Diversification

Imagine that you are standing at the open door of an airplane, preparing yourself to leap. Would you rather be safe on the ground, or are you eagerly anticipating the adrenaline of the skydive? There is, of course, no answer that fits everyone. Investing is much the same, where one person finds comfort; the other person finds anxiety. Where one person chases the highs, the other sees only the risks.

Investing for the long-term, in our view, is about trying to build a portfolio in such a way that the chance of meeting goals and objectives is maximized while the risks involved are minimized. Going back to the illustration above, even those yearning for the thrill of skydiving still appreciate and rely on a parachute.

When investing, there is a trade-off between higher-return (and higher-risk) investments such as stocks versus lower-risk (and lower-return) investments, such as bonds. In the chart below, we highlight a series of illustrative stock and bond portfolios. As you see, in the long run, and based on our index illustration, stocks outperform bonds. Still, over the near term, the results are much less predictable. We believe employing a diversified mix of stocks, bonds, cash, and alternatives can help provide you with the right balance between opportunity and protection.

### Key Takeaways

- Diversification is having a mix of investments, each with their own purpose
- Diversified portfolios can help balance return opportunity and potential loss
- Understand your risk profile, as it can aid in helping you pursue your goals
- Plan, don’t react in haste

### Best, Worst and Average Returns for any 12-Month period since 1957

<table>
<thead>
<tr>
<th>Year</th>
<th>Best</th>
<th>Worst</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock</td>
<td>32.7%</td>
<td>-5.6%</td>
<td>6.4%</td>
</tr>
<tr>
<td>Bond</td>
<td>30.8%</td>
<td>-4.7%</td>
<td>6.9%</td>
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<tr>
<td></td>
<td>33.2%</td>
<td>-7.7%</td>
<td>7.4%</td>
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<tr>
<td></td>
<td>36.5%</td>
<td>-12.1%</td>
<td>7.9%</td>
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<tr>
<td></td>
<td>39.9%</td>
<td>-17.0%</td>
<td>8.4%</td>
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<td></td>
<td>43.3%</td>
<td>-21.9%</td>
<td>8.9%</td>
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<td></td>
<td>46.8%</td>
<td>-26.6%</td>
<td>9.5%</td>
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<td></td>
<td>50.3%</td>
<td>-31.1%</td>
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<td>57.5%</td>
<td>-39.4%</td>
<td>11.0%</td>
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<tr>
<td></td>
<td>61.2%</td>
<td>-43.3%</td>
<td>11.6%</td>
</tr>
</tbody>
</table>

Stocks / Bonds

0% / 10% / 20% / 30% / 40% / 50% / 60% / 70% / 80% / 90% / 100%

Sources: Morningstar. American Enterprise Investment Services, Inc. Stocks represented by the S&P 500 Total Return Index, and Fixed Income represented by the IA SBBI U.S. IT Govt TR Index, which is a custom index designed by Ibbotson Associates that measures the performance of U.S. Treasury bonds with a maturity of five years. Past performance is not a guarantee of future results.
Decisions made in haste and during challenging times often turn out poorly when looking from the other side of history. Diversification, at its root, is about creating a portfolio that doesn’t leave you anxious or ready to make significant changes in times of market stress. In the chart below, we illustrate how a mix of different portfolios (highlighting individually the 100% stock, 100% bond, and 60% stock / 40% bond portfolios) performed during the lead-in to the Global Financial Crisis (2007-2009). The chart also shows how each performed in the resulting bear market, the recovery phase, and finally in the years after.

There are a couple of takeaways from this illustration. The first is (again) that stocks tend to be more volatile than bonds. The second and more critical point in our view is that diversification can help you reach your goals. All eleven illustrative portfolios in our “Stock/Bond Mixes” example above that started at the end of 2004 would have arrived at nearly the same destination in March 2013. The aggressive investor (i.e., the daring skydiver) would have had a bit of a rollercoaster experience during the financial crisis while the conservative investor (that preferred to stay safely on the ground) would have had a slow and steady journey. Results, of course, vary if we look at different periods in the market but history indicates that diversified portfolios may provide a balance between opportunity and risk.

In our opinion, the best path for success lies in matching the investment mix - how much cash, stocks, bonds, and alternatives are in the portfolio – to the goals of the investor. For long-term investors, we recommend the following by risk profile:

- **Conservative**: Conservative assets, such as cash and bonds, are emphasized given the desire to limit the amount of loss that a portfolio may experience.
- **Moderately Conservative**: With a little less sensitivity to potential loss, assets with a higher potential for increasing wealth, like equities, take on a more meaningful role in the portfolio.
- **Moderate**: A more neutral view between opportunities and loss allows for growth assets like equities to assume a more central role. Equities are more volatile than assets like cash and bonds, and this risk profile typically balances a portfolio between stocks and bonds.
- **Moderately Aggressive**: Growth assets like equities take a leading role in a portfolio. Moderately aggressive investors are more focused on potential reward than risk.
- **Aggressive**: Investors here have a high tolerance for the risks associated with investing. Growth assets like equities make up the majority, if not all, of the portfolio.

Importantly, a diversified portfolio that combines stocks with bonds, as well as cash, has historically experienced lower risk than an all-stock portfolio. **In our view, investing in the right risk profile is paramount for long-term success.**
Global Asset Allocation Committee

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As of March 31, 2020

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