

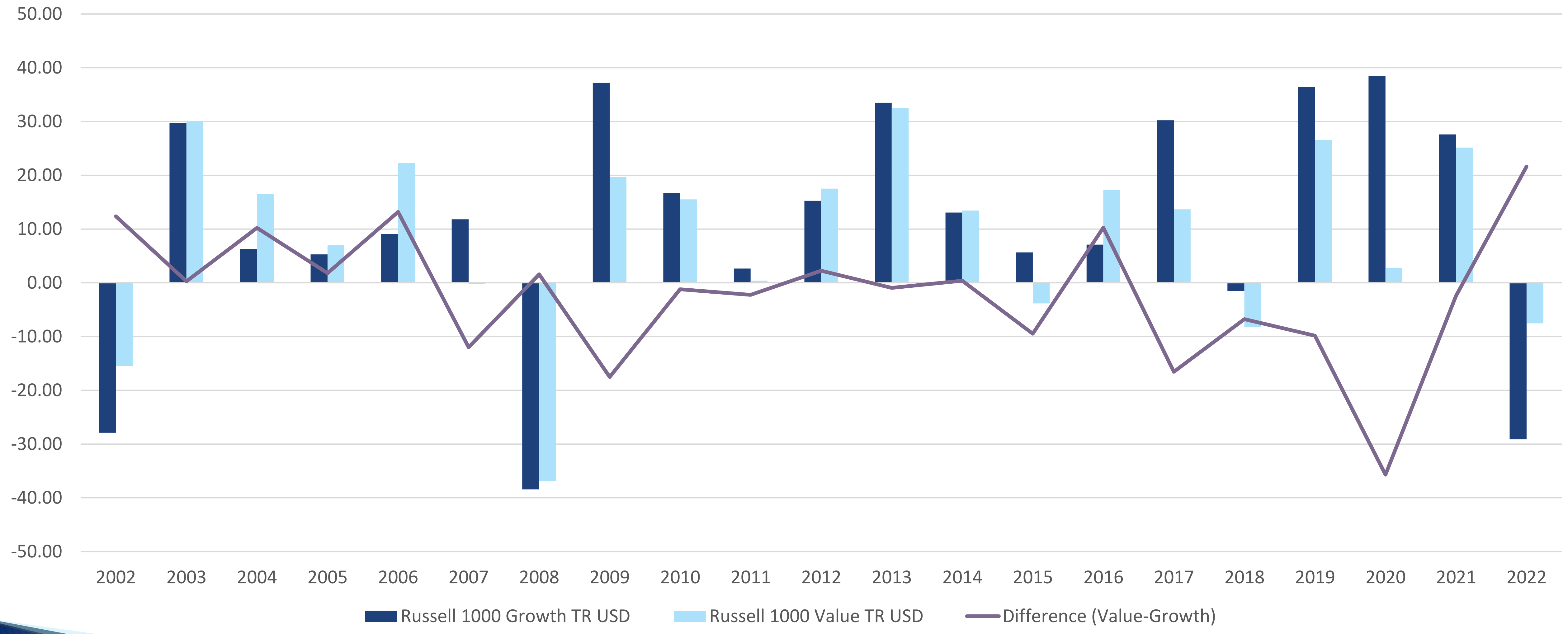
- Smaller stocks have higher volatility but historically greater returns



Sources: Morningstar, Great Lakes Advisors. Data as of 12/31/22.

