SILVER BRIDGE Institute

Thought Leadership

Silver Bridge Insights

Silver Bridge Institute is an innovative educational platform focused on empowering the broader community of individuals, families and the next generation to become more engaged in their financial lives.

The educational curriculum provides a knowledge base and a unique set of tools for continual and collaborative learning.

A Fresh Perspective on Asset Allocation: Aligning Your Investments with Your Goals

July 6, 2011

In May, 2011, Silver Bridge clients and guests explored goals-based investing with Ashvin Chhabra, creator of the innovative Goals-Based Wealth Allocation framework. The discussion explored new thinking in wealth and risk allocation for families and its importance in today's challenging market environment.

In setting the stage, Chhabra asked the audience to consider that one of the goals that motivates people is a desire to move up the wealth spectrum: out of poverty and into the middle class; upper middle class to affluent; and wealthy to truly rich. How is this achieved? A review of the principle sources of wealth generation for the names on the 2009 Forbes 400 list offers some insight: 8% of the people achieved their wealth through real estate; 12% inherited their wealth; 20% were investors/investment managers; and 60% were business owners.

The distinguishing characteristic of these wealth generating investments—real estate, hedge funds, private equity, and business ownership—is that they require leverage and concentration of assets in order to achieve big payoffs, which necessitates taking substantial risk. And, he further pointed out, substantial risk of capital flies in the face of traditional asset allocation.

A Historical Perspective

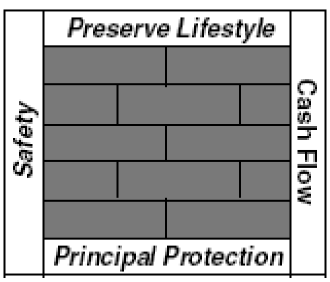
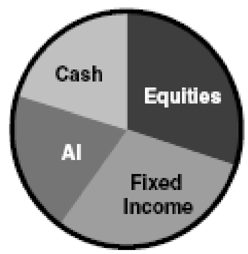
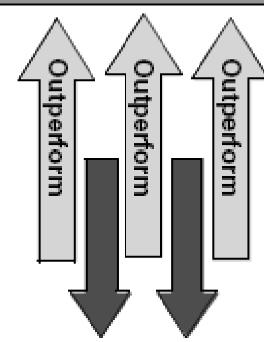
Investors have long been coached to understand asset allocation as a framework that involves dividing an investment portfolio among different asset categories, such as stocks, bonds, and cash. The asset allocation mix that works best for an individual and their family changes during their lifetime and will depend largely on their time horizon and their ability to tolerate risk, with time horizon and risk being a very individual matter.

As in life, investment risk and reward are inextricably entwined. Investing involves accepting some pre-set degree of risk in order to achieve potential gain. Factor in the individual's time horizon for the intended use of the monies (the goal), either short-term or long-term, and you have the necessary elements to create a simple asset allocation framework. Further consider diversification, the strategy of spreading your money among various investments in the hope that if one investment loses money, the other investments will more than make up for those losses, and you are describing the well known framework of Modern Portfolio Theory.

Investment firms have spent considerable years and money to explain how Modern Portfolio Theory, the amount of risk an investor is willing to assume (as measured in terms of standard deviation) set against the return they are trying to achieve, will plot along a curve known as the Efficient Frontier, which is the preferred position for a diversified portfolio to be in to eliminate idiosyncratic risk.

And while long considered the primary path toward achieving wealth preservation, there is more thought and effort needed to move up the wealth spectrum. This is where idiosyncratic risk and new thinking in asset allocation intersect.

The Wealth Allocation Framework: The Three Dimensions of Risk

"Personal " Risk	"Market " Risk	"Aspirational " Risk
		
"Do Not Jeopardize Basic Standard of Living"	*"Maintain Lifestyle"*	*"Enhance Lifestyle"*
• Minimize downside risk • Safety • Accept below-market returns for minimal risk	• Balance risk and return to attain market-level performance from a broadly diversified portfolio	• Maximize upside • Take measured risk to achieve significant return enhancement

Source: Chhabra, Ashvin, "Beyond Markowitz: A Comprehensive Wealth Allocation Framework for Individual Investors," Journal of Wealth Management, Spring 2005

New Thinking in Asset Allocation

Ashvin Chhabra's work sets forth the premise that upward wealth mobility is unlikely without the assumption of idiosyncratic risk. And wealth mobility, as defined by keeping up with your wealth segment and not moving down market, requires structuring your portfolio within three dimensions of risk: personal risk, market risk, and aspirational risk.

In Chhabra's presentation of his Wealth Allocation Framework the three buckets include one each for Personal Risk, Market Risk and Aspirational Risk. The Personal Risk bucket is essential for providing protection against financial losses that could jeopardize the client's lifestyle. This is typically the home for assets with high liquidity and of a short duration. These assets rarely provide for upward wealth mobility.

The more traditional application of asset allocation takes place in the Market Risk bucket; and these funds are earmarked for maintaining personal lifestyle. As the overall market goes up and down, so will these broadly diversified assets. Risk and return are weighed against each other to achieve the optimal return under normal market conditions.

In order to achieve upward wealth mobility, the individual and their family must take on measured risk. This Aspirational Risk is unique and personal in nature, and may involve alternative investments, private equity/hedge funds, investment in real estate, small business ownership, or concentrated stock and stock option positions. The opportunity and the challenge for the Client Advisor is in properly identifying, organizing, implementing, and maintaining the portfolios to satisfy the client(s) goals.

Simplicity: An Integrated Goal Based Approach

Goal	Accounts	% Invested	Personal	Market	Aspirational
Retirement Life Style	Brokerage Account	30%	40%	60%	0%
	IRA Account	5%	20%	80%	0%
	Private Investments	10%	0%	0%	100%
	Employee Stock & Stock Options	10%	0%	0%	100%
Legacy Wealth Goal	Trust Account 1	10%	20%	80%	0%
	Trust Account 2	10%	20%	80%	0%
	Trust Account 3	20%	40%	60%	0%
Charity Goal	Charitable Trust Account	5%	0%	100%	0%
Total Portfolio (Including All Goals)		**100%**	**25.0%**	**55.0%**	**20.0%**

Source: Chhabra, Ashvin, "Creating a Goal based Wealth Allocation Process: (Journal of Wealth Management, Winter 2008)

This new thinking has a certain elegant simplicity when viewed across an individual or family's various accounts and investments. Chhabra has presented his concept to many wealthy individuals over the past few years and he shared a favorite quote; it is worth repeating here: "If you cannot explain the essence of the advice in a few sentences, chances are the more complex output is of very limited value." For Chhabra, the most important risk to a family is not loss in the portfolio. The most important risk to a family is not meeting its goals.

1 Ashvin Chhabra is Chief Investment Officer, Institute for Advanced Study, Princeton, NJ and is the architect of the Wealth Allocation Framework that integrates Modern Portfolio Theory with the field of Behavioral Finance. He is also formerly Managing Director, Wealth Management at Merrill Lynch, and Head of Quantitative Research at JP Morgan.

2 Portfolio Theory was first introduced in modern terms by Harry Markowitz in 1952 in the Journal of Finance. Thirty-eight years later, he shared a Nobel Prize with Merton Miller and William Sharpe for what has become a broad theory for portfolio selection.