GREAT-WEST CAPITAL MANAGEMENT, LLC (GWCM) RESEARCH NOTE
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GREAT-WEST FINANCIAL
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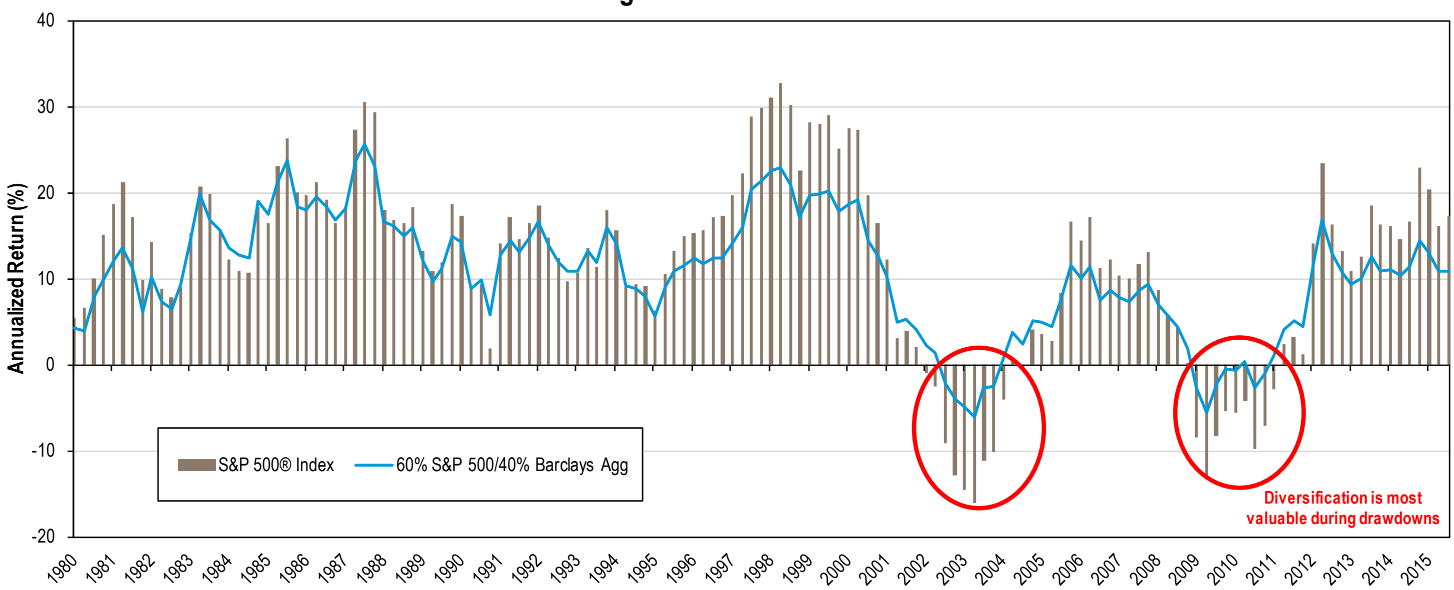
Back to Basics on Asset Allocation

Often times when markets pull back significantly, as they have in late August 2015, it pays to go back to basics with respect to how we think about asset allocation.[1] Although stock market rallies feel good to both our investment psyche and our bank accounts, they don't last forever. If they did, we wouldn't need the benefits of diversification in our investment portfolios.[1] As we're now well into the sixth year of this bull market, it becomes more and more difficult for investors to recall their pain from the 2008 financial crisis, and easy to think "why would I include anything but stocks in my investment portfolio?"

As the chart below illustrates, the real value of portfolio diversification comes when markets turn down. The two largest equity market pullbacks since 1980 occurred during the post-2001 period after the bursting of the tech bubble, and the period including 2007 and 2008 when the financial crisis riled global markets. During both of these periods, investors benefited greatly from the inclusion of fixed income in their portfolios.

The gray bars in the chart reflect the rolling three-year annualized return of the S&P 500® Index, which represents the U.S. large-cap equity market. In contrast, the blue line represents a portfolio that is constructed of 60% S&P 500® Index and 40% Barclays U.S. Aggregate Bond, which represents a broad cross-section of the U.S. investment-grade fixed-income sector. Although the 60/40 portfolio has tended to lag the all-stock portfolio when markets are rallying, it also tends to keep pace with the all-stock portfolio during moderate market environments and hold up significantly better during downturns.

Rolling Three-Year Returns



Source: Morningstar® Direct℠; GWCM Analysis. The gray line reflects the returns of the S&P 500® Index and the blue line represents a simulated portfolio that is constructed of 60% S&P 500 and 40% Barclays U.S. Aggregate Bond. The simulated portfolio is rebalanced back to the target weights on a monthly basis. *Past performance is not a guarantee of and may not be indicative of future results.*

1 Asset allocation and diversification do not ensure a profit and do not protect against loss in declining markets.

Diversifed Portfolios Have Performed Well Over Time, Despite Their Allocations to Less High-Flying Fixed-Income Investments

Trailing Investment Returns, as of 06/30/2015

Name	YTD	1-Year	3-Year	5-Year	10-Year	15-Year
S&P 500® Index	1.23	7.42	17.31	17.34	7.89	4.36
Barclays US Aggregate Bond Index	-0.10	1.86	1.83	3.35	4.44	5.42
60% S&P 500® Index/ 40% Barclays US Aggregate Bond Index	0.79	5.28	10.98	11.76	6.79	5.10

Source: Morningstar® Direct℠; GWCM Analysis. The table reflects the annualized returns of the S&P 500® Index, and a simulated portfolio that is constructed of 60% S&P 500 Index and 40% Barclays U.S. Aggregate Bond Index as of June 30, 2015, rebalanced monthly. *Past performance is not a guarantee of and may not be indicative of future results.*

The table above shows that over the long term, a diversified investment strategy composed of both stocks and bonds has provided protection through a variety of market cycles and conditions. A diversified investment strategy that provides both capital appreciation as well as income helps to reduce overall risk during down market periods, dampening overall portfolio volatility. Additionally, the equity exposure of a diversified portfolio provides participation during up markets.

Every asset class has a different potential for risk and reward. Equities offer the potential for higher returns, but carry more downside risk. Fixed income, on the other hand, generally has lower expected return potential, but provides more stability in the form of lower volatility. With that said, a diversified portfolio made up of equities and fixed-income may provide more stable returns over long periods of time. The bond portion of a portfolio helps offset the risks associated with the equity portion. No asset allocation mix can ensure a profit or guarantee against a loss, but a diversified portfolio that spreads investment dollars out over a variety of asset classes can take advantage of upside markets while managing downside risk during bear markets and/or market corrections.

In a perfect world we would simply buy stocks only when they are performing well and sell stocks when they are performing poorly, but this is not reality. Financial markets are notoriously difficult to predict with any degree of certainty. GWCM believes that the best solution for long-term investors is to construct a broadly diversified portfolio that is designed to weather all types of market environments. It is important for investors not to lose sight of their long-term investment goals in the face of a multi-year bull market.