New paradigms in equity allocations

The art and science of strategic equity allocation

Federated Hermes Multi-Asset Group

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Key takeaways

- **Growth has become increasingly scarce and investors have been willing to pay a premium for companies exhibiting higher growth rates.**
- **Value, long a potential source of excess return, has gone through a long period of underperformance versus growth.**
- **Along with non-US and small cap stocks, the disruption in long-term asset class relationships has caused us to re-evaluate our long-term target asset allocations.**

Our profession teems with adages, especially warnings, about extrapolating historical data. However, asset allocation is necessarily bound by historical data analysis and long-term trends. As asset allocators, we take historical data, put it into the current context and make our assessments from that.

While the post-war economic boom shaped the last half of last century, the current environment has been shaped by the events over the last 25 years. The mega-cap technology trend has shaped the current state of the equity market, but it is not the only trend that has come into play. The dot-com bust, the real estate crash and subsequent recession, prolonged low interest rates, the global pandemic, an inflation flare-up and the march of technology have had tremendous effects on the allocation paradigm for long-term investors.

What we've observed

1. Scarcity of growth

We have seen the major US indexes become dominated by a narrow group of technology-driven growth companies. Outside of these companies, growth opportunities have become increasingly scarce. Because of this, investors are willing to pay a premium for these companies that exhibit higher growth rates as a way to pursue higher returns. There are few alternatives, which has driven the prices of these stocks even higher. One indication of growth scarcity is the Russell style index membership. The Russell 1000® style indexes are roughly equal in market capitalization and sorted by valuation statistics, with some overlap in names. As of September 30, 2025, the Russell 1000® Growth Index had 391 members and the Russell 1000® Value Index had 870 members. The scarcity of growth is both literal and figurative.

Exhibit 1: Number of stocks in Russell Large Cap Indexes (9/30/25)

Index	Number of stocks
Russell 1000® Value	870
Russell 1000® Growth	391

Source: FTSE Russell

The impact of the mega-cap companies is, arguably, the predominant feature of markets over the last 10 years. Called various names, from FANG to Magnificent 7, and with various memberships, these large cap growth stocks, while highly profitable for investors, have created problems for portfolio managers and asset allocators alike looking to build diversified portfolios. And they are not just growing in a vacuum. Their impact is felt throughout the markets by drawing money away from other areas.

It isn't just earnings growth that is driving their stock prices. Intangibles, or a wide economic moat, a concept associated with Warren Buffett, are qualities a company has developed that allow it to defend its profitability. While intangibles aren't necessarily a growth or value concept, the mega-cap companies have exploited their competitive advantages: branding, high barrier to entry, pricing power, etc., to build up extraordinarily large and profitable franchises. Intangibles, as the word implies, are difficult to value in a traditional sense, but they help these companies command and maintain a price premium.

Because many investment approaches embrace the fundamental tenet of diversification, the highly concentrated and transcendent returns of mega cap shares have created issues for investors seeking to diversify their return sources. These stocks have taken an increasingly larger share of the indexes in which they are members, and by extension, investors' portfolios, making portfolio diversification more difficult.

2. Value reconsideration

Early academic work into the factors that drive stock prices identified "value" – stocks with a perceived company value below the current stock price – as a potential source of persistent outperformance. But, "traditional" value factors such as low price-to-book or price-to-earnings ratios have seemingly lost some of their predictive edge. With the advance of computers and the commoditization of market data, it became easier for investors to spot “cheap” stocks, which eroded the value premium, as more investors sought those stocks.

The fact that the number of stocks in the Russell 1000® Value Index is more than twice the size of the Russell 1000® Growth isn’t a result of value stocks becoming cheaper. The performance of the growth stocks has simply far exceeded the value stocks. However, as the value cohort of stocks has grown larger, we have begun to think about them differently, no longer as a single allocation to “value” but encompassing two types of value companies, cyclical and defensive.

