

ASSET ALLOCATION BULLETIN

Johnny Gibson, CFA[®], CMT[®] – Chief Investment Officer
Cameron Dawson, CFA[®] – Chief Market Strategist

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METHODOLOGY OVERVIEW

The asset allocation process is one of the foundational elements of portfolio construction. In its simplest form, it considers an investor's return goals and how much risk the investor is willing to take. It uses this risk and return profile to determine an optimal portfolio mix between asset classes, such as higher risk/higher return equities and lower risk/lower return fixed income. The result is an "efficient" pairing of risk and return. This means an investor is minimizing the amount of risk taken to achieve a return target, or maximizing the amount of return received given a tolerable amount of risk. This highlights the two approaches to the asset allocation process: return targeting and risk (also called volatility) targeting. Though it may seem like a nuance on the surface, there is a substantial difference between these two approaches, and adopting one or the other can have a significant impact on both the long-term returns and experienced volatility in a portfolio.

First, let's define one set of key inputs into this asset allocation process (also known as mean variance optimization): capital market assumptions. These are the return and risk figures that are expected for each asset class into the future. Though these are long-term expectations, these assumptions aren't static, meaning they can change over time. Notably, return expectations tend to change more than risk expectations. Risk expectations are determined using long-term historical observations of the volatility of an asset class, with the assumption that future volatility will be close to historical volatility. Return expectations also use historical return data to predict future returns, but often other inputs are included as well. For the equity asset class, these can include the level of interest rates, current valuations versus history, economic growth expectations, and more. The result is that return expectations should change as we move through the economic and market cycle. With equities, for example, higher returns should be expected when valuations are low and economic growth is recovering (eg. 2003), while lower returns should be expected when valuations are high and economic growth is slowing (eg. 2000).

Back to the two approaches to asset allocation. The most common approach of the two is the return targeting method. This method starts with a return goal in mind, let's say it is 5% per year, and then determines the optimal

combination of various asset classes in order to accomplish that 5% return goal while taking on the least amount of risk/volatility. Despite its popularity, this method has a major logical flaw. Imagine a scenario where the return expectation for a higher return/higher risk asset class, like equities, starts to be reduced in the late days of an economic cycle. This return targeting method would take the lower expected return of the equity asset class and actually increase the weighting to equities to it in order to reach that 5% return goal. The opposite is true at a market bottom, where forward return expectations are higher, the model will decrease the weighting to equities because it doesn't need as much to reach the 5% return goal. This literally forces investors to buy high and sell low! It encourages irrational risk-seeking behavior at the exact wrong time in the cycle. This is precisely the opposite of the discipline asset allocation should provide to a portfolio.

At Fieldpoint, we take the opposite, surprisingly uncommon approach. We use the risk targeting method. This method advises us to sell high and buy low; reducing our exposure to risky assets when forward return expectations fall, and enabling us to increase our overall portfolio return by buying risky assets when return expectations rise. This is not meant to try and accomplish perfect market timing, but instead to establish a strong logical discipline in order to reduce large drawdown risks (which would be caused by increasing risky asset allocations into a market top). It also provides us the disciplined framework to avoid the wall of worry at the start of a market cycle, so we can be properly allocated to risk assets when return expectations are strong. It is within this framework that we have updated our asset allocation recommendations for 2021.

ASSET ALLOCATION OVERVIEW

A note on the weighting classification of the asset classes. The underweight/neutral/overweight represents the tactical weightings versus our strategic targets. As we have updated our capital market assumptions given the current market conditions, our risk targeting approach has resulted in a reduction in the strategic weightings of some asset classes where the return expectations are now lower. For example, given near-record valuations, the return expectations for U.S. Large-Cap equities are now lower than in prior iterations of this model. This has resulted in a reduction in the strategic allocation to this asset class, and captures our concern of bubble-like conditions in parts of this asset class (high valuations reduce long-term returns but have less of an impact on short-term returns). As we progress through time, we will determine if an additional, shorter term change to the tactical weighting is warranted.

