LORING WARD

Portfolio Perspectives

Monthly Insights for Investors

The Effect of Diversification

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"Don't put all of your eggs in one basket."

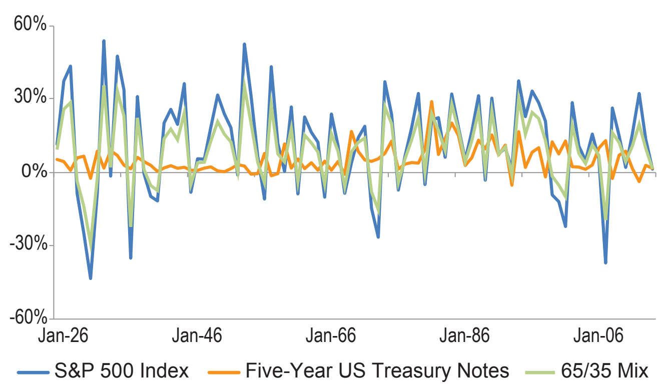
You've probably heard this old saying used on more than one occasion to emphasize the need for a diversified portfolio.

Though diversification does not guarantee a profit or protect against a loss, a combination of asset classes may reduce a portfolio's sensitivity to market swings because different assets — such as bonds and stocks — react differently to adverse events. For example, during the 2008 financial crisis the stock and bond markets moved in opposite directions, with stocks down 37% and bonds up 13% for the year.[1] So if a portfolio is diversified across both markets, downward movements in one may be offset by positive results in another. And even when stock and bond markets move the same direction, their movements may not be the same magnitude, which may also help reduce portfolio swings.

The chart below shows the annual returns of U.S. stocks, U.S. bonds and a combination of 65% stocks/35%[2] bonds from 1926 through the end of 2015. The magnitude of returns for stocks, both positive and negative, was much greater than those of bonds in almost every year with only a few exceptions over the 90-year period. By combining both stocks and bonds, the returns were steadier on a year-to-year basis than only stock returns, as illustrated by the green line.

Stocks, Bonds and a Diversified Portfolio

Annual Returns 1926 through 2015



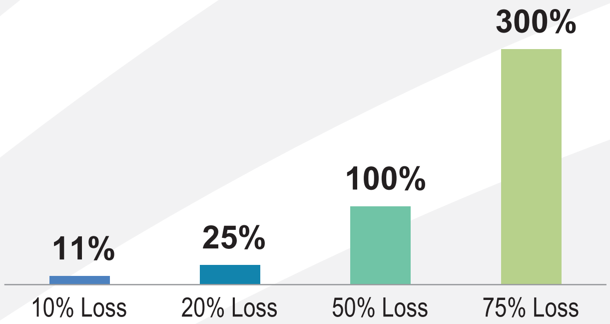
Past performance does not guarantee future results. Indexes are unmanaged baskets of securities in which investors cannot directly invest; they do not reflect the payment of advisory fees or other expenses associated with specific investments or the management of an actual portfolio.

Stock investing involves risks, including increased volatility (up and down movement in the value of your assets) and loss of principal.

Bonds are subject to market and interest rate risk. Bond values will decline as interest rates rise, issuer's creditworthiness declines, and are subject to availability and changes in price.

Although the upside potential for annual returns from the diversified portfolio may also be more limited, the long-term growth potential of the diversified portfolio may be greater. This may seem illogical given the fact that the historical long-term annualized return for stocks is greater, but this underscores the impact of portfolio volatility on long-term growth.

Return Required to Break-Even after Loss



One benefit of diversification is its potential to protect a portfolio from large losses, which can have a devastating effect on a portfolio's long-term growth. The larger the loss, the greater the amount needed to recover or "break-even" and this amount grows exponentially as losses increase. As shown in the chart on the left, an investment that declined 10% would need an 11% return to break even. If an investment declined 75%, it would need a 300% return to restore its original value.

The time required to recover losses is largely dependent on the particular market environment and/or the sequence and magnitude of returns following the loss. Depending on individual circumstances, as the return required to recover grows, a full recovery may not be achievable in an investors' lifetime. All the more reason to diversify to help potentially avoid large losses.

[1]Stocks measured by S&P 500 Index and bonds measured by Five-Year U.S. Treasury Notes. S&P 500 represented as the Standard & Poor's 90 from 1926 to March 3, 1957; the Standard & Poor's 500 Index from March 4, 1957 to 2015.

[2]65/35 Index Mix: 2% Cash, 16% ST US Fixed Income, 17% Global Bonds, 15% US Large, 12% US Value, 8% US Small, 4% US REITs, 14% Intl Large Value, 7% Intl Small, 5% Emerging Markets Value; rebalanced annually. Treasury notes are guaranteed as to repayment of principal and interest by the U.S. government. Foreign securities involve additional risks, including foreign currency changes, political risks, foreign taxes, and different methods of accounting and financial reporting. Fixed income investments are subject to interest rate and credit risk. Emerging markets involve additional risks, including, but not limited to, currency fluctuation, political instability, foreign taxes, and different methods of accounting and financial reporting. Real estate securities funds are subject to changes in economic conditions, credit risk and interest rate fluctuations. All investments involve risk, including the loss of principal and cannot be guaranteed against loss by a bank, custodian, or any other financial institution. The risks associated with investing in stocks and overweighting small company and value stocks potentially include increased volatility (up and down movement in the value of your assets) and loss of principal.