Cyclical value stocks tend to be more positively correlated with economic growth. Their industry, for example, may be out of favor due to the economic cycle, but otherwise healthy. Heading into a cyclical upturn, they could prove to be highly profitable.

On the other hand, defensive value stocks tend to have a low or negative correlation to the economic cycle. They would be expected to provide some type of performance cushion in a slowing growth environment. These types of companies might have a slow but stable growth rate, a consistent dividend payout or a product line with strong brand loyalty.

The number of stocks within the Russell 1000® Value Index indicates how heterogeneous that index has become. A single, unmanaged allocation to large cap value stocks may no longer capture the diverse economic sensitivities of such a large grouping. It may not provide the diversification, or hopefully excess return, sought in a multi-asset portfolio.

3. The small cap stock premium?

The performance of small cap stocks has challenged another portfolio building block of strategic asset allocation. Since Ibbotson and Sinquefield identified the small cap stock premium in the 1970s, small cap stock weightings have played a key role in investment portfolios after demonstrating long-term outperformance versus large cap stocks. But the performance of large cap stocks in general and large cap growth stocks in particular over the last decade has overshadowed other asset classes and called the persistence of the small cap performance premium into question. Despite this, over the past five years, small cap stocks, as measured by the Russell 2000® Index, have performed respectably and essentially in line with long-term stock market average returns.

Exhibit 2: Select trailing index total returns (%)

Index Name	1/1/00 through 9/30/25	1-year	3-years	5-years
Russell 1000® Index	8.18	17.75	24.64	15.99
Russell Top 200® Index	7.78	19.61	26.84	17.02
Russell 2000® Index	7.74	10.76	15.21	11.56

Source: FTSE Russell; Federated Hermes, Inc.

Past performance is no guarantee of future results.
For illustrative purposes only and not representative of performance for any specific investment.

The small cap premium rests on the concept that smaller companies are less efficient, occupy niche markets, are innovative and have higher growth rate potential (accompanied by higher risk) than large conglomerate-type companies with aging product lines, such as those that dominated the indexes in the 1970s and 1980s.

The small cap premium has been tested since the Global Financial Crisis (GFC). We believe that small caps require a combination of factors to thrive — primarily sustained economic growth and lower interest rates. Despite near-zero interest rates in the 2010s, economic growth was historically weak, making companies that could generate their own growth — namely, larger companies — more desirable, which drove their prices higher.

The harsh environment for small-cap stocks over the past 15 years was exacerbated by the Covid-19 recession, plunging interest rates and the subsequent rate-hiking cycle — each of which is difficult for smaller companies to manage in isolation, let alone in succession. We believe that the medium-term performance of small caps reflects these extended and extreme cyclical trends. We hold that the small-cap premium will reassert itself and we will continue to maintain our strategic overweight in the asset class.

