Asset Allocation – Week 5

Learning Outcomes

- ***Explain what is asset allocation and its importance.***

Asset allocation refers to the way you spread your investments across multiple asset classes. Each individual asset class differs in expected returns at a moment in time and average realized returns over time. On average these returns should line up, but not in the case of crisis or over a short horizon. Thereby asset allocation is important to create a diversified portfolio based on individuals risk aversion and objectives.

- ***Describe the key asset classes and their investment characteristics.***

Cash is money that can be accessed almost immediately, examples include, short term treasury, bank deposits, commercial paper and money market funds. They have characteristics of low nominal inflationary risk exposure and are tax inefficient at positive marginal tax rates.

Listed Shares are equity investments that represents ownership in a corporation. There shares offer capital gains, dividends and franking credits, and offer growth and liquidity for their holder. They are tax efficient at positive marginal tax rates and should have a higher weight as horizon or risk intolerance increases.

Fixed income are a certain group of investment products that promise certain cash flow streams, examples include, bonds, preference shares (hybrid) and convertible securities (hybrid). They have lower expected returns and risk between shares and cash and can accessed directly or through managed funds. They are suitable for conservative and medium term investments as well as liability/liquidity and investment constraint management.

Property includes residential homes, vacant land and a variety of income property, including warehouses, and office and apartment buildings. It is a tax efficient investment at positive marginal tax rates as you can deduct gearing and are able to receive a CGT discount. Home ownership provides tax benefits, growth and improved social security's benefits. Investment properties provide income and growth.

- ***Explain the role of managed funds and derivatives for asset allocation.***

Defensive assets/diversification – Managed Funds

Derivate – Hedging against currency or interest rate fluctuation

- ***Explain the concept and purpose of investment policy statement (IPS).***

An investment policy statement serves as a plan that guides an investor and the planner in the long term financial and investment decision. It identifies the goals of the portfolio, namely, the current income, capital growth, total return and preservation of capital. It identifies asset allocation and performance bench marks.

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