Understanding
ASSET ALLOCATION

An Educational Guide
for Your Financial Future

PACIFIC LIFE

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TABLE OF CONTENTS

GET READY FOR RETIREMENT

Asset allocation and discipline are two important fundamentals for investing, and whether or not to utilize asset allocation is one of the most important decisions you will make as an investor. The key to asset allocation is to include a variety of investments in a portfolio and remain focused on long-term financial goals. By balancing risk and reward, you may find that you stick with your investment strategy rather than buy and sell in reaction to sudden market movements. Over the long term, owning multiple asset classes may help smooth out the overall risk to your portfolio.

WHAT IS ASSET ALLOCATION?

Asset allocation is the process of distributing investments among various asset classes (for example, stocks, bonds, and cash) and determining their proportions within a portfolio.

When it comes to performance, asset-class leadership changes frequently. Because a single asset class is rarely the best performer year after year, diversification may help your portfolio weather the financial market's ups and downs.

DIVERSIFICATION MAY LESSEN THE IMPACT OF MARKET SWINGS

A well-diversified portfolio may allow investors to mitigate some of the risks associated with investing. By investing a portion of the portfolio in several different asset classes, portfolio volatility may be reduced. Diversification does not ensure a profit or protect against a loss.

While a 100% stock portfolio has outperformed a 100% bond portfolio in the long term, it has not been the top performer each and every year. Looking back over a 10-year period, the image below illustrates the annual performance of various portfolios in relation to one another.

Annual Total Returns

2007	2008	2009	2010	2011
10.1	13.1	26.5	15.1	9.5
8.9	0.6	19.2	13.1	7.6
7.8	–11.9	12.0	11.1	5.8
6.6	–24.5	4.8	9.1	3.9
5.5	–37.0	–2.4	7.1	2.1

Portfolios

1 (100% Stocks)
2 (75% Stocks, 25% Bonds)
3 (50% Stocks, 50% Bonds)
4 (25% Stocks, 75% Bonds)
5 (100% Bonds)

Source: Morningstar®, 2017. The examples are hypothetical and do not represent any specific investment. Stocks are represented by the Ibbotson® Large Company Stock Index. Bonds are represented by the five-year U.S. government bond. An investment cannot be made directly in an index. The data assumes reinvestment of all

The concept of asset allocation is far from new; in fact, it is based on a Nobel Prize-winning theory that was pioneered by Harry Markowitz in his paper, "Portfolio Selection," published in 1952 by The Journal of Finance.

2012	2013	2014	2015	2016
16.2	32.4	13.7	1.9	12.0
12.5	24.0	11.0	1.7	9.5
9.0	15.7	8.4	1.6	6.9
5.6	7.3	5.8	1.5	4.4
2.1	–1.1	3.1	1.4	1.9

income and does not account for taxes or transaction costs. Past performance does not guarantee future results. There is no assurance that a diversified portfolio will achieve a better return than a nondiversified portfolio.

YOUR OVERALL INVESTMENT STRATEGY

A good first step in determining the right investment mix is to speak with your financial advisor. When working with him or her to decide where to invest your money, there are some key questions to consider.

What Is Your Time Horizon?

How long do you plan to stay invested? This is a key element in determining an appropriate investment option. Long-term investments help provide you the opportunity to ride out market swings. Conversely, if your time horizon is shorter, it is likely you would want to take on less risk.

What Are Your Financial Goals?

Are you planning for retirement? Preparing to buy a home? Are you thinking about how to send your kids to college? Your financial goals are essential to identify the most appropriate investment options to consider.

How Much Money Can You Afford to Invest?

How stable is your job and personal financial situation? How much investment risk can you afford to take? How much do you expect things, such as your income and expenses, to change over time? Knowing the answers to these questions will help you narrow down the options for your decision.

> "If I have noticed anything over these 60 years on Wall Street, it is that people do not succeed in forecasting what's going to happen in the stock market."
>
> – Benjamin Graham, legendary investor and author, *Security Analysis*

How Much Risk Are You Comfortable Taking?

Your tolerance for risk depends on your ability or willingness to withstand possible declines in the value of your original investment in exchange for potential higher returns. How aggressively do you want to pursue investment growth? Are you willing and able to tolerate the financial market's ups and downs?

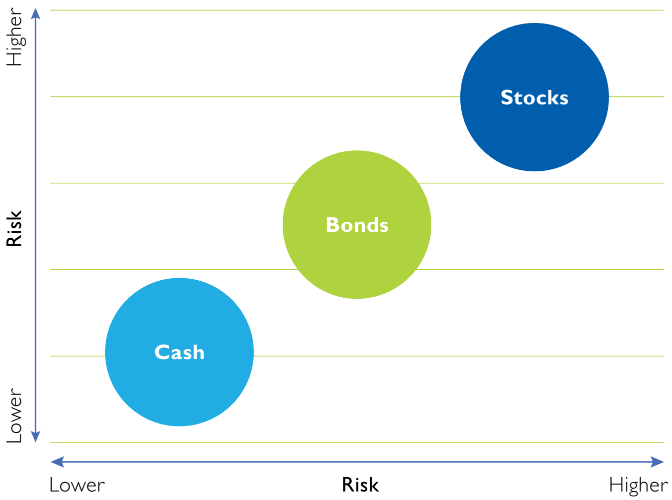
> Asset allocation seeks to maximize performance returns for a given level of risk.