4. Challenges for non-US stocks

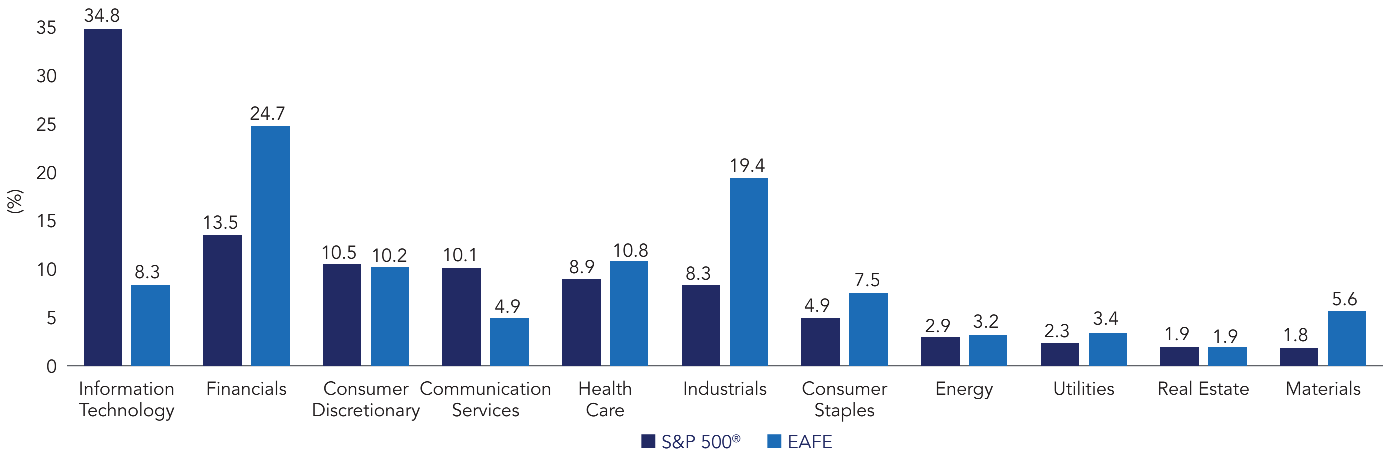
Another diversifier, non-US stocks, has lagged in performance, but in a more meaningful way. Finding the right balance between US and non-US stocks, and similarly, developed and developing stocks, has been a challenge. Allocators have long supported a significant position in non-US equities, both developed and developing, citing both lower correlations to US holdings and higher economic growth potential. However, the returns of the last 10 years have led to an erosion of confidence in investing outside the US for domestic US investors. A well-known industry observer even went so far as to publish an article titled “Are International Stocks Worth the Bother?” a few years ago.

As the S&P 500® does not fully represent the US market, neither does the MSCI EAFE Index (EAFE) represent the non-US market. The index does have some notable characteristics indicative of the choices available to US investors. With over 600 stocks, the index is similar in number to the S&P 500®, but the 10 largest holdings only represent approximately 12% of the index. Making it much less concentrated than the S&P 500®, where the 10 largest holdings represent nearly 40% of the index.

Additionally, the information technology sector is only about 8% of EAFE compared to 33% of the S&P 500®. And that 33% does not include Amazon, Meta, Alphabet or Tesla, innovators underpinned by leading-edge technologies. That is to say, EAFE is largely a “value” index. The same forces that have governed US value stocks, namely a lack of broad economic growth and the emergence of tech-dominant companies, have affected developed market stocks.

An additional headwind not to be overlooked has been until recently the strength of the dollar. But currency exposure is an additional diversifier and works both ways. A weakening dollar can work to the benefit of non-dollar asset holders and be a significant contributor to return.

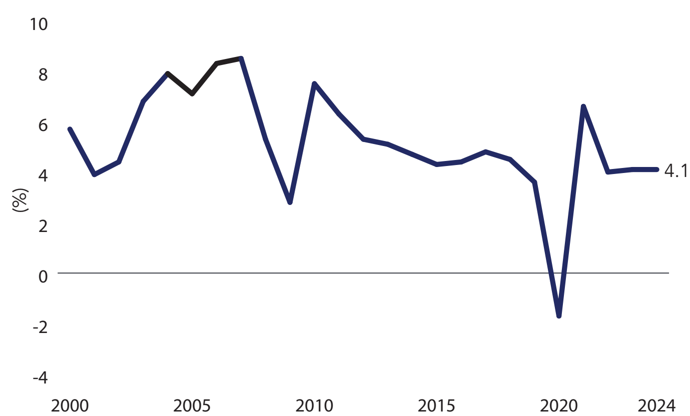
Exhibit 3: EAFE and S&P 500® sectors – US is weighted toward technology



Source: S&P Global; MSCI; Federated Hermes, Inc., as of 9/30/25

Emerging markets (EM) have faced similar forces, but their returns are more idiosyncratic and tend to be affected by macro forces such as currency strength, commodity prices, overall global GDP growth and their own domestic economies. Before the GFC, EM were on a strong and consistent GDP growth path. Since then, the two economic crises have been challenging to overcome on a long-term basis, despite a quick recovery after each.

