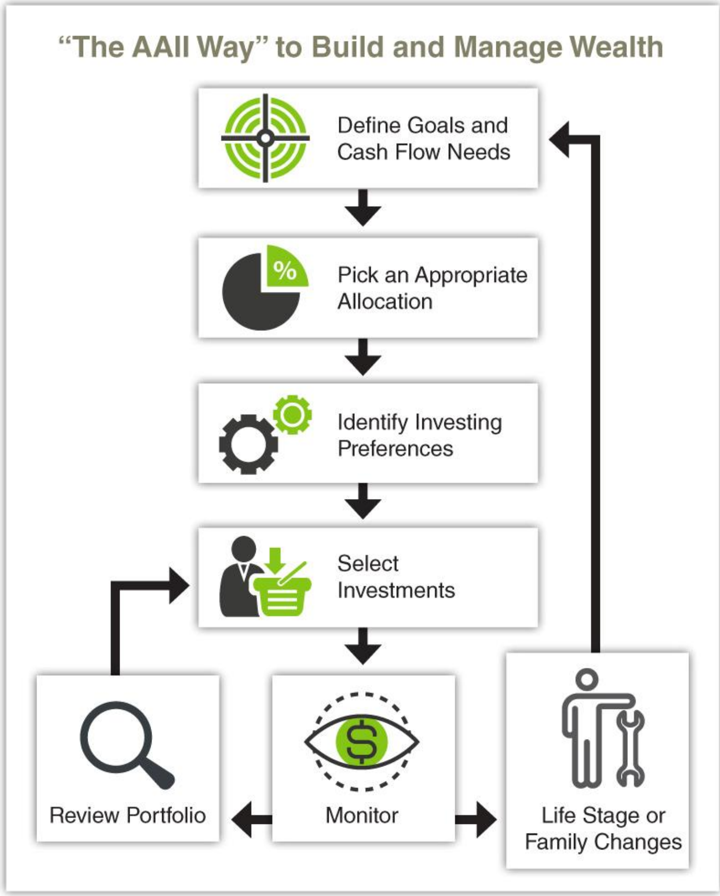
The AAII Way Update: Asset Allocation

Charles Rotblut, CFA
Vice President & *AAII Journal* Editor
American Association of Individual Investors
charles@aaii.com

“The AAII Way” is a new project to help you create a comprehensive and personalized plan for investing.

It will help you to become a more effective manager of your own assets.

