Reserve

Build diversification into your portfolio

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Planning your investment is like building your own financial skyscraper.[1] And, like building a skyscraper, you need a blueprint, the best construction materials, the best suppliers, the best tools and the best architect to build the tallest.

To elaborate on this analogy:

- Your blueprint is your financial plan
- Your materials are the assets you choose
- Your tools would be the investment product you use
- Your suppliers are the investment providers
- Your architect is your financial adviser

However, there is one more important point you should not miss while you are building your financial skyscraper. You have to stick to your blueprint. When you find yourself standing on the girders of the 50th floor in a howling wind, do you dare to continue building upwards?

In investments, howling winds are like market crashes, risks or volatility. The stronger the wind, the more likely you are to give up building the skyscraper and cash-out your investments at a low point.

Remember, the objective of investment is not only to get rich, but also not to get poor. You may consider that losing money is your biggest risk, but not meeting your future needs is another, perhaps bigger risk.

Diversification in investment terms is the practice of spreading financial risk across several different asset types, to reduce the likelihood of a large loss in your portfolio. It acts as a safety net while you continue building your financial skyscraper and can help you to meet your goals without worrying about the howling winds of market volatility.

If you look at it holistically, in addition to spreading risk across different asset classes, diversification is also about spreading your financial risk across:

- different geographies or markets
- different fund managers
- different products or investment vehicles
- different currencies

As each of these elements has a different risk profile, making several different investments can be better than just a few similar ones. Each different asset class you hold reduces the overall portfolio risk. By including several different asset classes, sectors and geographies in your portfolio, you can create an efficient set of investments that work together to achieve your financial goals with less risk and potentially higher returns.

1 "The Intelligent Asset allocator" by William Bernstein and "All about Asset Allocation" by Richard. A. Ferri, CFA.

How can diversification generate a potentially higher return?

While everyone talks about diversification lowering your portfolio risk, we very rarely hear that diversification can increase your potential return. As no single asset class performs consistently over the long term, diversification using various asset classes, investment styles, themes and time horizons can give you an opportunity to improve your potential return.

Let's look at two examples:

Example 1

Portfolio 1
Customer X invested **USD 500,000** in a single fund, with a return of 6% pa over 25 years.

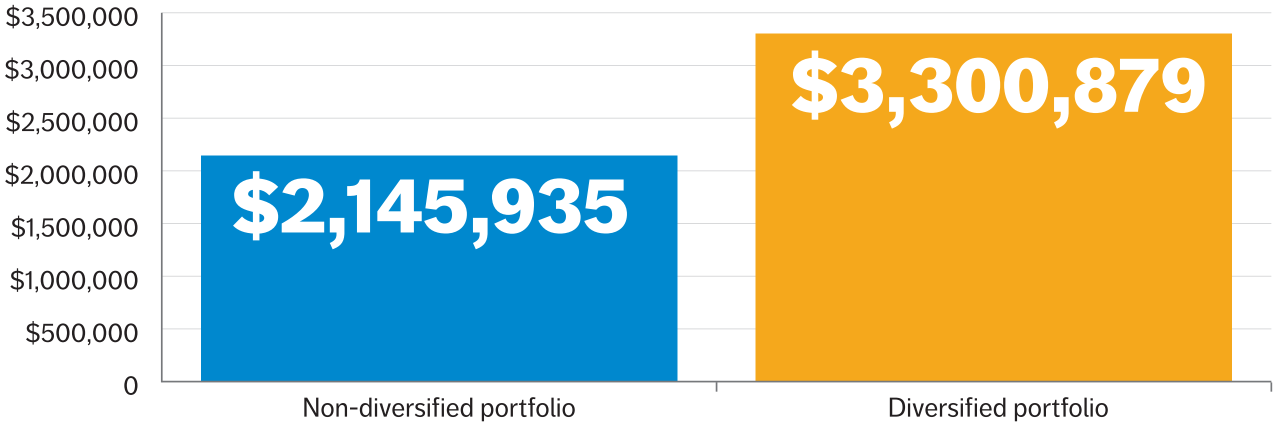
Portfolio 2
Customer Y invested **USD 500,000** in five different funds, with 20% of the investment allocated to each. The funds achieved different levels of return (see table) but with a weighted average annual return across the five funds of 6% over 25 years.

Portfolio 1 – Customer X	
Funds	**Single Fund**
CAGR[2]	6%
Invested single premium	$500,000
Amount at the end of 25 years	**$2,145,935**

Portfolio 2 – Customer Y						
Funds	**A**	**B**	**C**	**D**	**E**	**Weighted Average/Total**
CAGR[2]	0%	3%	6%	9%	12%	6%
Invested single premium	$100,000	$100,000	$100,000	$100,000	$100,000	$500,000
Amount at the end of 25 years	**$100,000**	**$209,378**	**$429,187**	**$862,308**	**$1,700,006**	**$3,300,879**

2 Compound annual growth rate.

Graph 1 – Benefits of diversification



That is a difference of USD 1.1m even when both portfolios generated the same average 6% pa return over 25 years!