Exhibit 4: Developing markets real GDP growth (%)



Source: International Monetary Fund through 12/31/24.

Allocation in practice

As allocators, we seek to minimize unintended risk exposures and avoid market concentrations that can contribute to downside risk. Over the last few years, we have seen clients, and those that advise them, move their allocations further from what might historically be considered normal — either a passive global benchmark or some other "neutral" position. We have seen increased allocations to US large cap stocks or a reduction in non-US exposure either by design or by not rebalancing significantly. And in the last several years, there has not been a performance penalty, except for brief periods, for being overweight in large cap growth stocks or underweight non-US stocks.

After seeing some of these historical relationships stay out of balance for longer than anticipated, we began to review our strategic allocations to see if there was a better way to create a neutral portfolio (a baseline long-term allocation that suits a client's risk preference and time horizon) and adjust asset exposures to take advantage of near-term or tactical opportunities without significantly altering a portfolio's risk exposure. We reviewed the last 10 years of performance to see if we could identify where allocation decisions could have had the most impact.

What we found

Using index returns, we examined eight basic allocation tilts (Exhibit 5) that could have potentially added value to a portfolio. We ranked those relative returns to see which decisions could have added the most value. A lower number indicates a potentially more favorable allocation decision.

Exhibit 5: Asset allocation choices ranked by relative return differential (lower rank is more impactful)

Asset class choices	Last 10 years	Last 5 years	Last 3 years	Last 1 year	Average Rank
US Large vs US Small	3	3	3	3	3
US Large Value vs US Growth	1	1	1	1	1
US Small Value vs US Growth	8	7	8	5	7
US Large vs Intl. Large	2	2	4	2	2.5
US Small vs Intl. Large	4	6	7	8	6.25
Intl. Large vs Intl. Small	7	8	5	6	6.5
Intl. Large vs EM	6	4	2	4	4
Intl. Small vs EM	5	5	6	7	5.75

Green = more impactful   Orange = less impactful

Source: Morningstar, Inc.; Federated Hermes, Inc., through 8/31/25.

Please see explanation in the Notes to Exhibit 5 on page 5.

Past performance is no guarantee of future results. For illustrative purposes and not representative of any specific investment.

The key decisions we found that we could have added value were:

- Large vs. small
- Large value vs. growth
- Domestic vs. international large
- International large vs. EM

Our experience and the data that supported it have led us to reconsider our framework for constructing a neutral, strategic allocation portfolio and what "tilts" we would consider within that framework to potentially add value.

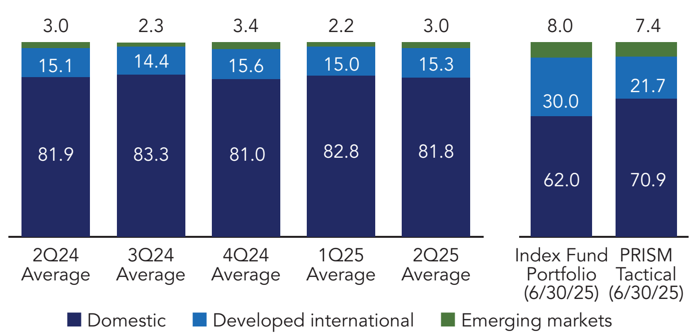
Efficient vs. livable portfolios

Looking at the key decisions above, we were faced with another challenge. Even though being contrarian — different from the consensus — may be profitable in the long run, it requires confidence and often patience in the short run.

For instance, many allocators suggest that a baseline neutral international equity (developed and developing) exposure for certain investors is upward of 20%. But the Federated Hermes Portfolio Construction Solutions team's analysis of advisor model portfolios suggests that actual non-US equity exposures are below that. Investors have a known home bias, and performance over the last decade-plus has left some questioning the need for non-US exposure. Our Multi-asset team has been looking to address the gap between "textbook" efficient portfolios and practical, livable portfolios that an investor feels comfortable with. If a suggested allocation is deemed too high, an investor may not increase exposure or avoid it altogether, thus not capturing the diversification benefits.

