LPL FINANCIAL RESEARCH

mixing it up

ASSET ALLOCATION - BUILDING ONE PORTFOLIO AT A TIME

LPL Financial

Your investment portfolio should reflect not only your financial needs but also your attitudes toward risk, savings, and wealth. Effective asset allocation helps drive that balance between risk and reward.

MEETING INVESTOR GOALS

LPL Financial Research applies its asset allocation process to more than 200 portfolio models that your financial advisor may choose from or take into consideration when creating your investment plan.

Asset allocation is important because, when investing in multiple asset classes, your portfolio may perform more consistently over time and it may minimize the risk of underperformance. Market conditions that can help one asset class to perform well may cause another to have average or poor returns over the same time period. And, a portfolio consisting of a diversified group of investments may be able to limit your losses and reduce the fluctuations of investment returns without sacrificing potential gain.

Our collaborative process between members of our team with specific expertise ensures that all of our models are well diversified—not only among broad investment types (equities, bonds, cash, and alternative strategies), but also attempts to have the most optimal mix to meet your objectives.

Adapting to Market Conditions

LPL Financial Research provides advice and implements both strategic and tactical asset allocation models. The key difference between these two types of advice is the timeframe over which we are targeting investment opportunities.

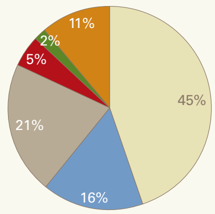
Our strategic asset allocation process looks out over a three- to five-year time period. Quarterly, we retest the strength of our asset allocation recommendations. However, we do not anticipate making adjustments until "halftime" of our strategic timeframe, which generally is about every two to three years. If significant market fluctuations warrant a change, however, we may make adjustments sooner, though we anticipate this being a very rare occurrence.

Relative to strategic asset allocation, tactical models are designed to focus over a much shorter timeframe, and potentially take advantage of opportunities as short as a few months. Tactical asset allocation is not the same as "market timing." Rather, more timely changes can allow portfolios to benefit from rapidly changing opportunities within the market.

*Growth with Income: Investors in this portfolio should have a long time horizon, and an understanding of the volatile history of equity investments. The primary investment objective of this portfolio is growth of principal. Fixed income assets are included to generate income and reduce overall volatility.

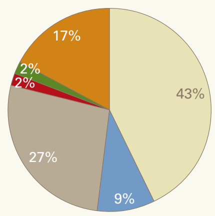
GROWTH WITH INCOME* MODELS

The models we create are set within the five investment objectives that cover the risk spectrum. The five pie charts below depict examples of models we recommend that meet specific investor needs.



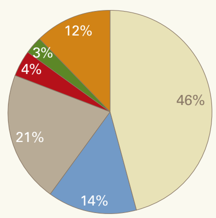
Alpha Focused

Alpha Focused portfolios seek higher excess return but with higher overall volatility.



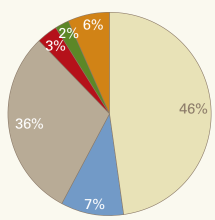
Downside Risk Aware

Downside Risk Aware portfolios seek to outperform, especially in down markets, by lowering overall volatility and minimizing surprises.



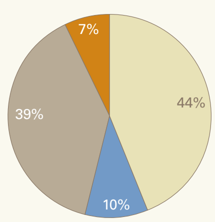
Income Focused

Income Focused portfolios attempt to generate significantly higher overall yields with a secondary goal of moderating volatility.



Socially Responsible

Socially Responsible portfolios utilize socially responsible investments and adhere to differing sets of social objectives or constraints.



Tax Aware

Tax Aware portfolios seek to minimize the impact of taxes and are made up of investments that explicitly pursue a tax aware strategy or have historically shown a penchant for minimizing realized taxes.

US Equity | Intl Equity | US Bond
Intl Bond | Other | Cash

Focus on the Big Picture

The LPL Financial Research asset allocation process is a multi-disciplined, collaborative effort. Each week potential investment opportunities are discussed with the goal of augmenting and refining shorter term asset allocation, while still ensuring a focus on the "big picture" investment environment.

As part of the asset allocation process analysts focus on several factors.

- Risk Analysis is the start of the asset allocation process. Understanding when the market environment is rewarding or penalizing risk-taking helps to set the framework of the asset allocation to either a defensive or opportunistic tone.
- Insight on current factors that are impacting the markets such as U.S. and global economic growth, corporate earnings trends, market sentiment, interest rates, monetary and fiscal policy, and geopolitical concerns.
- Vital details on the ever changing fundamental and valuation inputs to the different sectors and asset classes. We believe that prices matter and spend time understanding which investment opportunities offer the best risk/reward tradeoff.
- Consolidated views from the hundreds of portfolio managers we recommend and monitor. This valuable input provides an important complement to our ideas and investment process.
- Data and analysis tools to help make solid tactical decisions. Quantitative analysts provide real time, technical overlay to our process on asset allocation, helping us to not only make the correct decision on which asset class to allocate to, but also providing us with the optimal time to make that decision.

Whether we are heading into a recession or bull market, we make decisions that can work with the current environment while keeping an eye on conditions down the road.

Our definitive asset allocation process, coupled with a strong manager selection methodology, allows us to create portfolios that are intended to outperform, do it often, and minimize surprises.

Real Time Decision Making

Our investment decisions and model portfolios are monitored closely on a daily basis against their benchmarks, peers, and our own internal metrics. We review each model's risk and return characteristics daily and formally review them at bi-weekly meetings that cover: market capitalization, sector exposure, duration, credit quality, foreign exposure, equity style (growth versus value), and tracking error.

