



Monthly Musings

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The Benedict-McLoughlin Group @ Morgan Stanley

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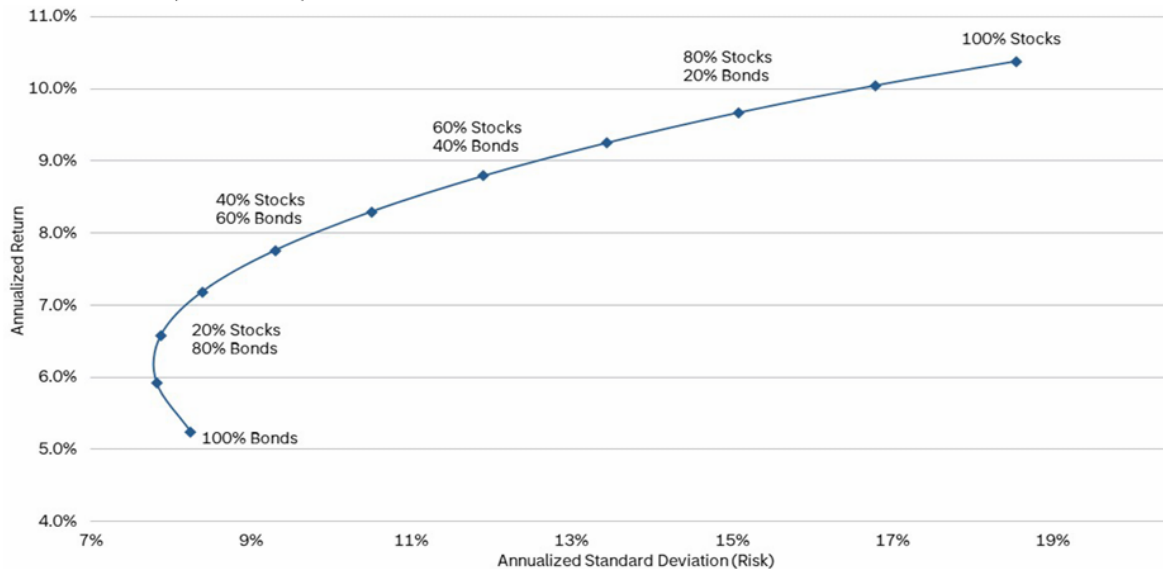
In this Musings, I'll cover the following:

- Effective diversification can help optimize an investor portfolio from a risk/return perspective
- Setting a proper strategic asset allocation target can help investors stick with and achieve their long-term goals
- Periodic rebalancing and tactical adjustments can be very useful tools

Diversification has been described as the only “free lunch” in investing. It allows for the possibility to reduce expected risk without giving up expected return. This is possible due to the fact that most individual securities (as well as asset classes) are not perfectly correlated with each other. In simpler terms, some investments zig while some zag across different time periods. This is why most stock portfolios hold positions in different economic sectors (i.e., some healthcare and financial stocks to balance the technology stocks, for example). Similarly, it is recommended to diversify an overall portfolio across different asset classes (see below).

HISTORICAL STOCK AND BOND BLENDS

ATA FROM JANUARY 1, 1926 – MAY 31, 2025



Source: Morgan Stanley ChartBook (See disclosures below)

In theory, an investor is better off adding a security to their portfolio as long as it reduces expected risk by more than it reduces expected return...and vice versa. Graphically, it's why the line above depicting various portfolios is convex and not straight. Furthermore, the graph shows that diversifying by just 30% into stocks from an all bond portfolio, investors would have increased their annual return from just over 5% to just over 7% without increasing overall risk (as measured by standard deviation). These numbers could potentially be optimized further by adding other asset classes like alternative investments (for appropriate investors), for example.

