



North American Management

Financial Planning Note

Lea Ann Knight, CFP®
Director of Client Management

Why Diversification Matters in Your Financial Plan

For those of you who could not be on our recent webinar, *Why Diversification Still Matters*, I thought I would recap and expand on a few of the concepts raised in that discussion.

The crafting of a well-diversified portfolio should, in fact, go hand-in-hand with a three-step financial planning exercise. As many of you have experienced already, we like to start our visits with you talking not about investments, but about your financial needs and aspirations. This is the first critical step in understanding what type of diversified investment portfolio you need.

The second step in our planning process involves a discussion of risk. Since risk can have different meanings, we often break down the discussion into trying to answer three separate, but related questions:

1. How much risk is required in a portfolio for you to accomplish your goals?
2. How much ability does your financial situation have to take on risk?
3. How much risk can you tolerate?

Required risk is what must be taken to accomplish your short and long term goals, such as living comfortably in retirement. Sometimes what is necessary to achieve your goals, however, can be different than what your financial situation can bear. For example, if you need to have a very aggressive portfolio to achieve all of your goals, your investment portfolio will be very volatile. Such volatility can result in significant losses at the same time you may have significant cash needs. This is a financial situation that is not sustainable. In this example, your goals may need to be modified to better match the risk tolerance of your financial situation.

A different example is when you may not require much risk in your portfolio at all in order to achieve your financial goals. In this case, your tolerance for risk is actually greater than what you need to take. Do you stick with a conservative portfolio or take on more risk in the expectation of higher long term returns?

Based on your need, your financial situation, and your personal appetite for risk, we then create an investment portfolio that helps balance these three risk factors. We are able to do this through the third step of planning: investment diversification and asset allocation.

A well-diversified portfolio will consist of multiple asset classes at different weightings. As you can see from the colorful chart below, allocating your investments across asset classes can limit returns in any given year. However, that same allocation will also provide you with downside protection in years that certain asset classes do not perform well. This approach has the effect of maximizing returns at a lower level of risk over longer periods of time.

1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Best															
EM Equity 77.9	REITs 26.4	REITs 13.9	Commodities 23.9	Small Cap 47.3	REITs 31.6	EM Equity 35.8	REITs 35.1	EM Equity 33.6	Fixed Income 5.2	EM Equity 62.8	REITs 28.0	REITs 8.3	REITs 19.7	Small Cap 38.8	REITs 28.0
Intl Equities 27.3	Commodities 24.2	Fixed Income 8.4	Fixed Income 10.3	EM Equity 46.7	Intl Equity 20.7	Commodities 17.5	EM Equity 28.8	Intl Equity 11.6	Cash 3.0	High Yield 58.2	Small Cap 26.9	Fixed Income 7.8	Intl Equity 17.9	Large Cap 32.4	Large Cap 13.7
Small Cap 21.3	Fixed Income 11.6	EM Equity 7.9	REITs 3.8	Intl Equity 39.2	Small Cap 18.3	Intl Equity 14.0	Intl Equity 26.9	Commodities 11.1	Asset Alloc. -24.9	Intl Equity 32.5	Commodities 16.7	High Yield 5.0	EM Equity 17.4	Intl Equity 23.3	Fixed Income 6.0
Large Cap 21.0	Cash 6.3	High Yield 5.3	Cash 2.0	REITs 37.1	EM Equity 16.4	REITs 12.2	Small Cap 18.4	Fixed Income 7.0	High Yield -26.2	REITs 28.0	High Yield 15.1	Large Cap 2.1	Small Cap 16.3	Asset Alloc. 15.2	Asset Alloc. 5.7
Commodities 18.6	Asset Alloc. -0.5	Cash 5.0	High Yield -1.4	High Yield 29.0	Asset Alloc. 12.1	Asset Alloc. 8.0	Large Cap 15.8	Asset Alloc. 6.5	Small Cap -33.8	Small Cap 27.2	Large Cap 15.1	Cash 0.2	Large Cap 16.0	High Yield 7.4	EM Equity 5.6
Asset Alloc. 16.2	Small Cap -3.0	Small Cap 2.5	Asset Alloc. -6.3	Large Cap 28.7	High Yield 11.1	Large Cap 4.9	Asset Alloc. 14.8	Large Cap 5.5	Commodities -36.6	Large Cap 26.5	EM Equity 14.4	Asset Alloc. -0.3	High Yield 15.8	EM Equity 3.8	Small Cap 4.9
Cash 4.8	High Yield -5.9	Asset Alloc. -3.3	EM Equity -7.1	Asset Alloc. 25.6	Large Cap 10.9	Small Cap 4.6	High Yield 11.8	Cash 5.4	Large Cap -37.0	Asset Alloc. 24.1	Asset Alloc. 13.0	Small Cap -4.2	Asset Alloc. 12.0	REITs 2.9	High Yield 2.5
High Yield 2.4	Large Cap -9.1	Large Cap -11.9	Intl Equity -15.7	Commodities 22.7	Commodities 7.6	Cash 3.1	Cash 4.8	High Yield 1.9	REITs -37.7	Commodities 18.7	Intl Equity 8.2	Intl Equity -11.7	Fixed Income 4.2	Cash 0.1	Cash 0.1
Fixed Income -0.8	Intl Equity -14.0	Intl Equity -21.2	Small Cap -20.5	Fixed Income 4.1	Fixed Income 4.3	High Yield 2.7	Fixed Income 4.3	Small Cap -1.6	Intl Equity -43.1	Fixed Income 5.9	Fixed Income 6.5	EM Equity -12.5	Cash 0.2	Fixed Income -2.0	Intl Equity -4.5
Real Estate -4.6	EM Equity -25.4	Commodities -22.3	Large Cap -22.1	Cash 1.3	Cash 1.3	Fixed Income 2.4	Commodities -2.7	REITs -15.7	EM Equity -45.7	Cash 0.4	Cash 0.2	Commodities -13.4	Commodities -1.1	Commodities -9.6	Commodities -17.0