The Five-Step Process

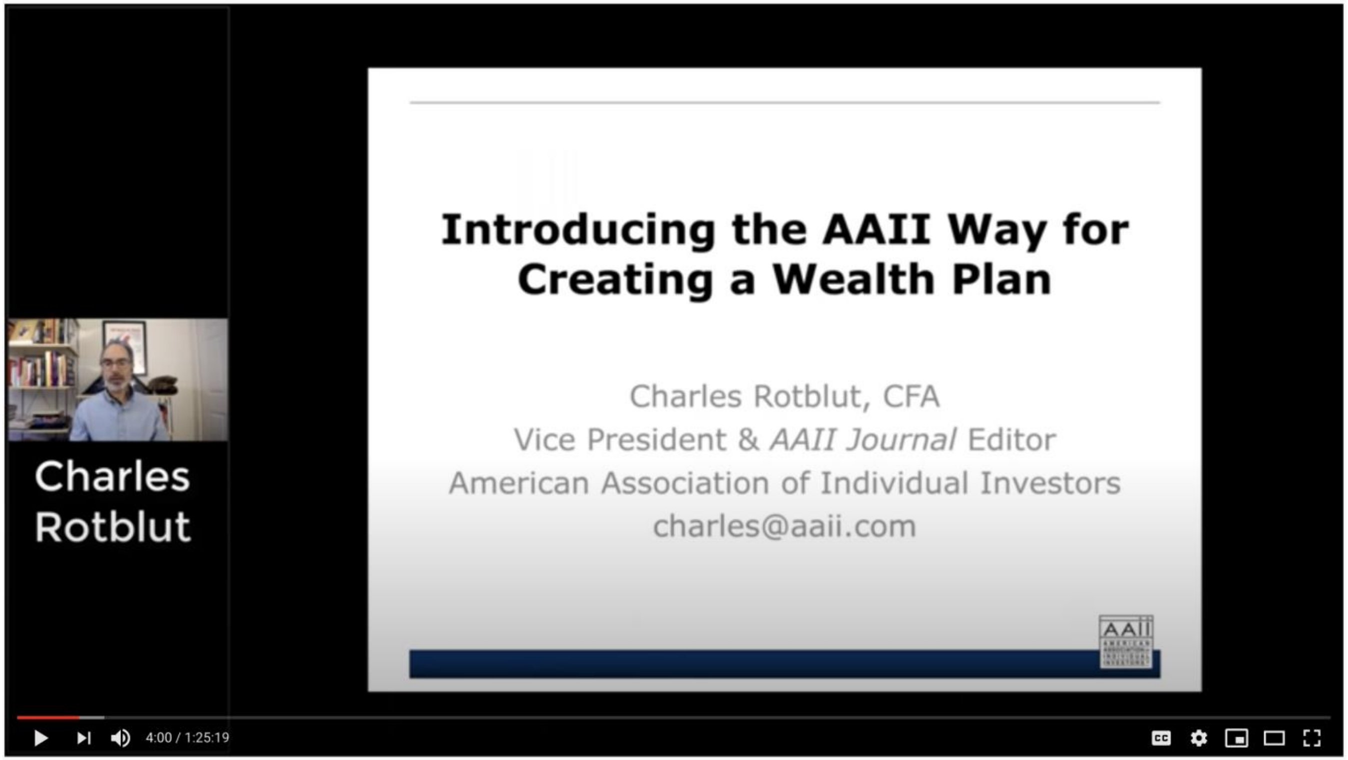


Source: "A Process for Creating Your Own Wealth Plan," *AAII Journal*, June 2020.

What Does It Encompass?

- A series of worksheets unveiled at www.aaii.com/AAIIWay
- Commentaries in the weekly AAII Investor Update
- Revised versions of the worksheets in the *AAII Journal*
- Longer-term: Integrated into AAII.com and potentially a new book

AAII Way Introduction



https://www.aaii.com/webinars

July 1, 2020: https://www.aaii.com/webinars or https://youtu.be/DRaGbFpQWjc

Let’s talk about asset allocation.

Asset allocation is a function of your goals and your tolerance for risk.

Existing AAII
Asset Allocation Models

Aggressive Investor
90% Diversified Stock

Suggested Allocation Breakdowns	
20%	Large-Cap Stocks
20%	Mid-Cap Stocks
20%	Small-Cap Stocks
20%	International Stocks
10%	Emerging Markets Stocks
10%	Intermediate Bonds
0%	Short-Term Bonds

Allocations

10% Fixed Income
90% Diversified Stock

Moderate Investor
70% Diversified Stock

Suggested Allocation Breakdowns	
20%	Large-Cap Stocks
20%	Mid-Cap Stocks
10%	Small-Cap Stocks
15%	International Stocks
5%	Emerging Markets Stocks
30%	Intermediate Bonds
0%	Short-Term Bonds

Allocations

30% Fixed Income
70% Diversified Stock

Conservative Investor
50% Diversified Stock

Suggested Allocation Breakdowns	
25%	Large-Cap Stocks
10%	Mid-Cap Stocks
10%	Small-Cap Stocks
5%	International Stocks
0%	Emerging Markets Stocks
40%	Intermediate Bonds
10%	Short-Term Bonds

Allocations

50% Fixed Income
50% Diversified Stock

https://www.aaii.com/asset-allocation

Revised Moderate Asset Allocation Model

Original	Revised
Moderate Investor	**Moderate Investor**
70% Diversified Stock	**60%** Diversified Stock
Suggested Allocation Breakdowns	**Suggested Allocation Breakdowns**
20% Large-Cap Stocks	**20%** Large-Cap Stocks
20% Mid-Cap Stocks	**15%** Mid-Cap Stocks
10% Small-Cap Stocks	**10%** Small-Cap Stocks
15% International Stocks	**15%** International Stocks
5% Emerging Markets Stocks	**0%** Emerging Markets Stocks
30% Intermediate Bonds	**30%** Intermediate Bonds
0% Short-Term Bonds	**10%** Short-Term Bonds
Allocations	**Allocations**
30% Fixed Income	**40%** Fixed Income
70% Diversified Stock	**60%** Diversified Stock

Source: "The Changes Being Made to AAII's Asset Allocation Models," September 2020 *AAII Journal.*

Why 60/40?

