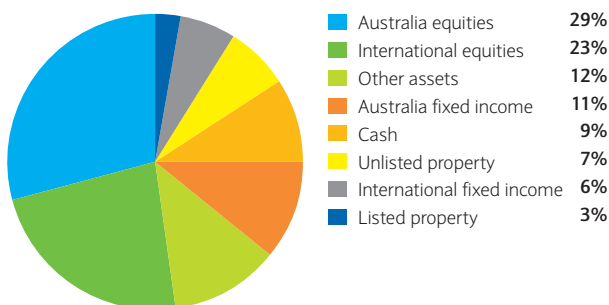


# STRATEGIC ASSET ALLOCATION (SAA)

## What is Strategic Asset Allocation?

One of the first decisions when investing is to choose the broad categories of investments (or asset classes) to include within the overall portfolio and how much to invest in each. The resulting long-term portfolio mix of broad asset classes (equities, property, bonds, cash, etc) is commonly known as the *strategic asset allocation*, or *SAA*. This represents the asset mix that will be adopted over the medium to long term in order to achieve the portfolio investment objectives. The chart shows a typical SAA for a diversified portfolio, much like many default investment options offered by superannuation funds.

### Sample Strategic Asset Allocation



Setting the SAA of an investment portfolio requires the investor to make assumptions regarding the return, risk and correlation characteristics of each individual asset class. Having done this, an *optimal* portfolio can be constructed which best meets the needs of the particular investor. Changing any of the assumptions regarding the underlying asset classes or the investor's requirements will almost certainly give a different outcome in terms of the optimal SAA.

Predicting asset class returns is, however, extremely difficult. One of the best ways to manage overall portfolio risk is to diversify across a broad range of different asset classes, styles, geographies, and sectors, thus limiting exposure to any one particular asset class.

## Historical trends in SAA

SAA traditionally considered a small number of broad, widely recognised, developed asset classes, similar to those shown in the pie chart. More recently however in the search for further portfolio diversification and additional sources of uncorrelated returns, many portfolios have moved towards a much broader array of asset classes within their SAA. It is not uncommon to see allocations to infrastructure, private equity, unlisted property, hedge funds, emerging market equities, and small-cap equities. Many of these asset classes are available as ETFs globally, and in time the product offering in Australia will expand to include more of these.

## How should SAA be implemented?

Having set the portfolio SAA, the aim is simply to match the broad market exposures as closely as possible, at reasonable cost and with minimal portfolio volatility. Put simply, the SAA should be implemented, taking into account the three most important factors for any investment portfolio – *return*, *risk* and *cost*:

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**Return** The investments should seek to match the returns of widely recognised benchmarks, representative of each individual asset class. For example, an US equities investment might seek to match the returns of the S&P 500 Index.

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**Risk** Volatility of returns relative to the chosen benchmark (also known as *tracking error*) should be minimised. This is best achieved by investing in passively managed strategies, which aim to closely track their stated benchmark.

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**Cost** Lower fees and expenses means higher returns to the portfolio. Access to simple, diversified, broad market returns is available at low cost via passively managed index strategies.

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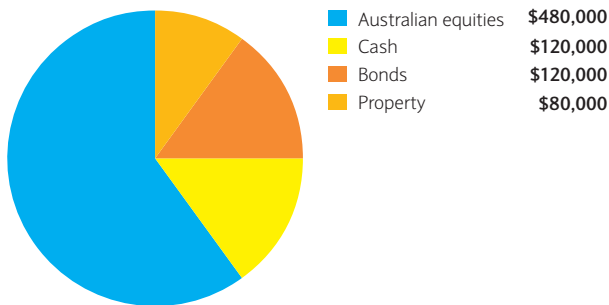
## Client case study – Tim and Julia

- **Age:** 40s ■ **Portfolio:** 100% Australian ■ **Interests:** entertaining their young family
- **Goal:** complement their Australian portfolio with broad international exposure

### Meet Tim and Julia

Tim and Julia's portfolio consists of Australian equities, property, bonds and cash. Even though they have diversified Australian investments, because their assets are all domestic they would like to diversify their portfolio internationally.

### Tim and Julia's portfolio



### Factors important to their decision:

- **Risk:** they are becoming more confident in investing in overseas markets that are similar to Australia
- **Time horizon:** they are looking to buy and hold because the focus is on long-term diversification and wealth creation
- **Single stock risk:** They do not wish to pick single stocks as they do not know the markets intimately
- **Cost:** they do not want it to cost more than their Australian investments

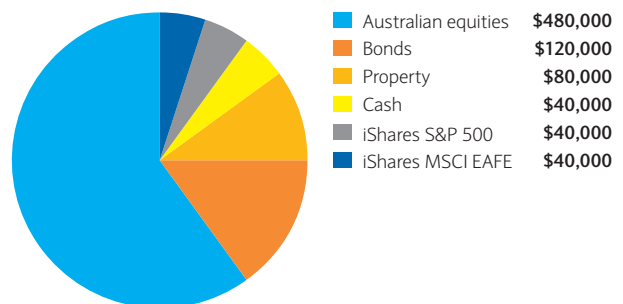
### Working with a financial adviser

Tim sets up a meeting with their financial adviser to discuss their options. Developed markets fit best with their risk profile, and after talking through the product options they choose exchange traded funds for their cost-efficiency and diversification.

The financial adviser shows them that an equal investment in the iShares S&P 500 (ASX: IVV) and the iShares MSCI EAFE (ASX: IVE) will give them an international solution that is highly correlated to the MSCI World ex-Australia<sup>SM</sup> benchmark. Tim and Julia are surprised that they can get this exposure with just two ASX trades, through the same process as buying Australian equities and at a cost of just 0.215% per annum.

They direct their adviser to use existing cash to purchase \$40,000 of each iShares ETF. In the usual T+3 settlement cycle, their adviser confirms their new portfolio.

### Tim and Julia's new SAA



## The outcome

### Good for the client:

- ✓ Broad developed international exposure – developed markets focus with no need to pick stocks.
- ✓ Comfort around the process – same as buying shares.
- ✓ Fees were much less than expected, and significantly cheaper than domestic managed funds.

### Good for the adviser:

- ✓ Client is happy with the solution.
- ✓ Offered a differentiated level of service.
- ✓ Greater control over risk and cost through the new SAA.

For more information visit [iShares.com.au](http://iShares.com.au) or call 1300 iShares (1300 474 2737)

### Important information

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