

What is Asset Allocation?

Asset allocation. It's so ingrained in how we manage our clients' investment portfolios, we talk about it all the time. But what is it? What are assets, and what happens when you allocate them?

A Classy Subject

Big picture, an *asset* is anything beneficial you have or have coming to you. For our purposes, it's anything of value in your investment portfolio. After bundling your investable assets into asset classes, we *allocate*, or assign, each asset class a particular role in your portfolio.

To offer an analogy, allocating your portfolio into different asset classes is similar to storing your clothes according to their roles (pants, shirts, shoes, etc.), instead of just leaving them in a big pile in your closet. You may also further sort your wardrobe by style, so you can create ideal ensembles for your various purposes. Likewise, asset allocation helps us tailor your portfolio to best suit you — efficiently tilting your investments toward or away from various levels of market risks and expected returns. Your precise allocations are guided by your particular financial goals.

That's it, really. If you stop reading here, you've already got the basics of asset allocation. Of course, given how much academic brainpower you'll find behind these basics, there is a lot more we could cover. For now, let's take a closer look at those asset classes.

Asset Classes, Defined

At the broadest level, asset classes typically include domestic, developed international, and emerging market versions of the following:

- **Equity/stocks** (an ownership stake in a business)
- **Bonds/fixed income** (a loan to a business or government)
- **Hard Assets** (a stake in a tangible object such as commodities or real estate)
- **Cash or cash equivalents**

Just as you can further sort your wardrobe by style, each broad asset class (except for cash) can be further subdivided based on a set of *factors*, or expected sources of return. For example:

- **Stocks** can be classified by company size (small-, mid-, or large-cap), business metrics (value or growth), and a handful of other factors more recently identified.
- **Bonds** can be classified by type (government, municipal or corporate), credit quality (high or low ratings), and term (short-, intermediate-, or long-term due dates).

We can then mix and match these various factors into a rich, but manageable collection of asset classes—such as international small-cap stocks, intermediate government bonds, and so on.

Generally speaking, the riskier the asset class, the higher return you can expect to earn by investing in it over the long haul.

Asset Allocation

To convert plans into action, we turn to select fund managers with low-cost fund families that track our targeted asset classes as accurately as possible. Sometimes a fund tracks a popular index that tracks the asset class; other times, asset classes are tracked more directly. Either way, the approach lets us turn a collection of risk/reward “building blocks” into a tightly constructed portfolio, with asset allocations optimized to reflect your investment plans.

Who decides which asset classes to use, based on which market factors? To be honest, there is no universal consensus on THE correct answer to this complex and ever-evolving equation. As evidence-based practitioners, we turn to ongoing academic inquiry, professional collaboration, and our own analyses. Our goal is to identify allocations that seem to best explain how to achieve different outcomes with different portfolios.

We look for robust results that have:

- **Been replicated** across global markets
- **Been repeated** across multiple, peer-reviewed academic studies
- **Lasted** through various market conditions
- **Actually worked**, not just in theory, but as investable solutions, where real-life trading costs and other frictions apply

Asset Allocation in Action

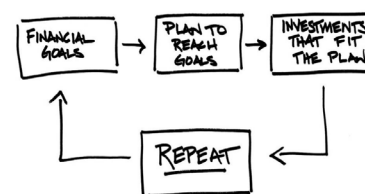
As we learn more, sometimes we can improve on past assumptions, even as the underlying tenets of asset allocation remain our dependable guide. Bottom line, by employing sensible, evidence-based asset allocation to reflect your unique financial goals (including your timelines and risk tolerances), you should be much better positioned to achieve those goals over time.

Asset allocation also offers a disciplined approach for staying on course toward your own goals through ever-volatile markets. This is more important than most people realize. As Dimensional Fund Advisor's David Booth has observed, “Where people get killed is getting in and out of investments. They get halfway into something, lose confidence, and then try something else. It's important to have a philosophy.”

So, now that you're more familiar with asset allocation, we hope you'll agree: Properly tailored, it's a fitting strategy for any investor seeking to earn long-term market returns. Please let us know if we can tell you more.

Until next time, no regrets!

David Bromelkamp
President and CEO



Headlines

- We had a great time last month with clients, friends and colleagues at our Fall Wealth Management Workshop titled *Generational Wealth: Successful Transfer Strategies*.
- We were pleased to welcome one new client into the firm during the third quarter of 2019.
- Our office will be closed December 25 and January 1 for company holidays.

