



ASSET ALLOCATION

Strategic Risk Allocation

2Q 2014

How should investors approach strategic asset allocation? Within categories, we believe they should broadly diversify and risk balance as a starting point, but perhaps mildly deviate toward overweighting assets with high Sharpe ratios or good diversification benefits if they can identify these.

However, when deciding on broad categories (building blocks for top-down decisions) and weighing across them, investors cannot rely on risk parity or Sharpe ratio estimates. Instead, they should identify the most important “real-world” considerations and incorporate them as best they can. Introspection (“know thyself”) and heuristic short-cuts (such as the “4 Cs” — conviction, constraints, conventionality and capacity) can help them go beyond quant tools.

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