As a result, we are favoring lower strategic limits for US Large Value equity and non-US equity (developed and developing) due to the volatile nature of these premia. Each has failed to deliver on its expected premia for years and become noticeably underweight in many portfolios. However, there may be times when portfolios can benefit from absolute or risk-adjusted returns by increasing exposures to these areas.

Exhibit 6: Advisor model portfolio allocations vs passive and FHI PRISM® (%)



Source: Federated Hermes Portfolio Construction Solutions Team, as of 6/30/25. Index Fund Portfolio is created for purpose of comparison and designed with 60% allocation to the Vanguard Total World Stock Index Fund ETF Shares (seeks to track FTSE Global All Cap Index) and 40% to iShares Core Total USD Bond Market ETF (seeks to track Bloomberg US Universal Index). Index Fund and PRISM® allocations are for illustrative and comparison purposes only and not an investment recommendation.

PRISM® Tactical: Reflects the Federated Hermes PRISM® Committee's internal tactical asset allocation decisions relative to a diversified static benchmark, using a global diversified moderate, 60/40 allocation.

Active management and additional sources of return

Identifying asset classes that may outperform is only part of the equation if one employs active strategies versus passive index funds. Index funds can solve several allocation problems, but we believe that certain asset classes possess more active alpha-generation potential than others. Within specific market segments, we were able to see meaningful outperformance between the annualized 10-year return for the 25th percentile of a Morningstar Category and its respective asset class index (Exhibit 7).

Exhibit 7: Asset class outperformance

	Outperformance (%)*
US Large Growth	0.00
US Large Value	1.11
US Small Growth	1.54
US Small Value	0.85
Intl. Developed	0.68
Intl. SMID	1.03
EM Equity	0.99
US Govt	0.15
US MBS	0.45
US Corporates	0.40
US HY	0.00
Intl. Bond	1.86
EM Bond	0.82
Real Estate	0.00
Commodities	2.18
TIPS	0.00

*Please see explanation in the Notes to Exhibit 7 on page 5.

Sources: Morningstar, Inc. and Bloomberg, as of 9/22/25

Green = return differential greater than 1.0

Small cap growth, large cap value and international small/mid, among equities, were the areas we saw the highest potential for active management to add value, beyond asset allocation. Allocators can employ active or passive strategies, and the reasons for either choice are well-known. The analysis above indicates that selecting the right active strategy within certain asset classes has the potential to further boost returns.

Conclusion

While tactical allocations may be necessary in response to near-term events, setting strategic allocation positions considers long-term capital market trends. Long-term risk/return relationships have shifted; that much appears evident. In line with that, we've adjusted our strategic allocation positioning and will consider the need for tactical allocations in response to near-term trends as they emerge.

Notes for Exhibits 5 and 7: For Exhibit 5, return differential is calculated using the indicated indexes for the style/asset classes below. For exhibit 7, outperformance is derived from the annualized 10-year return difference between the 25th percentile of the specified Morningstar category and the corresponding asset class index return, with zero as the lowest possible return difference.

Asset class	Morningstar Category	Index
US large growth	US Fund Large Growth	Russell 1000® Growth
US large value	US Fund Large Value	Russell 1000® Value
US small growth	US Fund Small Growth	Russell 2000® Growth
US small value	US Fund Small Value	Russell 2000® Value
Intl. developed	US Fund Foreign Large Blend	MSCI EAFE NR
Intl. SMID	US Fund Foreign Small/Mid Blend	MSCI EAFE Small Cap NR
EM equity	US Fund Diversified Emerging Mkts	MSCI EM NR
US govt.	US Fund Intermediate Government	Bloomberg US Government
US MBS*	Mortgage-Backed	Bloomberg US MBS
US corporate bonds	US Fund Corporate Bond	Bloomberg US Credit
US high yield	US Fund High Yield Bond	Bloomberg US Corporate High Yield
Intl. bonds	US Fund Global Bond	Bloomberg Gbl Aggregate Ex USD
EM bonds	US Fund Emerging Markets Bond	JP Morgan EMBI Global Total Return
Real estate	US Fund Real Estate	FTSE Nareit All Equity REITs
Commodities	US Fund Commodities Broad Basket	Bloomberg Commodity
TIPS	US Fund Inflation-Protected Bond	Bloomberg US Treasury US TIPS

