

## How to Build a Strong Portfolio in Your 401(k)?

**Topic:** Importance of asset allocation in building a strong portfolio.  
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**Executive Summary:** Picking the right asset categories is the key factor in building a strong 401(K) portfolio. It has been shown that 94% of the variability in a portfolio's return is explained by the asset allocation mix and not by security selection or market timing.

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Take a look at last year's performance in your 401(k). How did you do compared to the market? The 2004 annual returns for the more popular benchmarks are as follows:

Index	2004 results
S & P 500	+ 9.0%
NASDAQ Composite	+ 8.6%
Russell 2000	+ 18.3%
Lehman US Aggregate Bond	+ 4.3%

Indexes are unmanaged and cannot be invested in directly.

Past performance is no guarantee of future results

Well, how did you do? Did you "win" the game? Many of us work hard to pick the best performing investments and achieve the highest return on our 401(k) portfolio. We tediously wade through analyst reports filled with terms like alpha, beta, standard deviation, Sharpe ratio. We scan the economic horizon and process all the watercooler talk about our funds. However, most of us are missing the boat when it comes to one of the largest determining factors for portfolio returns—picking the right asset allocation. Choosing the right mix of funds such as large cap growth, small cap value, foreign, or bonds is much more important than choosing the best investment in each category.

In a landmark study in 1983 by Brinson, Hood and Beebower, it was shown that 94% of the variability in a portfolio's return is explained by the asset allocation mix and not by security selection or market timing. These latter two variables and others make up the difference in the long-term investment outcomes of your portfolio.

How do you go about picking the right allocation mix? The right allocation mix for a 401(k) depends on several factors which makes it a very personal decision. At our firm, we work with our clients to first develop their financial goals and then design an allocation mix that fits their tolerance for risk, time horizon, and investment goals.

Experts generally suggest that younger people should put more money in equities because historically they have outperformed fixed income securities like bonds over a long time frame. As the investor gets older the asset mix should gradually move more toward the less risky fixed income securities. However, within each of the equity and bond allocations, there are a variety of "style" choices which greatly affect the asset allocations.

There are broad “style” classifications in both the equity and bond markets that the financial community has adopted. Here are some common classes:

Stock Classifications	Bond Classifications
Large Cap Growth, Blend, Value	High Yield (high risk)
Mid Cap Growth, Blend, Value	Medium Yield Short, Intermediate, Long Term
Small Cap Growth, Blend, Value	Low Yield Short, Intermediate, Long Term
International	US Treasuries Short, Intermediate, Long Term
International Emerging Market	Tax Exempt Short, Intermediate, Long Term
Sector (energy, health care, manufacturing, etc.)	International Short, Intermediate, Long Term

When striving to achieve a return that reflects the broad market year after year, it is necessary to diversify your portfolio among these classifications within the stock and bond groups and annually rebalance it. As mentioned above, proper asset allocation to the appropriate groups in your particular circumstances can give you the most impact toward reaching your overall portfolio return goal.

Vantage has developed benchmark portfolios to match broad risk categories suitable for different client situations. We compare your portfolio to the most appropriate benchmark to determine if any changes are necessary. This type of analysis compares the rate of return, risk profile, and asset allocation to the benchmark. We recommend any appropriate modifications at least annually.

If you want to build a strong portfolio in your 401(k), you should review your asset allocations now. Don't be a “buy and hold” investor who ignores the importance of asset allocation. Properly allocating and reallocating your portfolio should be at least an annual exercise.

Please note that every situation is different and should be assessed by a professional before proceeding. If you have any questions or would like assistance with this or other matters, please call us at Vantage 847-590-5555.

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