Improve Your Long-term **Return Potential**

Diversification Can Add Value to Your Investment Plan

Investors seeking to improve their long-term return potential may want to take a closer look at diversification. A diversified portfolio can help you make progress toward your investment goals without requiring more risk. Historically, diversification also has been shown to reduce risk over time. On the other hand, concentrated portfolios—even in conservative investments—can increase risk.

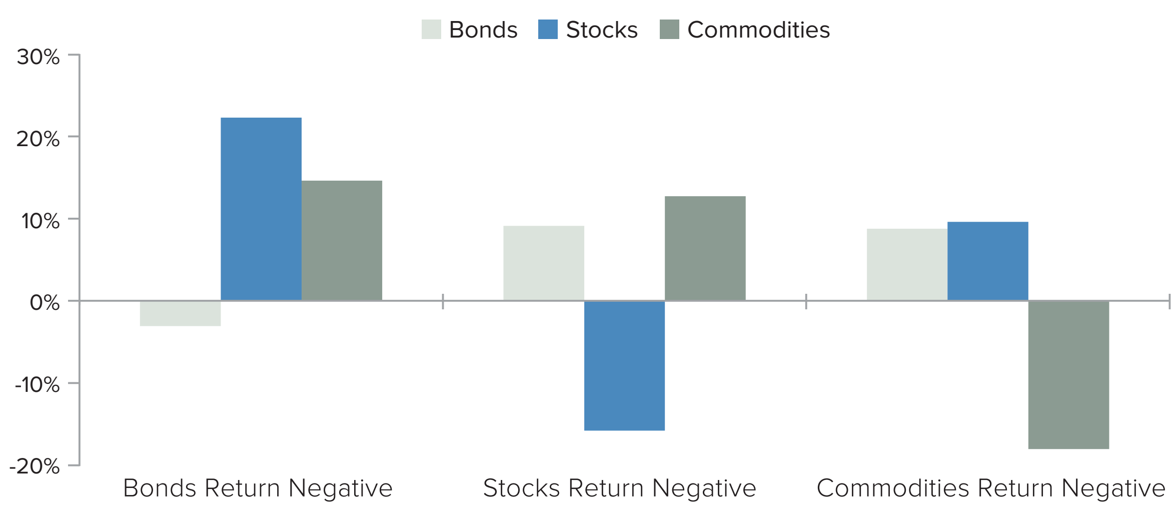
Diversification in Brief

Most investors know about asset allocation—an investment technique through which different asset classes, such as stocks and bonds, are combined in a portfolio. Studies have shown that asset allocation can provide a degree of stability to a portfolio by minimizing how much its returns fluctuate.

When you add diversification to the mix, you spread your investments across different asset classes **to help reduce risk without changing your return expectations**. A diversification strategy blends "uncorrelated" asset classes—those that move up and down at different times—in a portfolio to help prevent significant losses while not limiting potential gain. With a diversified portfolio, you have the potential of a **better risk-adjusted return**, as can be seen during periods when major asset classes experienced negative absolute returns. Between 1973 and 2013, when bond prices fell, stocks and commodities went up in value. When stocks dropped, bonds and commodities appreciated. When commodities declined, stocks and bonds generally performed well.

Major Asset Class Categories & Drawdowns

Average Yearly Returns when a Given Asset Class is Negative



Yearly returns are in USD and begin in 1979. Stocks are represented by the MSCI World Index, bonds are represented by the Barclays US Treasury Index, and commodities are represented by the S&P GSCI Total Return Index.

Uncorrelated assets are essential to getting the full potential benefits of diversification. However, correlations have increased over the years. Stocks and bonds are more correlated than they once were. Emerging markets equities, high-yield bonds, and real estate investment trusts (REITs) often move together. This is why the investment industry continues to create new asset classes that are, in theory, less correlated. Examples include mortgage-backed securities, asset-backed securities, managed futures, alternative investments, private equity, hedge funds, and exchange-traded funds. Some even newer examples include climate bonds, home rental asset-backed securities, and biofuels funds. All these securities may have investment potential in their own right and may enhance diversification.

Minimizing Portfolio Volatility

Concentrated portfolios can and do outperform diversified portfolios at times, especially when there is concentrated leadership in one area of the market. For example, in 2013, U.S. large-cap equities dominated all other asset classes. During this time, a well-diversified client portfolio invested 5% to 10% in emerging markets equities or emerging markets debt, both of which trailed U.S. large-cap stocks, would have underperformed.

However, no one knows what the future holds. That's why it is important to be as broadly diversified as possible. When you are invested in multiple, uncorrelated asset classes, you can help minimize portfolio volatility, even as the investment environment changes. For example, during periods of rising economic growth and falling inflation, 60% equity/40% fixed-income portfolios have historically performed extremely well. During periods of rising economic growth and rising inflation, commodities tend to outperform. In periods of falling economic growth and rising inflation, inflation-linked bonds have historically generated strong returns while in a deflationary environment, interest-sensitive investments have provided excellent hedging potential.

Diversification Works Over Time

A diversification plan may add value to your portfolio. When your portfolio is broadly diversified, stronger performing asset classes can potentially offset weaker performing asset classes, helping to minimize portfolio volatility. Furthermore, as economic and market conditions change, uncorrelated, temporarily out-of-favor investments may become your portfolio's top performers. Of course, diversification does not eliminate all risk. Just as a rising tide lifts all boats, a falling tide may negatively affect securities across entire markets. In other words, diversification works over time, not all the time.

All this underscores the importance of taking a big-picture approach to your investment plan. A well-diversified portfolio should be based on short-term and long-term financial goals, tolerance for risk, and individual tax and income circumstances.

Your financial advisor can answer your questions about diversification and how it can add value to your investment plan. Contact your advisor today to find out if your portfolio is appropriately and adequately diversified.

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