



The importance of asset allocation while saving for retirement

Your goals for retirement may look very different from those of your co-workers. This is especially true for people who are retiring in the next few years versus those who have a few decades until retirement.

While the end goals and years until retirement vary from person to person, most people want the same thing: to build their retirement nest egg while not taking too much risk. Beyond just choosing the best investments for your retirement savings account, it's important to also get the asset allocation decision right.

WHAT EXACTLY IS ASSET ALLOCATION, AND WHY DOES IT MATTER?

Simply put, asset allocation is an investment strategy that strives to balance risk by dividing assets among different categories such as stocks, bonds, cash and alternative investments. Since each asset class has different levels of risk and return, each will likely behave differently in varying market environments. A study by economists Roger Ibbotson and Paul Kaplan found that more than 90% of the variability of a typical plan sponsor's performance over time is attributable to asset allocation.¹ In other words, if you're a long-term investor, asset allocation is an important determinant of your investment earnings over the long run.

IN THIS PAPER

We'll discuss what asset allocation is, why it matters, and how you can help make sure your asset allocation is aligned with your long-term goals and risk tolerance.

DETERMINING YOUR ASSET ALLOCATION

Choosing your asset allocation is a decision unique to your goals, time horizon, and tolerance for risk, which can all change over time as your financial circumstances and needs evolve. It depends on factors such as your contribution rate, growth objectives, and target retirement date. A popular rule of thumb is to subtract your age from the number 110 to determine what percentage of your investments should be in stocks. The balance should then be allocated in bonds and cash. For instance, if you are 50 years old, 60% should be in stocks – and as you get older, the percentage in stocks should decrease.

Different asset classes achieve different objectives in a portfolio. In addition, certain asset classes can be more appropriate given your time horizon and risk tolerance. Risk can be defined in many ways, but most commonly it refers to the amount of money you feel comfortable losing, even temporarily.

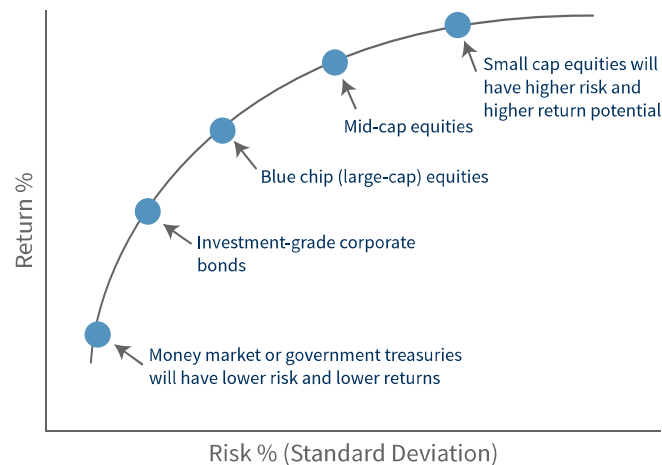
¹Ibbotson, Roger G. and Kaplan, Paul D., Does Asset Allocation Policy Explain 40, 90, 100 Percent Of Performance? Financial Analysts Journal, Jan/Feb 2000, Vol. 56, No. 1. Available at SSRN: <https://ssrn.com/abstract=279096>

A COMPARISON OF ASSET CLASSES

Asset Class	Objective	Time Horizon	Risk
Equity (stocks)	Capital Appreciation	Medium- to Long-Term (5+ years)	Moderate to High
Fixed Income (bonds)	Income, Capital Preservation	Short- to Medium-Term (3-5 years)	Low to Moderate
Cash	Capital Preservation	Short-Term (0-3 years)	Low

When determining your optimal asset class mix, it's important to understand the trade-off between risk and potential return. These two factors are directly related, meaning the higher the return you desire, the more risk you must be willing to accept. The graph below, though not inclusive of all investment categories, illustrates this concept.

THE RISK-REWARD TRADE-OFF OF VARIOUS INVESTMENTS



Source: Raymond James

Typically, the longer your investment time horizon, the more risk you can afford to take. This is because you have more time to recover from temporary losses due to market corrections. If you're at least 10 years from retirement, you may be able to tolerate more risk, thereby weighting your portfolio more heavily toward growth-oriented investments like stocks and corporate bond funds, which have a higher potential return but are also higher risk.

As you near retirement, your risk tolerance may warrant a higher allocation of lower-risk investments like high-quality bonds and

capital preservation funds. These asset classes can help protect you against permanent capital loss in the event the market corrects right before you're planning to retire.

DIVERSIFICATION

No asset allocation discussion is complete without mentioning diversification. Diversification is an investment strategy that incorporates a wide variety of investments into a portfolio in an attempt to limit excessive exposure to any single asset or risk. Simply stated, it's "not putting all of your eggs in one basket."