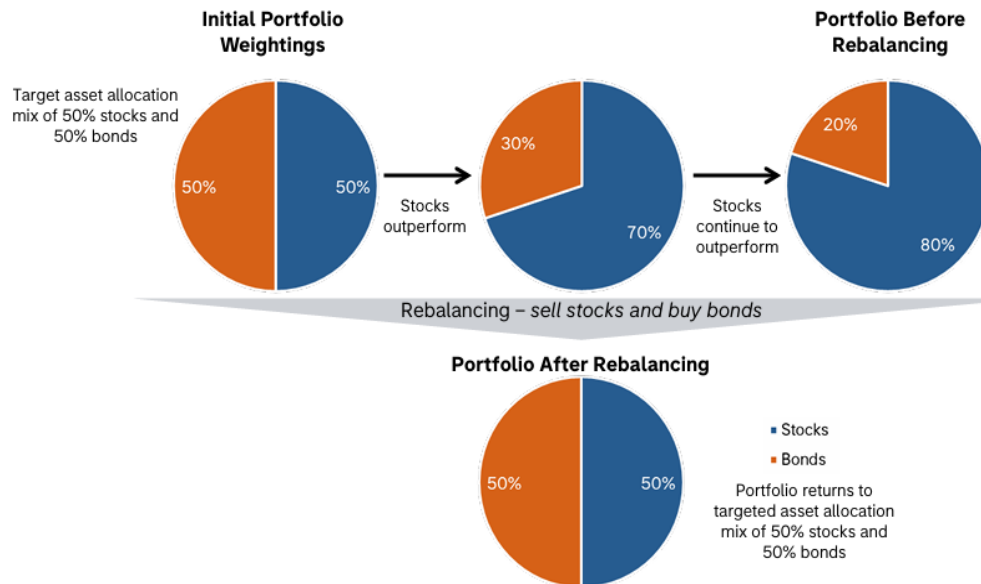
In practical terms, the ideal way to start an investment program is to begin with a plan that lays out what the investor is trying to accomplish in terms of overall return goals, income goals and risk tolerance. Once established, initial portfolio construction is the key to balancing and optimizing these goals. And, if done correctly, portfolio construction can be a very effective risk management tool. Empirically, the initial asset allocation will drive the bulk of the risk and return experienced by the portfolio.

Of course, over time, asset classes tend to perform differently during different time periods (the essence of diversification). Sometimes the difference in performance can be significant. For example, stocks have dramatically outperformed bonds since 2020 basically doubling while bonds are effectively flat.¹ So, a hypothetical investor that started out with a 50/50 (stocks/bonds) portfolio in 2020 would now be sitting on an allocation of 67% stocks and 33% bonds...a portfolio that has different risk/return expectations than a 50/50 allocation. At some point, rebalancing the portfolio would be a prudent move (see sample illustration below). In the example below, re-balancing doesn't occur until stocks become an 80% weighting...I'm not sure every investor would want to wait that long but, that decision is up to each investor and there may be tax consequences to consider.

Rebalancing Portfolios

Rebalancing typically involves the periodic buying and/or selling of assets in portfolios to maintain original desired level of asset allocation.

HYPOTHETICAL ILLUSTRATION OF THE REBALANCING PROCESS



Source: Morgan Stanley ChartBook (See disclosures below)

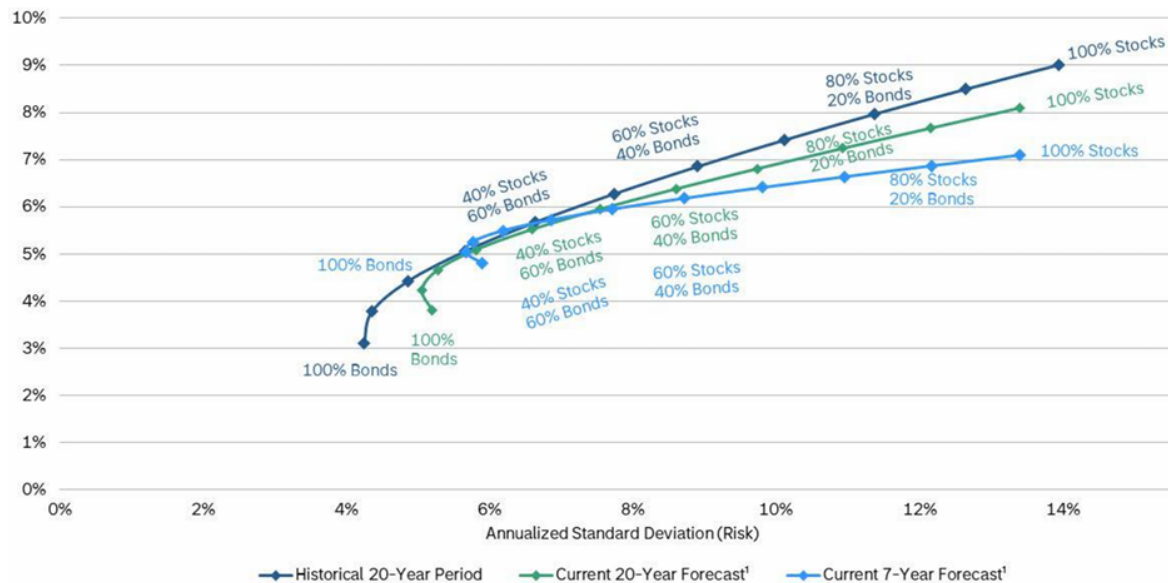
Another important consideration is the concept of “strategic” and “tactical” asset allocation targets. Strategic implies a long-term target and it can be a fixed target (i.e., 50%/50%) or it could be a target range (i.e., 35%-65%/35%-65%, for example). Utilizing a strategic range allows for some drift but, it also allows for tactical shifts within those ranges. An example of a tactical shift would be to move the equity weighting to the low end of the strategic range if you feel stocks are overvalued. These adjustments can happen at the asset class level, sub-asset class level and even at the economic sector level for equities.