Asset Class	Tactical Weighting	Rationale
Global Equities	Neutral	We are tactically neutral equities overall, with expectations for lower forward returns domestically captured lower strategic weightings to the U.S. portion of the allocation.
Fixed Income	Underweight	We are decreasing our weighting to fixed income given the low level of current yields, which do little to compensate investors for duration and credit risks.
Commodities	Neutral	We are neutral commodities, watching for a weaker dollar to move tactically overweight.
Alternatives	Neutral	We remain balanced with respect to low-correlation assets such as select hedge funds and return-enhancing investment such as private debt and private equity.
Cash	Overweight	We are increasing our weighting to cash given it provides flexibility and liquidity to take advantage of volatile markets, while it does not have duration or credit risk.

CAPITAL MARKET ASSUMPTIONS

Asset Class	Return Expectations				Expected Volatility Long Term	Correlations	
	5 yrs	10 yrs	15 yrs	20 yrs		Global Equities (L-T)	Global Gov Bonds (L-T)
Cash							
U.S. Cash	0.4%	1.0%	1.6%	1.9%	0.0%	0.0%	0.0%
Equities							
U.S. Large Cap	4.1%	5.0%	5.8%	6.3%	16.2%	87.0%	-15.0%
U.S. Small Cap	4.6%	5.6%	6.4%	6.9%	22.6%	87.0%	-17.0%
Global ex U.S. Large Cap	6.4%	6.8%	7.0%	7.2%	16.4%	91.0%	-12.0%
EM Large Cap	5.4%	6.4%	7.4%	8.0%	21.0%	73.0%	-10.0%
Fixed Income							
U.S. Gov Bonds (all maturities)	-0.5%	0.3%	1.0%	1.5%	5.5%	-38.0%	77.0%
U.S. Gov (10 yrs +)	-2.8%	-1.6%	-0.5%	0.2%	15.2%	-31.0%	77.0%
U.S. Agg Bonds	-0.1%	0.8%	1.5%	2.0%	4.2%	-11.0%	76.0%
U.S. Credit (all maturities)	-0.1%	1.0%	2.1%	2.7%	6.8%	18.0%	63.0%
U.S. Credit (10 yrs +)	-1.0%	0.6%	2.2%	3.2%	12.8%	24.0%	59.0%
U.S. Agency MBS	0.1%	0.8%	1.4%	1.7%	1.5%	-26.0%	35.0%
U.S. Bank Loans	2.7%	3.2%	3.7%	4.0%	8.1%	55.0%	-12.0%
U.S. Inflation Linked Gov Bonds	1.8%	2.2%	2.6%	2.7%	6.0%	1.0%	52.0%
U.S. HY	3.9%	4.3%	4.6%	4.8%	8.0%	63.0%	-1.0%
Global ex U.S. Gov Bonds	-0.5%	0.4%	1.2%	1.7%	3.5%	-17.0%	100.0%
USD EM Debt	2.8%	3.6%	4.2%	4.7%	10.3%	42.0%	37.0%
Alternatives							
Hedge Funds (global)	4.4%	5.1%	5.7%	6.1%	7.4%	84.0%	-19.0%
U.S. Private Equity (buyout)	17.1%	16.6%	15.9%	15.4%	32.0%	80.0%	-17.0%
Global Direct Lending	7.6%	8.0%	8.3%	8.5%	15.0%	73.0%	-11.0%
Global Infrastructure Equity	6.2%	6.7%	7.1%	7.3%	18.8%	64.0%	5.0%
U.S. Core Real Estate	5.9%	6.1%	6.2%	6.2%	12.1%	58.0%	16.0%
U.S. Infrastructure Debt	1.8%	3.0%	4.1%	4.8%	10.5%	27.0%	48.0%