Source: Bloomberg Please see the attached disclosure page for additional information on the above chart.

As you consider diversification within and across your investment accounts, we look forward to discussing the most appropriate asset allocation for your financial goals. If you have any questions, please contact me or your Relationship Manager.

North American Management

Ten Post Office Square, Suite 1200S

Boston, MA 02109

Telephone: 617.695.2136

Fax: 617.695.2121

North American Management Corporation (NAM) is an SEC registered investment adviser located in Boston, MA and St. Louis, MO. The information presented above reflects the opinions of NAM as of April 27, 2015, and is subject to change at any time based upon legislation change, market or other conditions. These views do not constitute individual investment advice and there is no representation that any of the statements or predictions will materialize. The data in this report is taken from sources that NAM believes to be reliable. Notwithstanding, NAM does not guarantee the accuracy of the data. Any specific investment or investment strategy can result in a loss. Asset allocation and diversification do not ensure a profit or guarantee against a loss. Past performance is no guarantee of future results.

Asset Allocation Performance Disclosures

The returns presented for the Asset Allocation Portfolio reflect hypothetical performance an investor would have obtained had it invested in the manner shown and does not represent returns that any investor actually attained. For calculation purposes, the Asset Allocation Portfolio weights were rebalanced back to their original weights on December 31st of each year (for weights see table below). Returns and standard deviations are based on monthly data. The U.S. Dollar is the currency used to express performance. Assumption changes may have a material impact on the model returns presented. There are frequently material differences between hypothetical, back tested or simulated performance results and actual results subsequently achieved by any investment strategy. Certain of the assumptions have been made for modeling purposes and are unlikely to be realized. No representation or warranty is made as to the reasonableness of the assumptions made or that all assumptions used in achieving the returns have been stated or fully considered. Changes in the assumptions may have a material impact on the hypothetical returns presented.

<u>Asset Class</u>	<u>Asset Allocation Portfolio Index</u>	<u>Allocation</u>
U.S. Equities	S&P 500 Total Return (TR) Index	25%
U.S. REITS	FTSE E/N All Equity REIT TR Index	5%
U.S. Small Cap Equities	Russell 2000 TR Index	10%
Commodities	Bloomberg Commodity Index	5%
Non U.S. Equities	MSCI Daily TR Gross EAFE USD Index	15%
Cash	Citigroup 3 Month T-Bill TR	5%
U.S. Bonds	Barclays U.S. Aggregated TR Index	25%
U.S. High Yield Bonds	Barclays U.S. Corporate High Yield Index	5%
Emerging Markets Equities	MSCI Daily TR Gross Emerging Markets Index	5%

The performance is based on back tested results using the weightings listed above and annual rebalances. The Asset Allocation Portfolio performance information presented herein is based on hypothetical portfolios for a specified time period (1/1/1999-12/31/2014) and not the results of an actual account. The recipient is cautioned that all performance results presented herein are done solely for educational and illustrative purposes and not intended for trading, or to be considered as investment advice.

The hypothetical performance data presented here through 12/31/2014 should not be taken as any guarantee or other assurance as to future results. The value of any investment may increase or decrease over time. Hypothetical performance results are presented gross of fees without consideration for trading expenses and other direct expenses, and before custody charges, NAM management fees, withholding taxes, and other indirect expenses. NAM's standard fee schedule is contained in its Form ADV and is available upon request. Actual fees may vary and a client's return will be reduced by the advisory fees and any other expenses a client may incur in the management of its account.

Hypothetical back-tested returns have many inherent limitations. Unlike actual performance, it does not represent actual trading. Since trades have not been actually executed, results may have under- or over-compensated for the impact, if any, of certain market factors, such as lack of liquidity, and may not reflect the impact that certain economic or market factors may have had on the decision-making process. Hypothetical back-tested performance also is developed with the benefit of hindsight. Other periods selected may have different results, including losses. There can be no assurance that NAM will achieve profits or avoid incurring substantial losses.

The data in this report is taken from sources that NAM believes to be reliable. Notwithstanding, NAM does not guarantee the accuracy of the data. Any specific investment or investment strategy can result in a loss. Asset allocation and diversification do not ensure a profit or guarantee against a loss.

PAST PERFORMANCE IS NO GUARANTEE OF FUTURE RESULTS.