- It is a well-established allocation benchmark
- A variety of models and strategies center around it, including the Vanguard Wellington fund which was started in 1929
- Easy to follow
- Has historically worked well with the 4% rule, even at 40-year timespans

Impact on Returns for Moderate Allocation Model

	Current Model	Revised Model
Annualized Returns (20 years)	6.6%	6.1%
Standard Deviation	12.4%	10.1%
Lowest Return	(23.8%)	(18.6%)
Highest Return	26.8%	22.5%

Returns for 2000–2019; indexes used for calculations.

Bonds: 1940–1959

- Only 20-year period since 1929 where annual bond returns mostly stayed below 3%
- 13 calendar years when intermediate-term government bonds returned less than 2%
- 60/40 portfolio realized a 9.9% annualized gain because of the stock portion

The Bond Allocation

- Our model uses intermediate- and short-term bonds, not long-term bonds
- You can ladder bonds or defined-maturity bond funds
- If nervous about interest rates, you could ladder certificates of deposit (CDs) instead
- Bond allocation reduces volatility
- Focus on investment-grade bonds; can use Treasury, corporate or municipal

Revised Conservative Asset Allocation Model

Original

Conservative Investor
50% Diversified Stock

Suggested Allocation Breakdowns

25% Large-Cap Stocks
10% Mid-Cap Stocks
10% Small-Cap Stocks
5% International Stocks
0% Emerging Markets Stocks
40% Intermediate Bonds
10% Short-Term Bonds

Allocations

50% Fixed Income
50% Diversified Stock

Revised

Conservative Investor
40% Diversified Stock

Suggested Allocation Breakdowns

20% Large-Cap Stocks
10% Mid-Cap Stocks
0% Small-Cap Stocks
10% International Stocks
0% Emerging Markets Stocks
40% Intermediate Bonds
20% Short-Term Bonds

Allocations

60% Fixed Income
40% Diversified Stock

Source: "The Changes Being Made to AAII's Asset Allocation Models," September 2020 *AAII Journal.*

Impact on Returns for Conservative Allocation Model

	Current Model	Revised Model
Annualized Returns (20 years)	5.9%	5.3%
Standard Deviation	7.9%	6.1%
Lowest Return	(13.2%)	(9.5%)
Highest Return	18.4%	14.4%

Returns for 2000–2019; indexes used for calculations.

No Change to Aggressive Asset Allocation Model

Original Model

Aggressive Investor

90% Diversified Stock

Suggested Allocation Breakdowns

20%	Large-Cap Stocks
20%	Mid-Cap Stocks
20%	Small-Cap Stocks
20%	International Stocks
10%	Emerging Markets Stocks
10%	Intermediate Bonds
0%	Short-Term Bonds

Allocations

10% Fixed Income
90% Diversified Stock

Revised Model

Aggressive Investor

90% Diversified Stock

Suggested Allocation Breakdowns

20%	Large-Cap Stocks
20%	Mid-Cap Stocks
20%	Small-Cap Stocks
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Allocations

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Source: “The Changes Being Made to AAII’s Asset Allocation Models,” September 2020 *AAII Journal.*

The AAII Way Worksheets

Identify and Prioritize Goals

Retired Couple: Bob and Jane are recently retired and have children and grandchildren.

Goal	Number of Years Away	Spending Duration	Priority	Comments
Pay for retirement	Now	30 years	1	Social Security and pension income should be sufficient
Help with older grandchild's college expenses	8 years	4 years	2	Do first, but balance with younger grandchild
Help with younger grandchild's college expenses	12 years	4 years	3	Try to proportionately match with first grandchild
Leave an inheritance	30-35 years	Zero	4	Invest aggressively to grow for heirs

Source: “Defining Your Investing Goals,” *AAII Journal*, July 2020.