HIGH TAX SENSITIVITY WITH ALTERNATIVES

as of Feb 1, 2021

	All Fixed Income		6% Vol Target		8% Vol Target		10% Vol Target		12% Vol Target		14% Vol Target		All Equity	
ALLOCATIONS	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical
Cash	5.0%	8.0%	4.0%	4.0%	3.0%	3.0%	3.0%	3.0%	0.0%	1.0%	0.0%	1.0%	0.0%	1.0%
Global Equities	0.0%	0.0%	21.0%	21.0%	30.0%	30.0%	40.0%	40.0%	50.0%	50.0%	62.0%	62.0%	80.0%	79.0%
U.S. Large Cap	0.0%	0.0%	12.0%	12.0%	16.0%	16.0%	20.0%	20.0%	25.0%	25.0%	30.0%	30.0%	40.0%	39.0%
U.S. Mid Cap	0.0%	0.0%	1.0%	1.0%	2.0%	2.0%	3.0%	3.0%	4.0%	4.0%	5.0%	5.0%	6.0%	6.0%
U.S. Small Cap	0.0%	0.0%	1.0%	1.0%	2.0%	2.0%	3.0%	3.0%	3.0%	3.0%	4.0%	4.0%	6.0%	6.0%
International Developed	0.0%	0.0%	4.0%	4.0%	5.0%	5.0%	7.0%	7.0%	9.0%	9.0%	12.0%	12.0%	14.0%	14.0%
Emerging Markets	0.0%	0.0%	3.0%	3.0%	5.0%	5.0%	7.0%	7.0%	9.0%	9.0%	11.0%	11.0%	14.0%	14.0%
Fixed Income	95.0%	92.0%	61.0%	61.0%	49.0%	49.0%	37.0%	37.0%	28.0%	27.0%	15.0%	14.0%	0.0%	0.0%
Municipal Bond	61.0%	58.0%	40.0%	40.0%	32.0%	32.0%	24.0%	24.0%	17.0%	16.0%	9.0%	8.0%	0.0%	0.0%
Municipal High Yield Bond	10.0%	10.0%	6.0%	6.0%	5.0%	5.0%	4.0%	4.0%	3.0%	3.0%	2.0%	2.0%	0.0%	0.0%
TIPS	3.0%	3.0%	2.0%	2.0%	2.0%	2.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	0.0%	0.0%
Developed ex U.S. Bonds	15.0%	15.0%	9.0%	9.0%	7.0%	7.0%	5.0%	5.0%	5.0%	5.0%	2.0%	2.0%	0.0%	0.0%
Emerging Markets Bonds	6.0%	6.0%	4.0%	4.0%	3.0%	3.0%	3.0%	3.0%	2.0%	2.0%	1.0%	1.0%	0.0%	0.0%
Commodities	0.0%	0.0%	1.0%	1.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	3.0%	3.0%	0.0%	0.0%
Commodities	0.0%	0.0%	1.0%	1.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	3.0%	3.0%	0.0%	0.0%
Alternatives	0.0%	0.0%	13.0%	13.0%	16.0%	16.0%	18.0%	18.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
Hedge Funds	0.0%	0.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Private Equity	0.0%	0.0%	3.0%	3.0%	6.0%	6.0%	8.0%	8.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Fieldpoint Private Research. For illustrative purposes only.

HIGH TAX SENSITIVITY WITHOUT ALTERNATIVES

as of Feb 1, 2021

ALLOCATIONS	All Fixed Income		6% Vol Target		8% Vol Target		10% Vol Target		12% Vol Target		14% Vol Target		All Equity	
	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical
Cash	5.0%	8.0%	4.0%	4.0%	3.0%	3.0%	3.0%	3.0%	0.0%	1.0%	0.0%	1.0%	0.0%	1.0%
Global Equities	0.0%	0.0%	30.0%	30.0%	42.0%	42.0%	54.0%	54.0%	66.0%	66.0%	80.0%	80.0%	100.0%	99.0%
U.S. Large Cap	0.0%	0.0%	17.0%	17.0%	22.0%	22.0%	27.0%	27.0%	33.0%	33.0%	40.0%	40.0%	48.0%	47.0%
U.S. Mid Cap	0.0%	0.0%	2.0%	2.0%	3.0%	3.0%	4.0%	4.0%	5.0%	5.0%	6.0%	6.0%	9.0%	9.0%
U.S. Small Cap	0.0%	0.0%	1.0%	1.0%	3.0%	3.0%	4.0%	4.0%	4.0%	4.0%	5.0%	5.0%	8.0%	8.0%
International Developed	0.0%	0.0%	6.0%	6.0%	7.0%	7.0%	10.0%	10.0%	12.0%	12.0%	15.0%	15.0%	18.0%	18.0%
Emerging Markets	0.0%	0.0%	4.0%	4.0%	7.0%	7.0%	9.0%	9.0%	12.0%	12.0%	14.0%	14.0%	17.0%	17.0%
Fixed Income	95.0%	92.0%	65.0%	65.0%	53.0%	53.0%	41.0%	41.0%	32.0%	31.0%	17.0%	16.0%	0.0%	0.0%
Municipal Bond	61.0%	58.0%	42.0%	42.0%	35.0%	35.0%	27.0%	27.0%	20.0%	19.0%	10.0%	9.0%	0.0%	0.0%
Municipal High Yield Bond	10.0%	10.0%	6.0%	6.0%	5.0%	5.0%	4.0%	4.0%	3.0%	3.0%	2.0%	2.0%	0.0%	0.0%
TIPS	3.0%	3.0%	3.0%	3.0%	2.0%	2.0%	1.0%	1.0%	1.0%	1.0%	1.0%	1.0%	0.0%	0.0%
Developed ex U.S. Bonds	15.0%	15.0%	10.0%	10.0%	8.0%	8.0%	6.0%	6.0%	6.0%	6.0%	3.0%	3.0%	0.0%	0.0%
Emerging Markets Bonds	6.0%	6.0%	4.0%	4.0%	3.0%	3.0%	3.0%	3.0%	2.0%	2.0%	1.0%	1.0%	0.0%	0.0%
Commodities	0.0%	0.0%	1.0%	1.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	3.0%	3.0%	0.0%	0.0%
Commodities	0.0%	0.0%	1.0%	1.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	3.0%	3.0%	0.0%	0.0%
Alternatives	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Hedge Funds	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Private Equity	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