So, what is the correct move in the current environment? Well, for those investors that have enjoyed the outperformance in equities in recent years, I would recommend looking how close you are to your strategic targets and make any prudent adjustments. From a projected asset class return perspective, Morgan Stanley forecasts lower than average equity returns and above average fixed income returns over the medium-term (see below), so, underweighting equities and overweighting fixed income over a 7-year horizon might make sense. Other adjustments within equities should also be considered (i.e., exposure of small vs large cap, international vs domestic as well as your sector weightings). The tactical tilts in my model portfolios are also listed below for reference.

Forecasted Efficient Frontiers

ANNUALIZED RETURN OF STOCK AND BOND BLENDS

AS OF AUGUST 31, 2025



Source: Morgan Stanley ChartBook (See disclosures below)

See My Previous Investment Commentaries here:

<https://advisor.morganstanley.com/benedict-mcloughlin-group>

***Tactical Allocation Strategies in my Global Core, Global Value Opportunities and Global High-Income Model Portfolios:**

Overweight

Global Value Equities, Long/Short Equity Strategies, Quality Dividend Paying Global Equities, Emerging Market Consumer Equities, Total Return Strategies, Shorter-term Corporate Bonds

Underweight

High P/E technology/growth stocks, Mid and Long-Term Fixed Income

* These weightings do not consider each client's unique profile, preferences and/or constraints and therefore may not be applicable to you.

* The Global Core and Global Value Opportunities strategies are designed to achieve growth via investments in global equities. The Global High-Income strategy is designed to achieve above average income via investments in bonds, ETFs, closed end funds and dividend paying equities.

The Benedict-McLoughlin Group always strives to use sound judgment...at every decision point.

We bring experience, credentials, and tenacity which we expect to continue to enable us to help achieve our clients' goals over time.

Regards,
Chris

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Alternative Investments Director

The Benedict-McLoughlin Group – “Institutional Caliber Portfolio Management, Customized to Your Personal Situation”

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Notes:

1. Bloomberg markets, 10/20/25.

Asset Allocation does not guarantee a profit or protect against a loss in a declining financial market.

Rebalancing does not protect against a loss in declining financial markets. There may be a potential tax implication with a rebalancing strategy. Investors should consult with their tax advisor before implementing such a strategy.

The investments listed may not be suitable for all investors. Morgan Stanley Smith Barney LLC recommends that investors independently evaluate particular investments and encourages investors to seek the advice of a financial advisor. The appropriateness of a particular investment will depend upon an investor's individual circumstances and objectives.

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Past performance is no guarantee of future results. Actual results may vary. Diversification does not assure a profit or protect against loss in a declining market.

Alternative investments involve complex tax structures, tax inefficient investing, and delays in distributing important tax information. Individual funds have specific risks related to their investment programs that will vary from fund to fund. Clients should consult their own tax and legal advisors as Morgan Stanley Wealth Management does not provide tax or legal advice.

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Actual results may vary and past performance is no guarantee of future results.

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Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

Bonds rated below investment grade may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio.

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Chartbook Source: FactSet, Morgan Stanley Wealth Management GIC. (1) The cyclically adjusted P/E ratio (CAPE), also known as Shiller P/E ratio, uses a 10-year average of inflation-adjusted earnings to value the stock market. Historically, cyclically adjusted price-earnings ratios have led subsequent returns with a 10-year lag. Recent price earnings levels suggest equity returns could be better going forward than they have been over the recent past, assuming the statistical relationship holds. Standard deviation (volatility) is a measure of the dispersion of a set of data from its mean. Past performance is no guarantee of future results. Estimates of future performance are based on assumptions that may not be realized. This material is not a solicitation of any offer to buy or sell any security or other financial instrument or to participate in any trading strategy. Please refer to important information, disclosures and qualifications at the end of this material.

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