STYLE: GROWTH VS. VALUE

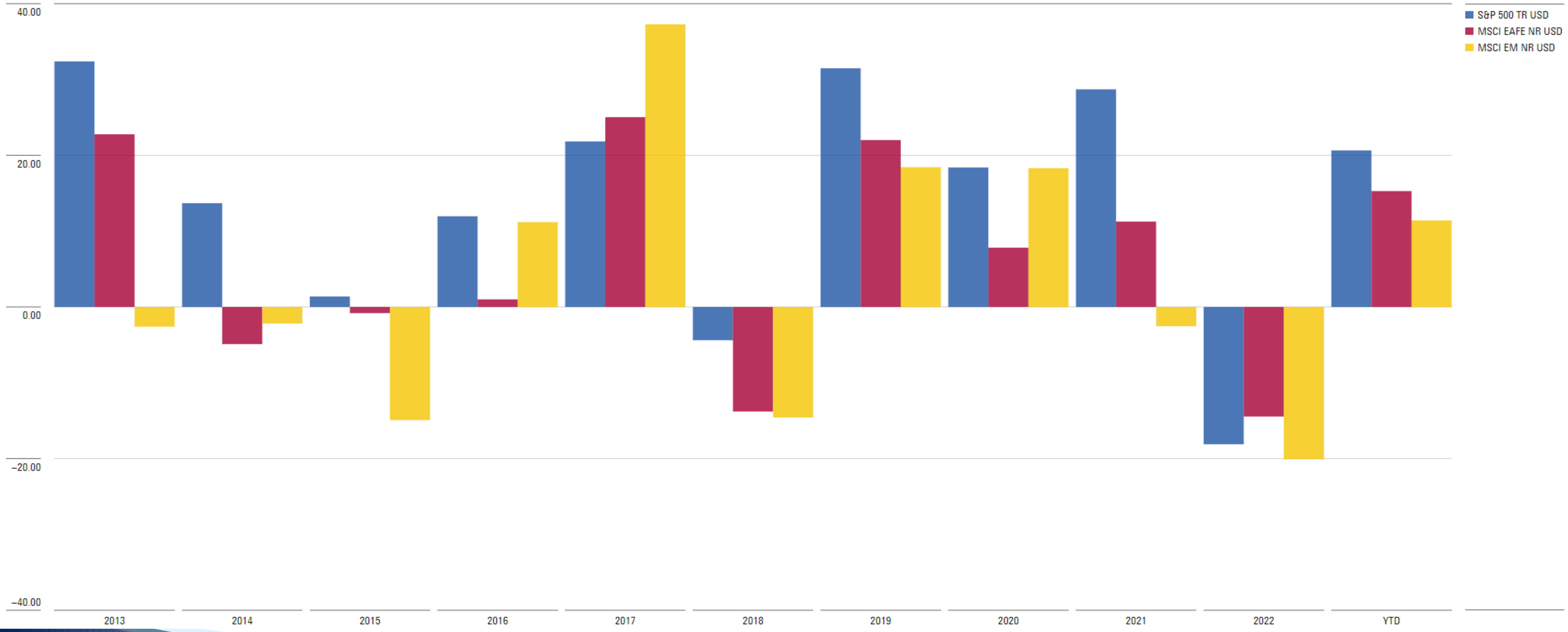
- Using both styles provides diversification



Sources: Morningstar, Great Lakes Advisors. Data as of 12/31/2022.

GEOGRAPHY

- All economies are not intertwined



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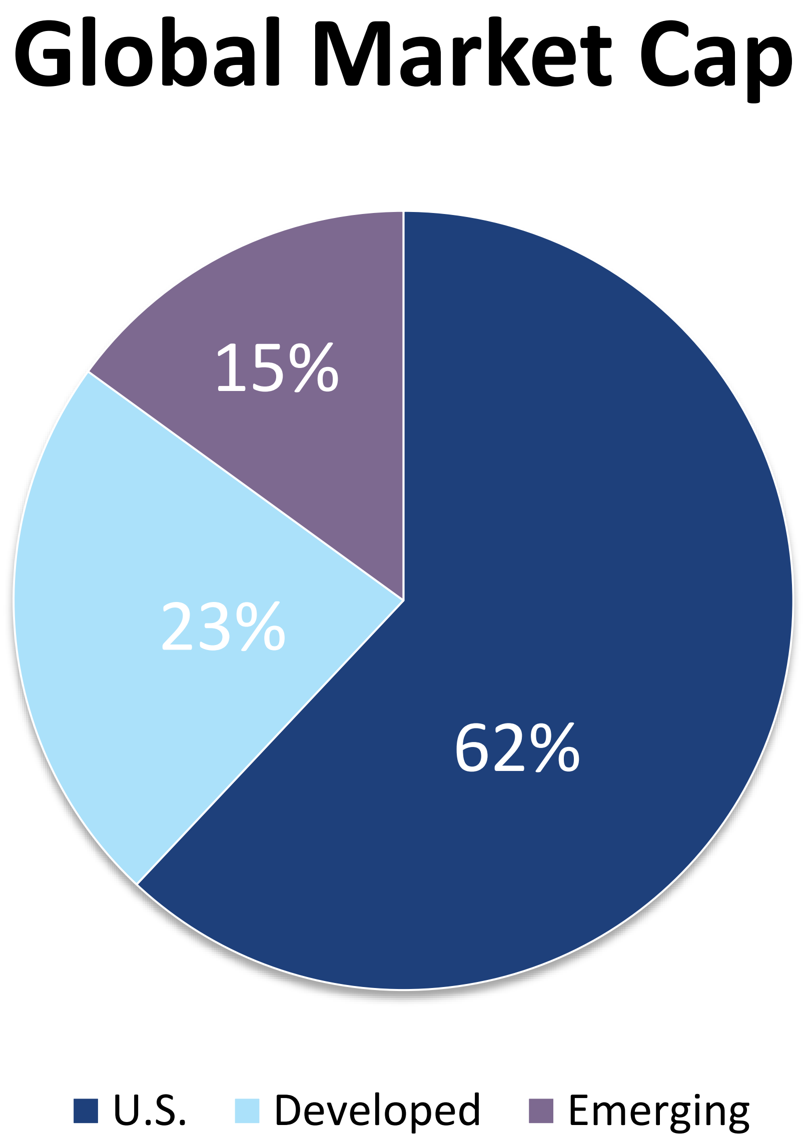