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LOW TAX SENSITIVITY WITH ALTERNATIVES

as of Feb 1, 2021

ALLOCATIONS	All Fixed Income		6% Vol Target		8% Vol Target		10% Vol Target		12% Vol Target		14% Vol Target		All Equity	
	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical
Cash	5.0%	8.0%	4.0%	6.0%	3.0%	5.0%	3.0%	4.0%	0.0%	1.0%	0.0%	1.0%	0.0%	1.0%
Global Equities	0.0%	0.0%	21.0%	21.0%	30.0%	30.0%	40.0%	40.0%	50.0%	50.0%	62.0%	62.0%	80.0%	79.0%
U.S. Large Cap	0.0%	0.0%	12.0%	12.0%	16.0%	16.0%	20.0%	20.0%	25.0%	25.0%	30.0%	30.0%	40.0%	39.0%
U.S. Mid Cap	0.0%	0.0%	1.0%	1.0%	2.0%	2.0%	3.0%	3.0%	4.0%	4.0%	5.0%	5.0%	6.0%	6.0%
U.S. Small Cap	0.0%	0.0%	1.0%	1.0%	2.0%	2.0%	3.0%	3.0%	3.0%	3.0%	4.0%	4.0%	6.0%	6.0%
International Developed	0.0%	0.0%	4.0%	4.0%	5.0%	5.0%	7.0%	7.0%	9.0%	9.0%	12.0%	12.0%	14.0%	14.0%
Emerging Markets	0.0%	0.0%	3.0%	3.0%	5.0%	5.0%	7.0%	7.0%	9.0%	9.0%	11.0%	11.0%	14.0%	14.0%
Fixed Income	95.0%	92.0%	61.0%	59.0%	49.0%	47.0%	37.0%	36.0%	28.0%	27.0%	15.0%	14.0%	0.0%	0.0%
U.S. Treasurys	26.0%	23.0%	17.0%	15.0%	14.0%	12.0%	10.0%	9.0%	6.0%	5.0%	3.0%	2.0%	0.0%	0.0%
Core Bonds	35.0%	35.0%	23.0%	23.0%	18.0%	18.0%	14.0%	14.0%	11.0%	11.0%	6.0%	6.0%	0.0%	0.0%
TIPS	3.0%	6.0%	2.0%	4.0%	2.0%	4.0%	1.0%	2.0%	1.0%	2.0%	1.0%	2.0%	0.0%	0.0%
High Yield	10.0%	7.0%	6.0%	4.0%	5.0%	3.0%	4.0%	3.0%	3.0%	2.0%	2.0%	1.0%	0.0%	0.0%
Developed ex U.S. Bonds	15.0%	15.0%	9.0%	9.0%	7.0%	7.0%	5.0%	5.0%	5.0%	5.0%	2.0%	2.0%	0.0%	0.0%
Emerging Markets Bonds	6.0%	6.0%	4.0%	4.0%	3.0%	3.0%	3.0%	3.0%	2.0%	2.0%	1.0%	1.0%	0.0%	0.0%
Commodities	0.0%	0.0%	1.0%	1.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	3.0%	3.0%	0.0%	0.0%
Commodities	0.0%	0.0%	1.0%	1.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	3.0%	3.0%	0.0%	0.0%
Alternatives	0.0%	0.0%	13.0%	13.0%	16.0%	16.0%	18.0%	18.0%	20.0%	20.0%	20.0%	20.0%	20.0%	20.0%
Hedge Funds	0.0%	0.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
Private Equity	0.0%	0.0%	3.0%	3.0%	6.0%	6.0%	8.0%	8.0%	10.0%	10.0%	10.0%	10.0%	10.0%	10.0%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