Additionally, we track daily, weekly, monthly, and quarterly performance reports on the investment vehicles within the models, as well as how the investment decisions have contributed to overall performance. Knowing how our tactical decisions have performed in the past, and more importantly, why they performed the way they did is a critical input to the decision making process.

Sell Discipline

Our sell discipline framework helps take much of the emotion out of the investing process and helps us monitor the risk/return characteristics of our trades on a real time basis. The sophisticated and in-depth sell discipline is an important part of our risk control and portfolio monitoring process. Our sell discipline enables us to determine:

- **How long we should wait until we sell an investment idea to avoid further losses?**
- **How long do we stay with a successful investment idea without getting greedy?**

The result is our team can focus on the continued validity of the investment thesis, or simply put, the basis for the trade determined at the outset of creating the model. We review such factors as macro variables, valuations, fundamentals, and technicals—to ensure whether or not the thesis is still valid.

Once a decision has been made, we track the risk and return expectations, and how the model is performing relative to its peer group.

BELIEFS THAT DRIVE OUR ASSET ALLOCATION

We stand by our ability to provide effective, unbiased asset allocation recommendations that are uniquely suited to meet a variety of investment objectives.

The foundation of a solid process is a set of beliefs that drive it. Determining beliefs helps to maintain focus, build consensus, and promote success. More importantly, these beliefs provide guideposts to assure a constant application of a disciplined investment philosophy.

The essential building blocks of any asset allocation process and its subsequent recommendations are to first understand what one stands for. These beliefs, outlined here, help drive the LPL Financial Research asset allocation framework that positions you with the best opportunities for investment success.

- **Price matters.** There is really only one rule that works in investing: buying low and selling high garners positive returns. Knowing the price of an asset class relative to its historical trends helps to determine the future price of that asset class. In the end, one can only achieve an average rate of return if one starts at an average price. By focusing on asset classes that are poised to benefit from reversion to the mean, LPL Financial Research positions clients for future success. Thus, we believe that where one starts is a key determinant of where one ends up.
- **There is no value premium.** We do not agree with an industry misconception that there exists a value premium, which implies that the value style is a fundamentally better investment than growth. In the end, the value style is not always undervalued relative to growth. Thus, our price matters belief drives our process to focus on the style, value or growth, which has the best opportunity for future success. Additionally, history shows that the key differential in total return between value and growth has been the yield spread (difference in dividends); however, this differential has been on the decline. We believe that allocations between value and growth should not be predicated on an imbedded value premium, but rather which offers the better chance of future success.
- **There is no small cap premium.** Similar to the value premium argument, the industry has a misguided belief that small cap stocks offer a return premium over large cap stocks. History shows that small and large company stocks are both attractive, but neither offers a consistent return premium over the other. Thus, we believe that allocations between different market caps should not be based on an implied premium, but rather which offers the better future investment opportunity.
- **There is neither an international premium nor international discount.** With continued globalization, some of the inherent risk exposure and return benefits historically present in international investing are becoming more negligible. Therefore, international investment should be viewed as another option in the asset allocation puzzle—on par with other domestic equity investments. We believe that there is not an inherent premium or discount in international investing.
- **Implementation matters.** There are three levels of asset allocation: strategic asset allocation, tactical asset allocation, and implementation. The best strategic asset allocation or tactical asset allocation is irrelevant if one cannot invest to take advantage of these opportunities. We believe

Not only must our asset allocation be something our advisors can implement, but also it must also be something they want to implement for you. We believe we must take your needs and wants into consideration when creating our asset allocation models.

in creating an asset allocation recommendation, we must ensure the resulting strategy can be optimally implemented.

- **More diversification is better than less.** Though we always position the portfolios to the most attractive asset classes, there is always the risk of being wrong. The best hedge for being wrong is to diversify. We believe allocating assets to more investments than less—if done with consideration to how those investments combine—is prudent.
- **Each asset class warrants its own spotlight.** Each asset class being considered for usage in our asset allocation models deserves it own set of expected return and risk assumptions. Simply making assumptions for the core asset class and then dividing the consequent allocation to get style or cap allocations is not effective. We believe all asset classes are not equal—nor should their expected risk and return assumption be.
- **Cash needs to be managed too.** Cash is an important component of a portfolio. It can offer downside protection qualities and reduces the need for multiple transactions when clients need distributions. However, our goal is to garner long-term returns above those attained by cash. We believe, therefore, that the right balance of return potential and distribution convenience needs to be weighed at all times when establishing the strategic and tactical weights to cash.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide or be construed as providing specific investment advice or recommendations for any individual. To determine which investments may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

Stock investing involves risk including loss of principal.

The Standard and Poor's 500 Stock Index (S&P 500) is an unmanaged index generally representative of the U.S. Stock Market, without regard to company size.

Investments in specialized industry sectors have additional risk such as credit, regulatory, operational, business, economic and political risk which should carefully be considered before investing.

Principal Risk: An investment in an Exchange Traded Fund (ETF), structured as a mutual fund or unit investment trust, involves the risk of losing money and should be considered as part of an overall program, not a complete investment program. An investment in ETFs involves additional risks: not diversified, the risks of price volatility, competitive industry pressure, international political and economic developments, possible trading halts and Index tracking error.

Asset Allocation does not ensure a profit or protect against a loss.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not ensure against risk.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price.

Small-cap stocks may be subject to higher degree of risk than more established companies' securities. The illiquidity of the small-cap market may adversely affect the value of these investments.

International and emerging markets investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

Alternative investments may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor's portfolio. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses.

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