* MBS uses Mortgage-backed Morningstar institutional category

Definitions

Bloomberg US Government Bond Index is a market value weighted index of US government and government agency securities (other than mortgage securities) with maturities of one year or more.

Bloomberg US Mortgage-Backed Securities Index tracks agency mortgage-backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLM).

Bloomberg US Credit Index is composed of all publicly issued, fixed-rate, nonconvertible, investment-grade corporate debt. Issues are rated at least Baa by Moody's Investors Service or BBB by Standard & Poor's, if unrated by Moody's. Collateralized Mortgage Obligations (CMOs) are not included. Total return comprises price appreciation/depreciation and income as a percentage of the original investment.

Bloomberg US Corporate High-Yield Index measures the market of USD denominated, non-investment grade, fixed-rate, taxable corporate bonds.

Bloomberg Global Aggregate ex USD Index: Is a measure of global investment-grade debt from different local currency markets outside the US. This multi-currency benchmark includes fixed-rate treasury, government-related, corporate and securitized bonds from both developed and emerging markets issuers.

Bloomberg Commodity Index (BCOM) provides broad-based exposure to commodities. The index uses a consistent, systematic process to represent the commodity markets. BCOM uses both liquidity data and U.S. dollar-weighted production data in determining the relative quantities of included commodities. The explicit inclusion of liquidity as a weighting factor helps to ensure that BCOM can accommodate substantial investment flows. The Indices are composed of exchange-traded commodity futures contracts.

Bloomberg US Universal Index is a market-cap weighted of US-dollar-denominated, bonds across the credit spectrum with one year until maturity or more. This index is broader than the Bloomberg US Aggregate Bond Index, due to inclusion of high-yield corporate bonds, emerging-markets bonds, commercial mortgage-backed securities, 144A securities, and Eurodollar bonds. This index is represented by iShares Core Total USD Bond Market ETF (IUSB).

Bloomberg US Treasury Inflation-Protected Securities (TIPS) Index: Represents securities that protect against adverse inflation and provide a minimum level of real return. To be included in this index, bonds must have cash flows linked to an inflation index, be sovereign issues denominated in US currency and have more than one year to maturity.

FANG is the early acronym for large tech stocks Facebook, Amazon, Netlfix and Google. It evolved to FAANG with the inclusion of Apple. These stocks are now commonly known as the Magnificent Seven (see definition).

FTSE Global All Cap Index is a market cap-weighted index comprised of all listed stocks domestically, developed and emerging markets. This index is represented by Vanguard Total World Stock Index Fund ETF Shares (VT).

FTSE Nareit Equity REITs Index contains all Equity REITs not designated as Timberland REITs or Telecommunications REITs.

Magnificent Seven is the moniker for seven mega-cap tech-related stocks Amazon, Apple, Google-parent Alphabet, Meta, Microsoft, Nvidia and Tesla.

J.P. Morgan EMBI Global Index includes only USD-denominated emerging markets sovereign/quasi-sovereign bonds and uses a traditional, market-capitalization weighted method for country allocation.

MSCI EAFE Index is an equity index which captures large- and mid-cap representation across 21 Developed Markets countries around the world, excluding the US and Canada.

MSCI EAFE Small Cap Index is an equity index which captures small cap representation across Developed Markets countries around the world, excluding the US and Canada MSCI Emerging Markets Index captures large- and mid-cap representation across 24 Emerging Markets (EM) countries.