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LOW TAX SENSITIVITY WITHOUT ALTERNATIVES

as of Feb 1, 2021

ALLOCATIONS	All Fixed Income		6% Vol Target		8% Vol Target		10% Vol Target		12% Vol Target		14% Vol Target		All Equity	
	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical	Strategic	Tactical
Cash	5.0%	8.0%	4.0%	6.0%	3.0%	5.0%	3.0%	4.0%	0.0%	1.0%	0.0%	1.0%	0.0%	1.0%
Global Equities	0.0%	0.0%	30.0%	30.0%	42.0%	42.0%	54.0%	54.0%	66.0%	66.0%	80.0%	80.0%	100.0%	99.0%
U.S. Large Cap	0.0%	0.0%	17.0%	17.0%	22.0%	22.0%	27.0%	27.0%	33.0%	33.0%	40.0%	40.0%	48.0%	47.0%
U.S. Mid Cap	0.0%	0.0%	2.0%	2.0%	3.0%	3.0%	4.0%	4.0%	5.0%	5.0%	6.0%	6.0%	9.0%	9.0%
U.S. Small Cap	0.0%	0.0%	1.0%	1.0%	3.0%	3.0%	4.0%	4.0%	4.0%	4.0%	5.0%	5.0%	8.0%	8.0%
International Developed	0.0%	0.0%	6.0%	6.0%	7.0%	7.0%	10.0%	10.0%	12.0%	12.0%	15.0%	15.0%	18.0%	18.0%
Emerging Markets	0.0%	0.0%	4.0%	4.0%	7.0%	7.0%	9.0%	9.0%	12.0%	12.0%	14.0%	14.0%	17.0%	17.0%
Fixed Income	95.0%	92.0%	65.0%	63.0%	53.0%	51.0%	41.0%	40.0%	32.0%	31.0%	17.0%	16.0%	0.0%	0.0%
U.S. Treasurys	25.0%	22.0%	18.0%	16.0%	15.0%	13.0%	11.0%	10.0%	8.0%	7.0%	3.0%	2.0%	0.0%	0.0%
Core Bonds	36.0%	36.0%	24.0%	24.0%	20.0%	20.0%	16.0%	16.0%	12.0%	12.0%	7.0%	7.0%	0.0%	0.0%
TIPS	3.0%	6.0%	3.0%	5.0%	2.0%	4.0%	1.0%	2.0%	1.0%	2.0%	1.0%	2.0%	0.0%	0.0%
High Yield	15.0%	12.0%	10.0%	8.0%	8.0%	6.0%	6.0%	5.0%	6.0%	5.0%	3.0%	2.0%	0.0%	0.0%
Developed ex U.S. Bonds	10.0%	10.0%	6.0%	6.0%	5.0%	5.0%	4.0%	4.0%	3.0%	3.0%	2.0%	2.0%	0.0%	0.0%
Emerging Markets Bonds	6.0%	6.0%	4.0%	4.0%	3.0%	3.0%	3.0%	3.0%	2.0%	2.0%	1.0%	1.0%	0.0%	0.0%
Commodities	0.0%	0.0%	1.0%	1.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	3.0%	3.0%	0.0%	0.0%
Commodities	0.0%	0.0%	1.0%	1.0%	2.0%	2.0%	2.0%	2.0%	2.0%	2.0%	3.0%	3.0%	0.0%	0.0%
Alternatives	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Hedge Funds	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
Private Equity	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Fieldpoint Private Research. For illustrative purposes only.

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