Horace Mann

Applying asset allocation

What is asset allocation?

With asset allocation, your assets are divided among a broad selection of investments, helping your portfolio level out the effects of market highs and lows. You decide how much to allocate into each investment type, also called asset class, based on your risk tolerance and your financial goals. Instead of chasing the performance of a particular investment, you make systematic, deliberate investments in a variety of asset classes.

How is risk tolerance involved?

There is a direct relationship between potential returns and risk. The higher the potential return, the higher the degree of risk, including the possibility of loss of principal. Before deciding on a personal investment strategy, you must consider how much or how little risk you are prepared to take with your money.

How hands-on are you?

In addition to considering your tolerance for risk, your investment strategy should account for how much you wish to personally manage your portfolio on a continuing basis. There are two methods for asset allocation — hands-off and hands-on — and both have the same goal: to manage your investment portfolio and help you reach your retirement goals.

Two approaches to asset allocation

1. **Hands-off:** Target date funds method: Based on an investment time horizon, these types of funds are designed to help you move through the stages of your life without having to adjust your investment options as your risk tolerance changes. Target date investment options utilize the investment expertise and continual oversight of the fund manager to keep your asset allocation on track.
2. **Hands-on:** You can decide how much to allocate into each investment type based on your risk tolerance and your financial goals. You then need to be sure to regularly revisit and possibly adjust your asset allocation over time. Horace Mann has tools, such as questionnaires and software, to help you keep your asset allocation on track.

Which approach best fits your investment style?

Which approach to asset allocation do you want to take when managing your investments?

☐ Hands-off ☐ Hands-on

If you selected the **hands-off method**, remember, target date funds are designed with a specific date in mind for when you expect to start using your money. Examples include:

- Year 2035 fund
- Year 2045 fund
- Year 2055 fund

If you selected the **hands-on method**, you can answer the following questions to determine your risk tolerance, which will help you determine which fund or funds are right for you.

"Over 90% of the variation in an investor's return is attributed to the asset allocation decision."
– Brinson, Singer & Beebower, *Financial Analysts Journal*

Risk profile questions

With any decision you make in life – like buying a home or changing careers – you need to decide if potential rewards offset any risks. The same is true for investing – determining your risk tolerance means figuring out the degree of uncertainty you are willing to take on to achieve potentially greater rewards.

Your Horace Mann representative can help you determine your risk tolerance by evaluating your answers to a series of questions. The following questions are designed to help you choose an appropriate asset allocation strategy for each of your investment goals. Answer these questions with a specific goal in mind—retirement, for example. Because you will likely have a number of investment goals, you should fill out the questionnaire more than once, with a different goal in mind each time. The following questions will measure two key factors: your time horizon and your risk tolerance.

Your time horizon

Determining when you will be begin withdrawing money from your account and how long you'll need it to last are key factors in your asset allocation.

1. How many years from now do you expect to start spending the money you're investing?

More than 30	☐ 5 pts
20 - 30	☐ 4 pts
10 - 20	☐ 3 pts
5 - 10	☐ 2 pts
Less than 5	☐ 1 pt

2. Once you begin withdrawing funds from this investment, how long do you expect the money to last?

I plan to take a lump sum distribution	☐ 1 pt
Less than 2 years	☐ 2 pts
2 - 5 years	☐ 3 pts
6 - 10 years	☐ 4 pts
11 years or more	☐ 5 pts

Time horizon score 0

(Sum of 1 and 2)

If your time horizon score is less than 3, stop here. A score of less than 3 indicates a very short term time horizon. Investing in equity investments may be significantly more volatile in the short term.

If your score is 3 or more, please continue.

Your risk tolerance

Some investments fluctuate more dramatically in value than others and have a potential for higher returns. It's important to select investments that fit your level of tolerance for risk.

3. With your understanding that investing involves a trade off between risk and reward, what is your primary investment goal?

I want to maximize the growth of my portfolio. I am willing to accept large and sometimes dramatic fluctuations in the value of my investments.	☐ 4 pts
The primary goal of my portfolio is growth. I am willing to accept some fluctuations in the value of my investments.	☐ 3 pts
I want my portfolio to be balanced, keeping risk to a minimum while trying to achieve slightly higher returns over time.	☐ 2 pts
I am very concerned with preserving the value of my portfolio. In order to minimize the chance of loss, I am willing to accept the lower long-term returns provided by conservative investments.	☐ 1 pt

4. How comfortable are you with potential fluctuations in your portfolio? The table below presents hypothetical best-case gain %, and hypothetical worst-case loss % of five sample portfolios over a one-year period. *For illustrative purposes only.*

	Hypothetical best case (%)	Hypothetical worst case (%)
Portfolio 1	+10%	-15%
Portfolio 2	+14%	-19%
Portfolio 3	+21%	-27%
Portfolio 4	+30%	-35%
Portfolio 5	+33%	-38%

Which portfolio would you prefer? Choose one.