The objective is to have the positive performance of some investments neutralize the negative performance of others. For example, when markets are healthy, holding a larger percentage of stocks serves as a strong tailwind, since stocks tend to earn higher returns than fixed income and capital preservation strategies over time. However, when markets correct, stocks also tend to experience greater declines in value. In volatile market environments, fixed income and capital preservation strategies are more likely to work in your favor.

If one could predict when these market changes will take place, you could shift your portfolio back and forth among the various asset classes to take full advantage of their benefits. However, it's very difficult to successfully time the market. Instead, most investors use diversification to help maximize their return potential over time while mitigating risk.

As you can see in the Callan Periodic Table, the various asset classes perform differently year after year. If your investment portfolio is well-diversified across a variety of asset classes, it can help ensure that you always have some exposure to the best performing investments, but are also protected against dramatic declines when markets reverse direction.

THE CALLAN PERIODIC TABLE OF INVESTMENT RETURNS

Annual returns for key indices ranked in order of performance (2014-2024). Data as of 12/31/2024.

ANNUAL RETURNS										
2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
Real Estate 15.02%	Large Cap Equity 1.38%	Small Cap Equity 21.31%	Emerging Market Equity 37.28%	U.S. Fixed Income 0.01%	Large Cap Equity 31.49%	Small Cap Equity 19.96%	Large Cap Equity 28.71%	High Yield -11.19%	Large Cap Equity 26.29%	Large Cap Equity 25.02%
Large Cap Equity 13.69%	U.S. Fixed Income 0.55%	High Yield 17.13%	Non-U.S. Equity 24.21%	High Yield -2.08%	Small Cap Equity 25.52%	Large Cap Equity 18.40%	Real Estate 26.09%	U.S. Fixed Income -13.01%	Non-U.S. Equity 17.94%	Small Cap Equity 11.54%
U.S. Fixed Income 5.97%	Real Estate -0.79%	Large Cap Equity 11.96%	Large Cap Equity 21.83%	Non-U.S. Fixed Income -2.15%	Non-U.S. Equity 22.49%	Emerging Market Equity 18.31%	Small Cap Equity 14.82%	Non-U.S. Equity -14.29%	Small Cap Equity 16.93%	High Yield 8.19%
Small Cap Equity 4.89%	Non-U.S. Equity -3.04%	Emerging Market Equity 11.19%	Small Cap Equity 14.65%	Large Cap Equity -4.38%	Real Estate 21.91%	Non-U.S. Fixed Income 10.11%	Non-U.S. Equity 12.62%	Large Cap Equity -18.11%	High Yield 13.44%	Emerging Market Equity 7.50%
High Yield 2.45%	Small Cap Equity -4.41%	Real Estate 4.06%	Non-U.S. Fixed Income 10.51%	Real Estate -5.63%	Emerging Market Equity 18.44%	Non-U.S. Equity 7.59%	High Yield 5.28%	Non-U.S. Fixed Income -18.70%	Emerging Market Equity 9.83%	Non-U.S. Equity 4.70%
Emerging Market Equity -2.19%	High Yield -4.47%	Non-U.S. Equity 2.75%	Real Estate 10.36%	Small Cap Equity -11.01%	High Yield 14.32%	U.S. Fixed Income 7.51%	U.S. Fixed Income -1.54%	Emerging Market Equity -20.09%	Real Estate 9.67%	U.S. Fixed Income 1.25%
Non-U.S. Fixed Income -3.09%	Non-U.S. Fixed Income -6.02%	U.S. Fixed Income 2.65%	High Yield 7.50%	Non-U.S. Equity -14.09%	U.S. Fixed Income 8.72%	High Yield 7.11%	Emerging Market Equity -2.54%	Small Cap Equity -20.44%	Non-U.S. Fixed Income 5.72%	Real Estate 0.94%
Non-U.S. Equity -4.32%	Emerging Market Equity -14.92%	Non-U.S. Fixed Income 1.49%	U.S. Fixed Income 3.54%	Emerging Market Equity -14.57%	Non-U.S. Fixed Income 5.09%	Real Estate -9.04%	Non-U.S. Fixed Income -7.05%	Real Estate -25.10%	U.S. Fixed Income 5.53%	Non-U.S. Fixed Income -4.22%

BEST
↑
↓
WORST

Sources:

- Bloomberg Corp High Yield
- Bloomberg Global Aggregate ex US
- MSCI Emerging Markets
- Russell 2000
- Bloomberg US Aggregate
- FTSE EPRA Nareit Developed
- MSCI World ex USA
- S&P 500

Source: Callan. Past performance is not indicative of future results. It is not possible to invest directly in an index. Any investor who attempts to mimic the performance of an index would incur fees and expenses which would reduce returns. There are inherent limitations to indices that are designed to track the alternative investments universe. Index data is shown for illustrative purposes only and not designed to represent any specific investment. Specific investment statistics could differ materially from those shown above. Data source: PerTrac Financial Solutions, LLC and eVestment

Large Cap Equity (S&P 500): This index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. It consists of 400 industrial, 40 utility, 20 transportation, and 40 financial companies listed on U.S. market exchanges. This is a capitalization-weighted calculated on a total return basis with dividends reinvested. The S&P represents about 75% of the NYSE market capitalization.