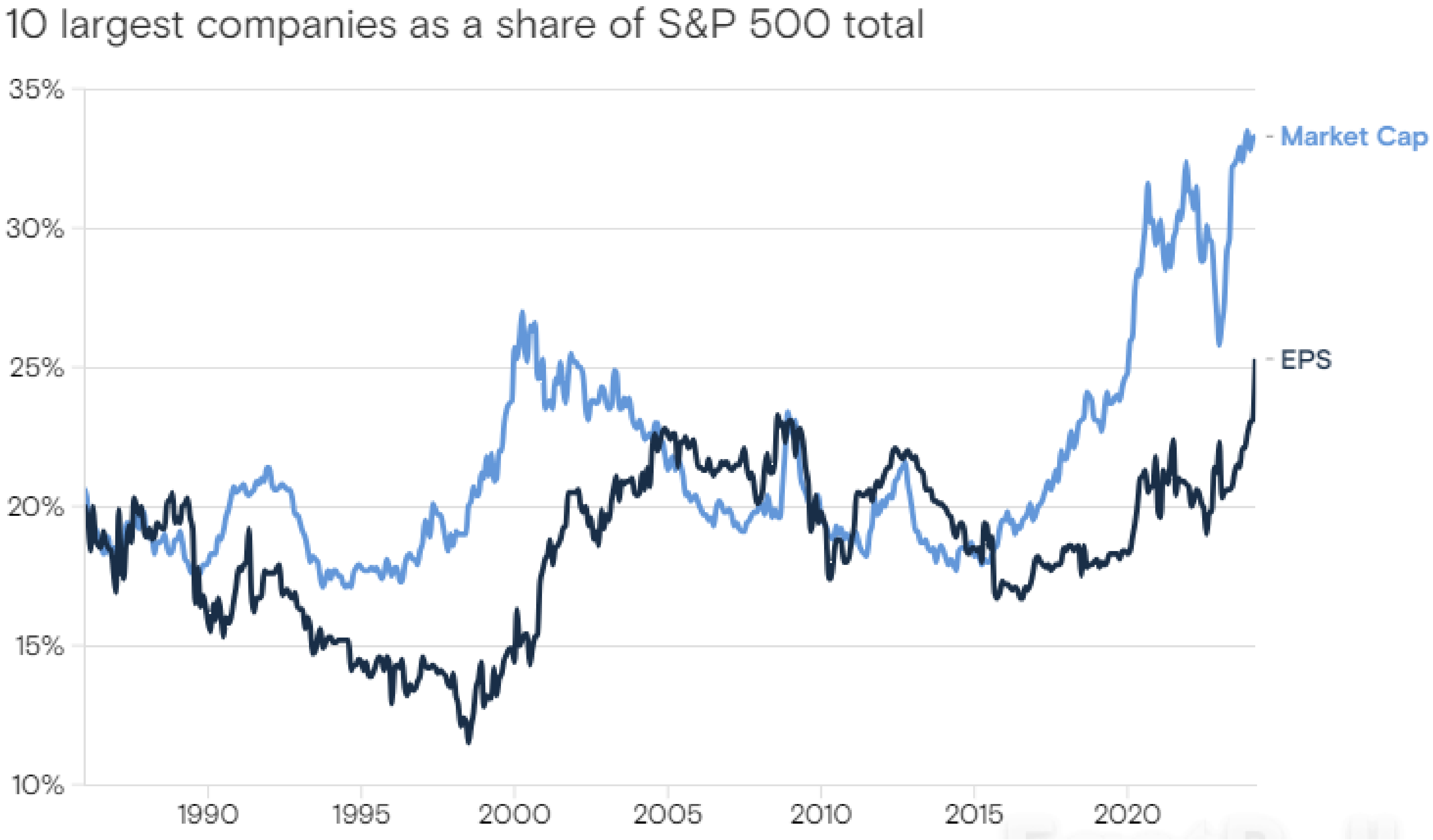
Sources: Morningstar, Great Lakes Advisors as of 7/31/2023