Portfolio 1	☐	1 pt
Portfolio 2	☐	2 pts
Portfolio 3	☐	3 pts
Portfolio 4	☐	4 pts
Portfolio 5	☐	5 pts

5. Historically, markets have experienced downturns and upswings. There have been several periods in history in which the value of the market has dropped more than 25% in a year. The most aggressive portfolios have seen even further declines. If the value of your portfolio fell from $100,000 to $75,000 (25%) in one year, how would you react assuming you still have 10 years until you begin withdrawals?

I would sell all of my portfolio.	☐	1 pt
I would sell some of my portfolio.	☐	2 pts
I would do nothing.	☐	3 pts
I would view this as an opportunity and potentially invest more in my portfolio or rebalance my existing portfolio.	☐	4 pts

6. I prefer low-risk investments even if their returns are lower than the inflation rate (the risk your money will buy fewer goods and services in the future because of rising prices).

Strongly agree	☐	1 pt
Agree	☐	2 pts
Neutral	☐	3 pts
Disagree	☐	4 pts
Strongly disagree	☐	5 pts

Risk tolerance score 0

(Sum of 3-6)

Recommending a portfolio

The summary scoring grid below facilitates determining the final portfolio selection by combining the time horizon and risk tolerance scores. Using the scoring grid below, find the intersection of the time horizon axis to the risk tolerance axis.

Time horizon score

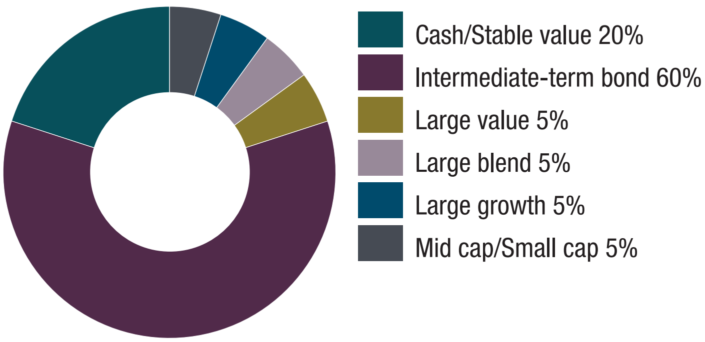
Risk tolerance	Score	2-3	4-5	6-7	8-9	10
Score	4-6	Conservative	Conservative	Conservative	Conservative	Conservative
	7-9	Conservative	Moderately conservative	Moderately conservative	Moderately conservative	Moderately conservative
	10-12	Conservative	Moderately conservative	Moderate	Moderate	Moderate
	13-15	Conservative	Moderately conservative	Moderate	Moderately aggressive	Moderately aggressive
	16-18	Conservative	Moderately conservative	Moderate	Moderately aggressive	Aggressive

Note: If an investor has a time horizon score of 2, even the most conservative portfolio may not be an appropriate investment option.

Selecting your investments

If you decided that you are a **hands-on** type of investor, find your investment style from among the charts below to see a typical distribution of investment classes for that style. Fixed income could be made up of investments in bond and/or cash/stable value funds or variable subaccounts. The fixed account of an annuity could also be used to satisfy the fixed income portion of your asset allocation.

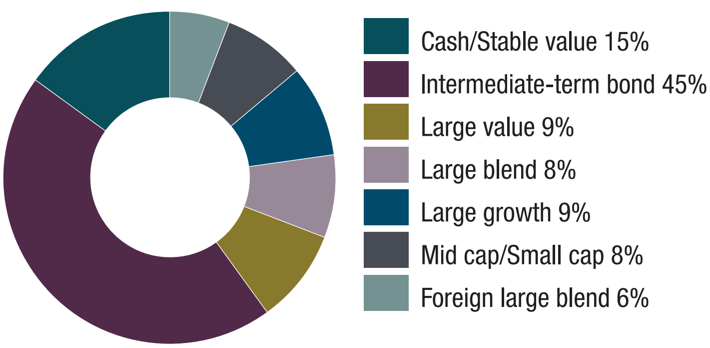
Conservative



Equity: 20% **Fixed income: 80%**

The primary objective is to preserve capital and minimize risk. Conservative investors typically need their portfolios to generate income rather than outpace inflation; are unwilling or unable to accept risk and volatility; are cautious investors; and have five or fewer years until they need to use the money from their investments.