Define Tolerance for Risk

<u>Financial and Psychological Risk</u>	
During market declines, you have:	
Significantly reduced my exposure to stocks and stock funds	1
Somewhat reduced my exposure to stocks and stock funds	**3** x
Maintained my allocation or bought more stocks	6
How much of your spending needs are covered by non-portfolio income?	
None	1
Some	3
All	**6** x
How would you describe your knowledge of key investing concepts?	
Basic/Low	1
Moderate	**3** x
High	6
Financial/Psychological Tolerance Score (total of scores above)	12
Based on your score, your financial and psychological tolerance is:	
Low	1-5
Moderate	6-11
High	12-18

Select Asset Allocation

Revised Asset Allocation Models

We've highlighted what's changing.

Aggressive Investor

90% Diversified Stock

Suggested Allocation Breakdowns

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Allocations

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Determine How Your Portfolio Will Be Managed

1. How much control do you want in determining which investments are held in your portfolio?
   - [x] Complete
   - [ ] A mix of self-directed and an adviser
   - [ ] Just keep me informed about my portfolio

2. Do you prefer an active approach to investing, a passive approach (indexing) or a blend of the two?
   - [ ] Active (try to beat the market)
   - [x] A blend (a mix of active and passive strategies)
   - [ ] Passive (indexing/tracking the market)

3. Are there any constraints on your strategy?
   - [ ] Limitations on what you can own [e.g. 401(k) plans, job-related restrictions, etc.]
   - [ ] Trading restrictions
   - [ ] Trusts or partnerships
   - [ ] Social or religious beliefs
   - [ ] Other: ______________________________
   - [x] None

4. How comfortable are you in researching and following investments?
   - [x] Enjoy researching and analyzing stocks
   - [ ] Enjoy researching and analyzing bonds
   - [ ] Content looking at mutual funds or exchange-traded funds (ETFs)
   - [ ] Not interested

List All of Your Accounts

The AAII Way: Investment Account Inventory List

Bank Accounts

Company / Credit Union	Type (Checking / Savings / Other)	Beneficiaries / Trusted Contact	Notes / Comments
Citibank	Checking		
Discover Bank	Saving		Emergency Savings

Taxable Investment Accounts

Company	Types of Investments Held (e.g., equities, muni bonds, taxable bonds, mutual funds, etc.)	Beneficiaries / Trusted Contact	Notes / Comments
TD Ameritrade	Stocks	Our Son	Frank's speculative account

IRAs, SEP IRAs, etc.

Company	Types of Investments Held (e.g., equities, muni bonds, taxable bonds, mutual funds, etc.)	Beneficiaries / Trusted Contact	RMDs? (Y/N)	Notes / Comments
Fidelity	Equity mutual funds	Our son	N	Frank's IRA
Fidelity	Equity mutual funds	Our son	N	Sue's IRA

Roth IRAs

Company	Types of Investments Held (e.g., equities, muni bonds, taxable bonds, mutual funds, etc.)	Beneficiaries / Trusted Contact	Roth Conversion? (list date, if yes)	Notes / Comments
N/A				

Track Your Expenses

Bob and Jane's Investment Expense Tracking Worksheet

Mutual Funds

Name (Ticker)	Transaction Fee	Expense Ratio*	Amount Invested	Fund Fees	Total Cost

Exchange-Traded Funds

Name (Ticker)	Commission	Expense Ratio*	Amount Invested	ETF Fees	Total Cost
Vanguard Total Internat'l Stock (VXUS)		0.0008	$420,000		$336
Vanguard Intermed-Term Bond ETF (BIV)		0.0005	$140,000		$70

Stocks/Bonds

Name (Ticker/Cusip)	Commission	Amount Invested	Other Fees / Costs	Total Cost
Bob's Stock Picks	$0	$840,000		$0

Other Fees

Name	Commissions	Other Fees / Costs	Total Cost
Retirement Plans [401(k), 403(b), etc.]			
Health Savings Accounts			
529 Savings Plans			
Adviser			
Services			$299
Commissions			
Other			