Small Cap Equity (Russell 2000): This index covers 2000 of the smallest companies in the Russell 3000 index, which ranks the 3000 largest U.S. companies by market capitalization. The Russell 2000 represents approximately 10% of the Russell 3000 total market capitalization. This Index includes the effects of reinvested dividends.

Non-U.S. Equity (MSCI World ex USA): Index captures large and mid cap representation across 22 of 23 Developed Markets (DM) countries*--excluding the United States. With 884 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. * DM countries include: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom.

Emerging Market Equity (MSCI Emerging Markets): The index captures large and mid cap representation across 24 Emerging Markets (EM) countries*. With 1,251 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. *EM countries include: Brazil, Chile, China, Colombia, Czech Republic, Egypt, Greece, Hungary, India, Indonesia, Korea, Kuwait, Malaysia, Mexico, Peru, Philippines, Poland, Qatar, Saudi Arabia, South Africa, Taiwan, Thailand, Turkey and United Arab Emirates.

U.S. Fixed Income (Bloomberg U.S. Aggregate Bond Index): The index is a measure of the investment grade, fixed-rate, taxable bond market of roughly 6,000 SEC-registered securities with intermediate maturities averaging approximately 10 years. The index includes bonds from the Treasury, Government-Related, Corporate, MBS, ABS, and CMBS sectors.

High Yield (Bloomberg U.S. Corp High Yield Bond Index): The index covers all fixed rate, non-investment grade debt, including corporate (both US and non-US Industrial, Utility, and Finance), and non-corporate sectors. Also included, Canadian and Global Bonds-(SEC registered, and issuers in non-emerging market countries), original issue zeroes, step-up coupon structures, and 144-As. Exclusions are Pay-in-kind bonds, Eurobonds, debt issues from emerging market countries, structured notes with embedded swaps or other special features, private placements, and floating rate securities. Must be publicly issued, dollar denominated, non-convertible, rated high-yield or lower by at least two of the following: Moody's, S&P, or Fitch. Unrated bonds, although a small number, are included but must have previously held a high yield rating or been associated with a high yield issuer, and must trade accordingly. As well, there must be at least 1 year left to maturity, and an outstanding par value of at least \$150 million.

Non U.S. Fixed Income (Bloomberg Global Aggregate ex U.S. Bond Index): The index provides a broad-based measure of the global investment grade fixed-rate debt markets, excluding the United States. Currency exposure is hedged to the US dollar.

Real Estate (FTSE EPRA/Nareit Developed REIT Index): Designed to measure the stock performance of companies engaged in specific real estate activities in the North American, European, and Asian real estate markets.

NEXT STEPS: PULLING IT ALL TOGETHER

Most 401(k) plans offer target-date funds, which adjust the asset allocation for you based on how many years you are from retirement. However, you also have the option to build your own asset allocation using the funds in the plan lineup. If you choose to do it yourself, the following considerations can help you determine an appropriate investment mix:

- Write down your expected time horizon until retirement, your retirement goals, and how much risk you are willing to tolerate.
- Based on your retirement goals, estimate how much money you'll need to have saved by retirement. Compare this amount to how much you currently have saved.
- If you're more than 10 years from retirement, you may want

to increase your potential growth rate by investing in higher risk/higher reward assets like stocks.

- If you're less than 10 years from retirement, you may be better served investing in lower risk/lower reward investments like bonds while increasing your monthly contribution rate.

Finally, talk to your financial advisor if you're still not sure how to apply these concepts to your 401(k) account. He or she can help you decide whether a target-date fund or customized approach is more appropriate for you. In addition, your 401(k) plan's recordkeeper may have educational resources and tools to help you meet your retirement goals.

There is no assurance that any investment strategy will be successful. Investing involves risk and investors may incur a profit or a loss. Asset allocation and diversification do not ensure a profit or protect against a loss.

Bond prices and yields are subject to change based upon market conditions and availability. If bonds are sold prior to maturity, you may receive more or less than your initial investment. There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices rise. Holding stocks for the long-term does not insure a profitable outcome.

Sector investments are companies engaged in business related to a specific sector. They are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

International investing involves special risks, including currency fluctuations, differing financial accounting standards, and possible political and economic volatility. Investing in emerging markets can be riskier than investing in well-established foreign markets.

Real estate investments may be subject to a higher degree of market risk because of concentration in a specific industry, sector or geographical sector. Declines in the value of real estate, economic conditions, property taxes, tax laws and interest rates all present potential risks to real estate investments. In a rising interest rate environment REITs (real estate investment trusts) may experience an increase in rent rates or mortgage rates or may experience higher acquisition costs.

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