

7Twelve Allocation Strategy: In Review

By: Laurie Skwerer, CFA, MBA, CIO

As we rapidly approach the end of 2010, a year during which TriPillar Investments portfolio returns are on pace to nearly double those of the market, we would like to take a moment to review the investment management process which has so greatly contributed to our outperformance. The "**7Twelve Asset Allocation Strategy**" was created by Dr. Craig Israelsen. Dr. Israelsen has based his strategy upon the tenets of the **Modern Portfolio Theory** (MPT). Nobel Prize winner Harry Markowitz first introduced the MPT in 1952. It became the gospel of all theoretical investment strategies for many decades.

The **7 Twelve** strategy is both intuitive and logical: Broad portfolio diversification among multiple asset classes will, in the long run, deliver better volatility-adjusted returns than traditional approaches which utilize fewer asset classes. The simplicity of the **7Twelve** methodology is particularly appealing as Dr. Israelsen has identified 7 core asset classes and provided additional guidance regarding the distribution within each class.

The construction of the portfolio is analogous to the assemblage of a team. Ideally, each component will be excellent on its own merits, with each player bringing a unique attribute to the table such that the sum is greater than the value of the individual parts. In addition, the players move in different but complementary manners.

In the investment world there is only one truly free commodity: **diversification**. By adding non-correlated assets to a portfolio an investor will potentially achieve higher returns with less risk. Correlation is measured between two assets and ranges from +1 to -1. If two assets are highly correlated they will move in the same direction most of the time and their correlation will be close to 1. The lower the correlation between assets the greater the benefit derived by adding the additional asset to the portfolio.

Dr. Israelsen's **7Twelve Balanced Strategy** has adhered fairly closely to the classic 60/40 rule of thumb for portfolio construction. US equity represents approximately 25% of a moderate risk portfolio, Non US equity about 17%, Real estate about 8%, Natural resources approximately 17%, Domestic Bonds 17%, Non US bonds about 8% and cash the remaining 8%. Within the domestic equity portfolio the 7Twelve fund is further diversified among large, mid and small capitalization stocks. In regard to non US equities there is a 50/50 breakdown between developed and emerging markets. The resource allocation is divided between commodities and natural resources. US bonds are split evenly between inflation protected bonds and an aggregate bond fund. This results in, and is the reason why we have, twelve sub-asset classes.

How has this strategy fared? A portfolio of \$10,000 beginning in 2000 would have grown to \$20,655 by year end 2009. This compares with \$9,019 from a \$10,000 investment in 2000 in the Vanguard 500 Index fund, a duplicate of the S & P 500. If an investor had chosen a simply 60/40 balanced approach at the beginning of 2000, investing in the Vanguard Balanced Index he would have done a bit better, ending with a balance of \$12,978. These results are due to the low level of correlation among the funds in the passive **7Twelve** portfolio which averaged .34 during the time period measured. Here at **Tri Pillar Investments**, we have added even more value to the **7Twelve**

strategy through our individualized, risk adjusted active portfolio management and mutual fund/ETF selection process.