



# ASSET ALLOCATION

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## Asset Allocation and Bad Habits

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This article documents the “bad habits” of investors in asset allocation practices. Whereas financial markets exhibit momentum over multi-month horizons but more reversion to the mean over multi-year horizons, many investors act like momentum investors even at these longer horizons.

Both these patterns are well known anecdotally but have not been well documented statistically, especially together. This article therefore addresses two empirical questions: How do funds reallocate based on past returns? And what are momentum/reversal patterns in financial markets returns?

In addressing the first question, the authors provide direct evidence using the CEM Benchmarking Inc. data on pension fund target allocations over a 22-year period. In addressing the second question, they provide evidence using more than a century of data.

Merging the findings from the two data sets provides evidence consistent with the premise that investors chase returns over multi-year horizons, which is likely to hurt their long-run performance. However, the statistical evidence on pro-cyclical multi-year asset allocations and multi-year mean reversion patterns in asset-class returns is on the borderline of statistical significance.

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