Russell 1000® Growth Index measures the performance of the large-cap growth segment of the US equity universe. It includes those Russell 1000® Index companies with higher price-to-book ratios and higher forecasted growth values. The Russell 1000® Growth Index is constructed to provide a comprehensive and unbiased barometer for the large-cap growth segment. The Index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect growth characteristics.

Russell 1000® Index measures the performance of the large-cap segment of the US equity universe. It is a subset of the Russell 3000® Index and includes approximately 1,000 of the largest securities based on a combination of their market cap and current index membership. The Russell 1000® Index represents approximately 92% of the US market. The Russell 1000® Index is constructed to provide a comprehensive and unbiased barometer for the large-cap segment and is completely reconstituted annually to ensure new and growing equities are reflected.

Russell 1000® Value Index measures the performance of the large-cap value segment of the US equity universe. It includes those Russell 1000® Index companies with lower price-to-book ratios and lower expected growth values. The R1000V is constructed to provide a comprehensive and unbiased barometer for the large-cap value segment. The Russell 1000® Value Index is completely reconstituted annually to ensure new and growing equities are included and that the represented companies continue to reflect value characteristics.

Russell Top 200® Index measures the performance of the largest cap segment of the US equity universe. The Russell Top 200 Index is a subset of the Russell 3000® Index. It includes approximately 200 of the largest US equity securities.

Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership.

S&P 500®: Is an unmanaged capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

PRISM® is a registered mark of FHI Holdings, Inc., a subsidiary of Federated Hermes, Inc.

Morningstar categories

Large value portfolios invest primarily in big U.S. companies that are less expensive or growing more slowly than other large-cap stocks. Stocks in the top 70% of the capitalization of the U.S. equity market are defined as large cap. Value is defined based on low valuations (low price ratios and high dividend yields) and slow growth (low growth rates for earnings, sales, book value, and cash flow).

Large growth portfolios invest primarily in big U.S. companies that are projected to grow faster than other large-cap stocks. Stocks in the top 70% of the capitalization of the U.S. equity market are defined as large cap. Growth is defined based on fast growth (high growth rates for earnings, sales, book value, and cash flow) and high valuations (high price ratios and low dividend yields).

Small value portfolios invest in small U.S. companies with valuations and growth rates below other small-cap peers. Stocks in the bottom 10% of the capitalization of the U.S. equity market are defined as small cap. Value is defined based on low valuations (low price ratios and high dividend yields) and slow growth (low growth rates for earnings, sales, book value, and cash flow).

Small growth portfolios focus on faster-growing companies whose shares are at the lower end of the market-capitalization range. These portfolios tend to favor companies in up-and-coming industries or young firms in their early growth stages. Because these businesses are fast-growing and often richly valued, their stocks tend to be volatile. Stocks in the bottom 10% of the capitalization of the U.S. equity market are defined as small cap. Growth is defined based on fast growth (high growth rates for earnings, sales, book value, and cash flow) and high valuations (high price ratios and low dividend yields).

Foreign large-blend portfolios invest in a variety of big international stocks. Most of these portfolios divide their assets among a dozen or more developed markets, including Japan, Britain, France, and Germany. These portfolios primarily invest in stocks that have market caps in the top 70% of each economically integrated market (such as Europe or Asia ex-Japan). The blend style is assigned to portfolios where neither growth nor value characteristics predominate. These portfolios typically will have less than 20% of assets invested in U.S. stocks.

Foreign small/mid-blend portfolios invest in a variety of international stocks that are smaller. These portfolios primarily invest in stocks that fall in the bottom 30% of each economically integrated market (such as Europe or Asia ex-Japan). The blend style is assigned to portfolios where neither growth nor value characteristics predominate. These portfolios typically will have less than 20% of assets invested in U.S. stocks.

Diversified emerging-markets portfolios tend to divide their assets among 20 or more nations, although they tend to focus on the emerging markets of Asia and Latin America rather than on those of the Middle East, Africa, or Europe. These portfolios invest predominantly in emerging market equities, but some funds also invest in both equities and fixed income investments from emerging markets.