AVOIDING CONCENTRATION

- Concentrated portfolios can produce large returns but are also full of risks
- Risks of Concentrated Portfolios
    - Higher Volatility
    - Returns only tracking a small part of the market
    - Exposure to unforeseen and unnecessary risks

Sources: Goldman Sachs, Great Lakes Advisors.

AVOIDING CONCENTRATION



Sources: Goldman Sachs, Great Lakes Advisors.

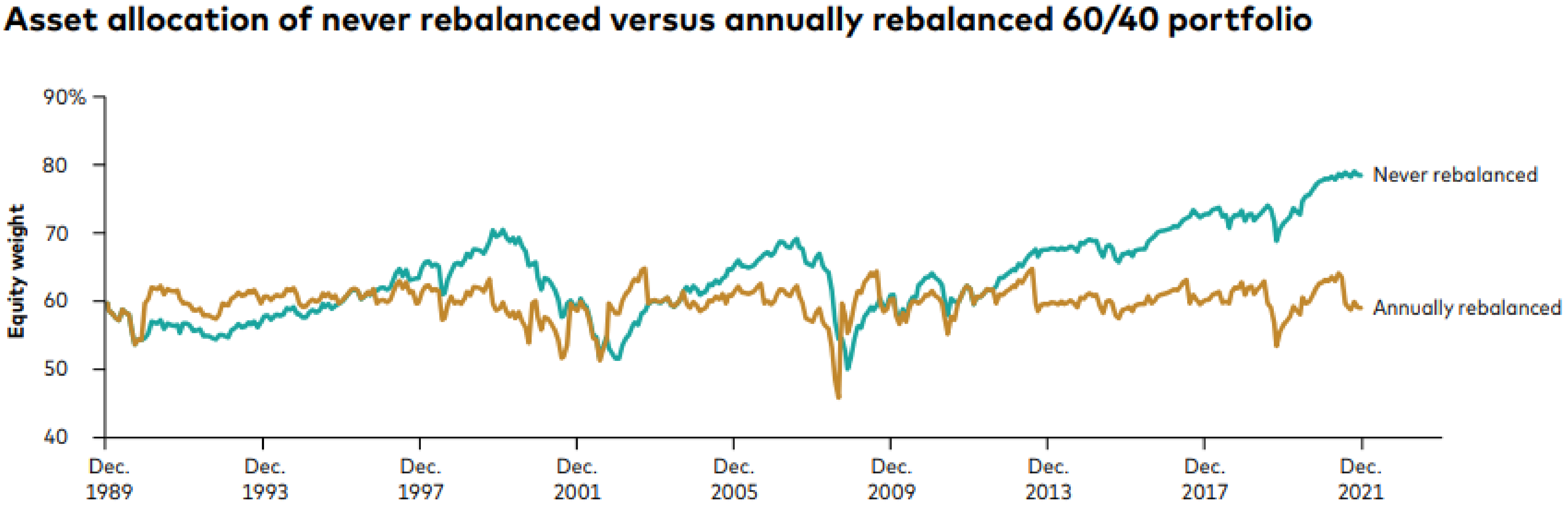
REBALANCING

- If diversification is the only free lunch in finance, rebalancing is how to get invited back to the table. - Jason Turner

- Rebalancing keeps your portfolio aligned with your desired asset allocation and keeps you diversified.