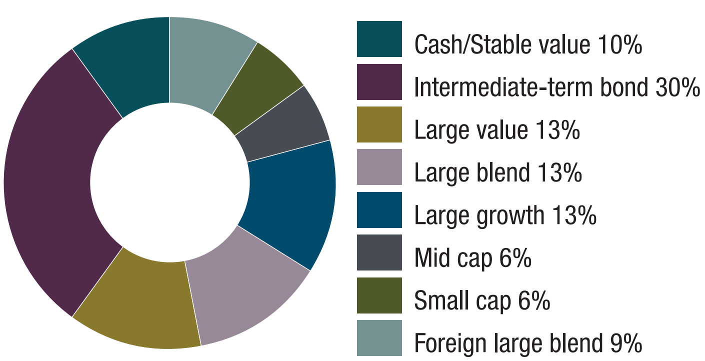
Moderately conservative



Equity: 40% **Fixed income: 60%**

Moderately conservative investors typically need their portfolios to generate income; are willing to accept a moderate degree of risk/volatility; are cautious or first-time investors; want some potential hedge against inflation; and have five or fewer years until they need to use the money from their investments.

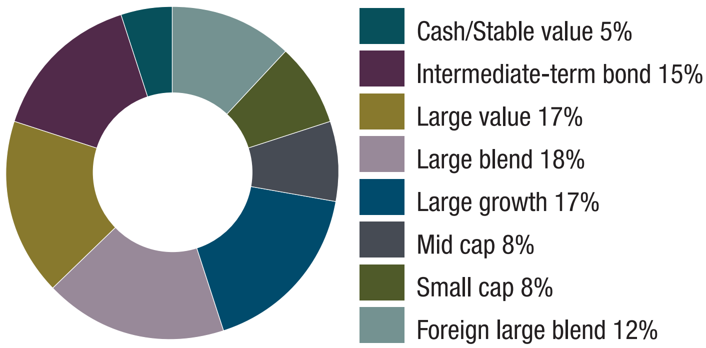
Moderate



Equity: 60% **Fixed income: 40%**

Primary objective is to reduce potential volatility by including income-generating investment in the portfolio. A moderate investor wants moderate growth of principal; is accepting of a moderate level of risk and is willing to tolerate short-term price fluctuations; is primarily a growth investor but looking for greater diversification; is concerned about inflation; and has five or more years before they need to use the money from their investments.

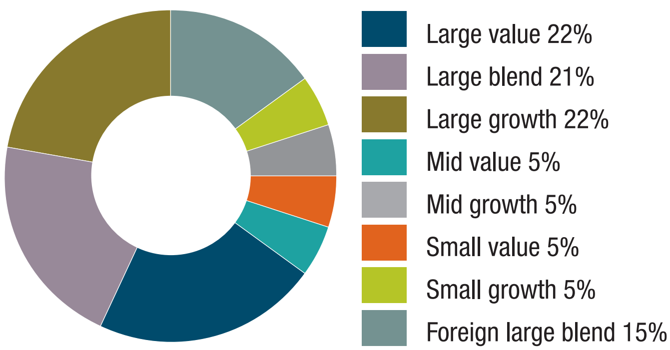
Moderately aggressive



Equity: 80% **Fixed income: 20%**

A moderately aggressive investor can tolerate market downturns and volatility in order to achieve higher growth of capital; is an experienced equity investor; and has 10 or more years before they need to use the money from their investments.

Aggressive



Equity: 100% **Fixed income: 0%**

Primarily a growth-oriented strategy that seeks to maximize the long-term potential for growth of principal. Aggressive investors can tolerate a high degree of short-term price fluctuations; and has a long-term investment time horizon, typically 15 years or more. Generating current income is not a primary goal.

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The earnings potential of each option reflects the degree of risk associated with it. The higher the potential return, the higher the degree of risk, including the possibility of loss of principal.

Fixed income securities are subject to increased loss of principal during periods of rising interest rates. Fixed income investments are subject to various other risks, including changes in credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications and other factors.

Large-cap U.S. stock funds invest primarily in stocks that fall in the top 70% of the U.S. market capitalization range as defined by SWBC Investment Advisory Services, LLC, d/b/a SWBC Retirement Plan Services.

Target date funds are managed for investors planning to retire (or to begin withdrawing substantial portions of their investments) in a particular year. These funds provide both asset allocation and rebalancing for investors following an investment strategy that grows more conservative as the target date approaches. It is important to note the principal value of target date funds is not guaranteed at any time.

Small-cap and mid-cap investment options are subject to more fluctuation in value and may have more risks than other investment options with stocks of larger, more stable companies.

International and global investment options are subject to additional risk due to fluctuating exchange rates, foreign accounting and financial policies, and other economic and political environments.

While bond funds are frequently used to help stabilize an investment program, bond funds do not guarantee the return of the principal invested. Interest rates, inflation and credit risks can affect the net asset value of bond funds, and ongoing fees and expenses are charged on shares of bond funds.

Not all investment options and asset classes are available in all plans.