Totals

	Total
Total Costs Incurred	$705
Portfolio Value	$1,400,000
Total Cost Ratio	0.1%

Write Down Portfolio Composition and Rules

Portfolio Composition and Notes

Equities	Portfolio Allocation	Strategies, Types of Investments and Rules
Large-Cap Stocks	15%	Frank uses value-oriented AAII Stock Screens and My Portfolio, sells stocks with Value Grades of F
Mid-Cap Stocks		
Small-Cap Stocks		
International Stocks		
Balanced/Target-Date Fund Portion	20%	Total market index funds; keep track of objective and index followed
Other:	40%	Equity portion of target-date funds held in 401(k) plans; keep track of objective and index followed
Total Equity Allocation	75%	
Fixed-Income Allocation		
Short-Term	10%	Bond funds held in Sue's inherited IRAs; monitor with AAII My Portfolio
Intermediate-Term		
Long-Term		
Balanced/Target-Date Fund Portion	15%	Fixed-income portion of target-date funds held in 401(k)s; keep track of objective and index followed
Other:		
Total Fixed-Income Allocation	25%	

Prototypes of Forthcoming Worksheets

Write Down Withdrawal Strategy

Retirement Accounts with Required Minimum Distributions		
Account	Balance	Current Year RMD
Totals		
Retirement Accounts without a RMD (Includes traditional brokerage accounts)		
Totals		
Retirement Assets		(Total of RMD & Non-RMD Accounts)

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Don’t Forget Estate Planning

<u>Estate Planning Summary</u>		
Fidicuaries	(See Account Inventory List)	
Account	Names	Next Date to Check
Financial and Estate Planning Professionals		
Type	Name	Phone Number and Email
Doctors (Included Because Heirs May Need the Information)		
Type	Name	Phone Number and Email

Create a Systematic Portfolio Review Process

Stocks	(Open Ended)	
Frequency of Reviewing		(Open Ended)
Any Meeting a Sell Rule?		(See Sell Rules; Sell Those Meeting a Sell Rule) (Open Ended)
Any Change in Strategy?		(Y/N) (If yes, revise buy and sell rules)
Bonds		
Frequency of Reviewing		(Open Ended)
Any Meeting a Sell Rule?		(See Sell Rules; Sell Those Meeting a Sell Rule) (Open Ended)
Any Change in Strategy?		(Y/N) (If yes, revise buy and sell rules)
Mutual Funds		
Frequency of Reviewing		(Open Ended)
Any Meeting a Sell Rule?		(See Sell Rules; Sell Those Meeting a Sell Rule) (Open Ended)
Any Change in Strategy?		(Y/N) (If yes, revise buy and sell rules)

Changes in Stage of Life

Over the past year, have any of the following happened?		
Family	Y/N	Who
Birth/Adoption		
Death		
Marriage		
Separation		
Divorce		
Employment (You or Family Member)		Description
New Job		
Job Loss		
Retirement		
Health (You or Family Member)		Description
Significant Changes		
Significant Changes		
Significant Changes		

Putting It All Together

My Financial Goals (See Goals Worksheet)		
Goal	Priority	
My Risk Tolerance (See Revised Risk Tolerance Worksheet)		
Timing Risk		
Financial/Psychological Tolerance		
Overall Risk Tolerance		(Very Cons, Conservative, Con-to-Mod, Moderate, Mod-Agg, Aggressive)
Allocation Model		(Very Cons, Conservative, Moderate, Aggressive)
Portfolio Management Choices		
My Investor Type		(See How Your Portfolio Is Managed Worksheet)
Types of Investments and/or Services Used		(See How Your Portfolio Is Managed Worksheet)
Individual Stocks		(Put checkmarks where applicable)

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See everything we’re creating for
The AAII Way at:
https://www.aaii.com/AAIIWay

The AAII Way Update: Asset Allocation

Charles Rotblut, CFA
Vice President & *AAII Journal* Editor
American Association of Individual Investors
charles@aaii.com

Upcoming Webinars

Register at
http://www.aaii.com/webinars

Larry Swedroe on What to Do When an Investment Strategy Performs Poorly
Wednesday, September 2, 2020, 7:30 p.m. CDT

Jack Vogel on Quantitative Momentum: A Systematic Process to Identify High Momentum Stocks
Wednesday, September 9, 2020, 7:30 p.m. CDT

Wayne Thorp on Investing Like a Stock Superstar: A Fundamental and Technical Approach to Seeking Growth Stocks
Wednesday, September 16, 2020, 7:30 p.m. CDT