Intermediate-government portfolios have at least 90% of their bond holdings in bonds backed by the U.S. government or by government-linked agencies. This backing minimizes the credit risk of these portfolios, as the U.S. government is unlikely to default on its debt. These portfolios have durations typically between 3.5 and 6.0 years. Consequently, the group's performance—and its level of volatility—tends to fall between that of the short government and long government bond categories.

Corporate bond portfolios concentrate on investment-grade bonds issued by corporations in U.S. dollars, which tend to have more credit risk than government or agency-backed bonds. These portfolios hold more than 65% of their assets in corporate debt, less than 40% of their assets in non-U.S. debt, less than 35% in below-investment-grade debt, and durations that typically range between 75% and 150% of the three-year average of the effective duration of the Morningstar Core Bond Index.

High-yield bond portfolios concentrate on lower-quality bonds, which are riskier than those of higher quality companies. These portfolios generally offer higher yields than other types of portfolios, but they are also more vulnerable to economic and credit risk. These portfolios primarily invest in U.S. high-income debt securities where at least 65% or more of bond assets are not rated or are rated by a major agency such as Standard & Poor's or Moody's at the level of BB (considered speculative for taxable bonds) and below.

Global bond portfolios typically invest 40% or more of their assets in fixed-income instruments issued outside of the US. These portfolios invest primarily in investment-grade-rated issues, but their strategies can vary. Some follow a conservative approach, sticking with high-quality bonds from developed markets. Others are more adventurous, owning some lower-quality bonds from developed or emerging markets. Some portfolios invest exclusively outside the US, while others invest in both US and non-US bonds. Many consistently maintain significant allocations to non-US dollar currencies, while others have the flexibility to make sizable adjustments between their US dollar and non-US currency exposures.

Mortgage-backed portfolios invest the majority of assets in mortgage-backed securities from a wide variety of issuers and with a wide range of maturities. These funds are exposed to both credit quality and interest rate risk, leading to both high risk and high return potential.

Emerging-markets bond portfolios invest more than 65% of their assets in foreign bonds from developing countries. The largest portion of the emerging-markets bond market comes from Latin America, followed by Eastern Europe. Africa, the Middle East, and Asia make up the rest.

Real estate portfolios invest primarily in real estate investment trusts of various types. REITs are companies that develop and manage real estate properties. There are several different types of REITs, including apartment, factory-outlet, health-care, hotel, industrial, mortgage, office, and shopping center REITs. Some portfolios in this category also invest in real estate operating companies.

Commodities Broad-basket portfolios can invest in a diversified basket of commodity goods including but not limited to grains, minerals, metals, livestock, cotton, oils, sugar, coffee, and cocoa. Investment can be made directly in physical assets or commodity-linked derivative instruments, such as commodity swap agreements.

Inflation-protected bond portfolios invest primarily in debt securities that adjust their principal values in line with the rate of inflation. These bonds can be issued by any organization, but the U.S. Treasury is currently the largest issuer for these types of securities.

Indexes are unmanaged and cannot be invested in directly.

Disclosures

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Stocks are subject to risks and fluctuate in value.

Diversification and asset allocation do not assure a profit nor protect against loss.

International investing involves special risks including currency risk, increased volatility, political risks, and differences in auditing and other financial standards.

Prices of emerging market securities can be significantly more volatile than the prices of securities in developed countries, and currency risk and political risks are accentuated in emerging markets.

Due to their relatively high valuations, growth stocks are typically more volatile than value stocks.

Value stocks may lag growth stocks in performance, particularly in late stages of a market advance.

Small company stocks may be less liquid and subject to greater price volatility than large company stocks.

Alpha is a measure of excess return.

There is no guarantee that actively managed strategies will outperform passive index strategies. Actively managed strategies typically have higher fees than passive strategies, which can reduce performance.

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