Note: To find out more about Allodium’s breaking news, please visit our website: www.allodium.com.

Upcoming Events

January 23, 2020

Join us for our 2020 January Investment Forum. We will be asking the question: *Is Your Brain Wired to be a Good Investor?* The event will be held at Golden Valley Country Club. More details will be coming soon.

For more information about this event, please contact Ilona Avraamides at (612) 230-3711 or iavraamides@allodium.com.

FINANCIAL PLANNING TIP:

Tips to Save Money

The new year is fast approaching as 2019 is coming to a close. You may be considering some New Year’s resolutions. One of your goals might be to save more money. We offer two tips to help you achieve your financial objectives.

Defensive Driving Course

One little known strategy to reduce the cost of your car insurance is to take a defensive driving course. According to the MN Safety Council, if you’re age 55 or older, you can get a 10 percent, 3-year discount on your auto insurance by taking the Defensive Driving Course, developed by the National Safety Council. The class teaches basic crash prevention techniques and has a proven record of reducing traffic violations and incidents. It can be taken online or in person and consists of lectures, films and discussions. There is no behind-the-wheel driving and there are no tests. After you complete the course, you will receive a certificate of completion to give to your insurance agent <https://www.minnesotasafetycouncil.org/traffic/mature.cfm>.

New Limits for Retirement Accounts

For those who are employed, we strongly encourage you to save money toward your future retirement utilizing a work-related retirement plan or individual retirement account. These retirement savings may reduce your taxable income and help to grow your wealth in a tax-advantaged manner, compounding without taxes due on the ongoing growth. The IRS increased the limits for 2020 on many of the retirement plan contributions.

Note: Contributions may not exceed 100% of your income.

Plan Type	2020 Annual Dollar Limit	2020 Catch-up Limit
401(k), 403(b), governmental 457(b), Federal Thrift Plan	\$19,500	\$6,500
SIMPLE plans	\$13,500	\$3,000
IRA/Roth	\$6,000	\$1,000

The maximum amount that can be allocated to your account in a defined contribution retirement plan such as a 401(k) or profit sharing plan in 2020 is \$57,000 plus age 50 catch-up contributions. This maximum limit includes both your contributions and your employer’s contributions. Special rules apply if your employer sponsors more than one retirement plan.

Finally, the maximum amount of compensation that can be taken into account in determining benefits for most plans in 2020 is \$285,000 (up from \$280,000 in 2019), and the dollar threshold for determining highly compensated employees (when 2020 is the look-back year) is \$130,000 (up from \$125,000 when 2019 is the look-back year).

These are just a couple of simple strategies you can take to save money and improve your situation. Please contact us if you would like to discuss your personal circumstances and identify additional strategies to meet your financial goals.

Invest for the long haul. Don’t get too greedy and don’t get too scared.

Shelby M.C. Davis

WE APPRECIATE YOUR INTRODUCTIONS

To optimize our objectivity and avoid conflicts of interest, we are a fee-only registered investment advisor that is completely independent from banks, brokerage firms and other financial product providers. If you know someone who may be looking for this type of objective investment advice, please contact Dave Bromelkamp at 612-230-3702 or dbromelkamp@allodium.com to arrange a friendly, no-obligation introduction.

Steward is published quarterly by Allodium Investment Consultants. Please contact Ilona Avraamides at 612-230-3711 or iavraamides@allodium.com if you have any comments about this publication or wish to be added to or removed from our mailing list.



© 2019 Allodium Investment Consultants

Allodium Investment Consultants, LLC (“Allodium”) is an SEC registered investment adviser with its principal place of business in the state of Minnesota. This newsletter is limited to the dissemination of general information pertaining to its investment advisory/management services and is not intended to provide investment, tax, legal or other advice. While taken from sources deemed to be accurate, the information contained herein is subject to change, and Allodium makes no representations about its accuracy, completeness or appropriateness for any given situation and disclaims any liability arising from use of or reliance on this information. Client satisfaction results and recognition by publications should not be construed as a guarantee of certain results when Allodium is engaged for investment advisory services, nor should it be construed as a current or past endorsement for Allodium by any of its clients. For additional information about Allodium, including fees and services, please request our disclosure statement as set forth on Form ADV using the contact information herein. Please read the disclosure statement carefully before you invest.