Sources: Vanguard, Great Lakes Advisors

REBALANCING



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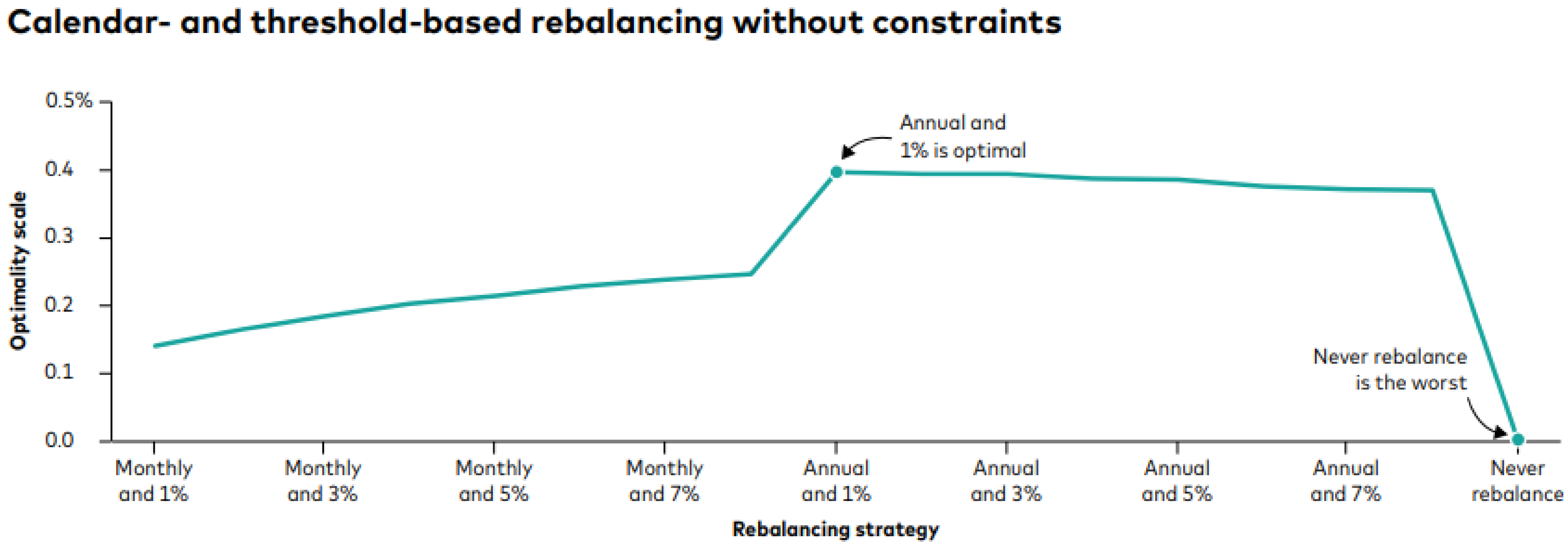
REBALANCING



Sources: Vanguard, Great Lakes Advisors

BENEFITS OF DIVERSIFICATION

- “The Only Free Lunch in Finance”
  - Reduce risk with little return given up or boost return without increasing risk
- Simple is not always better
  - Overconcentration of risk can lead to bad outcomes
- Aligns the Portfolio with its Stated Purpose
  - Maximize the probability of a successful outcome

PUTTING IT ALL TOGETHER

	5 Yr Outperform%	Annlzd Return	Realized Volatility	Sharpe Ratio
S&P 500	-	4.4%	10.4%	0.40
Balanced – Equity	64%	5.9%	10.3%	0.55
Balanced – Full	**66%**	**5.3%**	**4.9%**	**1.03**

20 year historical review of rolling 5 year return periods.

Sources: Morningstar, Great Lakes Advisors