TYPES OF ASSET CLASSES

Stocks, bonds, cash, and other asset classes make up the essential building blocks of a well-diversified portfolio. Each asset class offers a different level of risk and reward, which should be considered carefully before making an investment decision. To better understand how asset allocation works, it helps to know more about the investment options available to you. Working with your financial advisor, you can determine the mix most appropriate for your goals.

Stocks

A stock represents ownership in a corporation. When you purchase shares of stock, you own a part of a corporation and participate in the ups and downs of the corporation. Historically, stocks have the greatest risk and best returns among the three major asset categories.



Bonds

A bond represents a loan to a government or corporation. Individual bonds, if held to maturity, are a promise to return the original amount plus a specific rate of interest for a specific length of time. Historically, bonds have been less volatile than stocks, but offer more modest returns. Bonds are also referred to as fixed income.

Like stocks, there are different types of bonds. In general, bond issuers offer higher interest rates for long-term bonds and lower rates for shorter-term bonds (typically two years to maturity or less). Certain bonds offer high returns similar to stocks, but these bonds, known as high-yield or junk bonds, also carry a higher risk.

Cash

Cash and cash equivalents are generally short-term IOUs. Some examples include: savings deposits, certificates of deposit (CDs), Treasury bills, and money-market funds. These investments are less volatile, but offer the lowest return of the three major asset classes.

> Keep in mind that when interest rates rise, bond values fall (and vice versa).

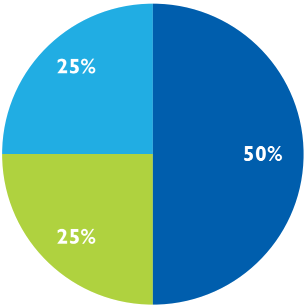
REBALANCING

Over time, your asset allocation mix may change because certain assets perform well while others do not, thus changing the original balance. Rebalancing allows you to sell some of the overweight assets and buy some underweight assets to maintain a consistent allocation.

By rebalancing, you ensure that your portfolio does not overemphasize one or more asset classes, and you'll return your portfolio to the risk level you are comfortable with.

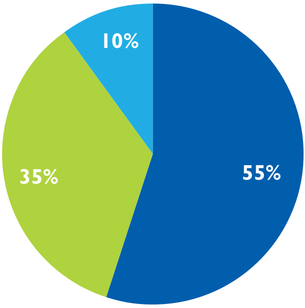
Target Allocations

Based on your risk tolerance and investment time horizon, your target portfolio allocation may look something like this.



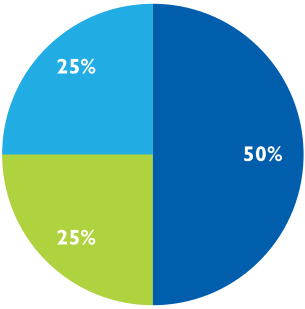
Current Allocations

Over time, with market fluctuations, your portfolio allocations may vary.



Rebalanced Allocations

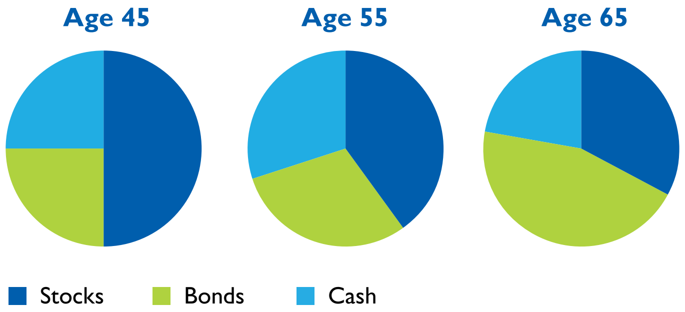
After rebalancing, your portfolio is brought back to the target allocations you started with.



Stocks Bonds Cash

TIMING

Target allocations may change based on the time remaining until retirement. For example:



ADDITIONAL WAYS TO DIVERSIFY

Asset allocation is an important step to achieving a diversified portfolio, but your investments should include other asset classes. While stocks, bonds, and cash are the most common asset classes, alternative investments include real estate, commodities, domestic and international equities, Treasury Inflation-Protected Securities (TIPS), and floating-rate loans. Investments in these categories have their own specific risk profiles. Your financial professional can help you select the best mix for your situation.

Another way to achieve diversification is through financial products such as variable annuities, fixed annuities, and mutual funds.

To learn more about asset allocation,
as well as some of the specific risks,
talk to your financial advisor to determine
the best investment strategy
to fit your goals.

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