The rates of return used above and on the next page are for illustrative purposes ONLY. These returns are not based on any actual past performance and the actual returns on your investments will be different. What you get back in the future depends on how your investments perform. The value of your investments can go down and up and you could get back less than you paid in. Some assets carry a higher level of risk than others and may be subject to sudden and large falls in value, this could erode some or all of you capital.

Example 2

Portfolio 1

Customer X invested **USD 500,000** in single fund with a return of 6% pa over 25 years.

Portfolio 2

Customer Y invested **USD 500,000** in 5 different instruments, with 20% of the investment allocated to each. Each of the funds achieved different returns (see table) but with a weighted average annual return across the five funds of 0.6% over 25 years.

Portfolio 1 – Customer X

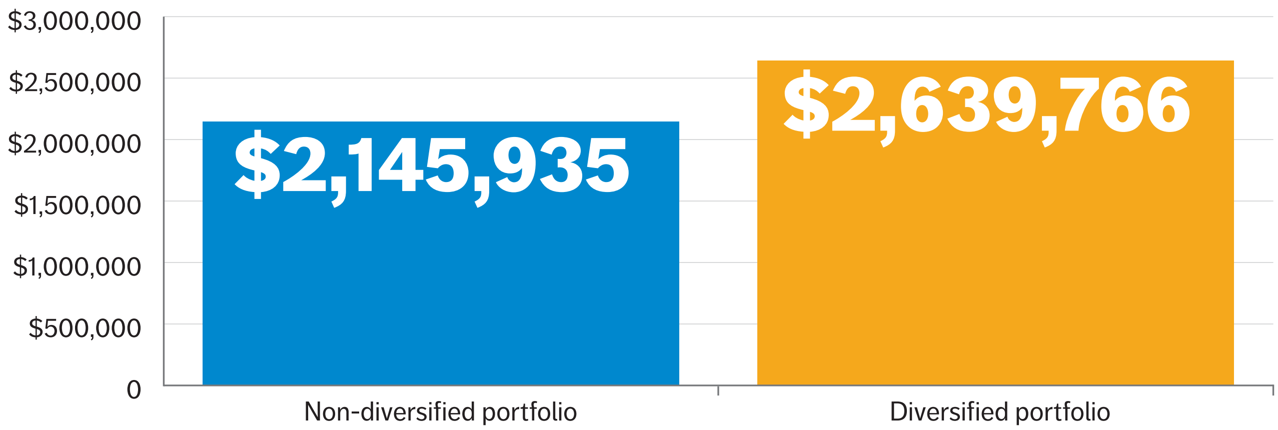
Funds	Single Fund
CAGR[2]	6%
Invested single premium	$500,000
Amount at the end of 25 years	$2,145,935

Portfolio 2 – Customer Y

Funds	A	B	C	D	E	Weighted Average/Total
CAGR[2]	-3.00%	-6.00%	-9.00%	9.00%	12.00%	0.60%
Invested single premium	$100,000	$100,000	$100,000	$100,000	$100,000	$500,000
Amount at the end of 25 years	$46,697	$21,291	$9,463	$862,308	$1,700,006	$2,639,766

2 Compound annual growth rate.

Graph 2 – Benefits of diversification (negative returns)



That is a difference of USD 493,831 after 25 years even though three of the funds have lost value.

How is this possible?

It is due to compounding effect, which is a function of simple mathematics. Because Customer Y has diversified, he gave himself an opportunity to earn higher returns from at least two of his investments which resulted in his portfolio beating Customer X's investment in a single fund.

Whilst these are extreme examples, the point is that diversification, into carefully selected assets, can reduce your portfolio risk and could provide potentially improved portfolio returns.

Reserve gives you access to a very wide range of assets including stocks and shares, bonds, alternatives and mutual funds across various geographical areas In fact, customers can access most investments available on a recognised exchange, meaning portfolio construction can be optimised to meet their needs. Reserve gives you the flexibility to diversify your investments which could then provide a safety net for your portfolio.

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LAST WORD

Reserve gives you the flexibility to not only reduce risk but improve returns on your investment.

One product | Limitless possibilities

Next steps

01 Visit **https://www.fpinternational.ae/invest/products/reserve/** to find out more.

02 Speak with your customers to learn more about their financial goals and which investments are best suited to their circumstances.

03 Inform your customers that they can manage their portfolio online on our Portal by simply registering at **https://portal.fpinternational.com**.

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