

The Dresen Diversified Portfolio Model

Overview of How to Use the Tool

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Asset Allocation Sensitivity Analysis - Minimization of Portfolio Variance

Target Portfolio Return	Russell 2000	Russell 2000 Value Index	Russell 2000 Growth Index	S&P 500 Index	S&P/Barra 500 Growth Index	S&P/Barra 500 Value Index	MSCI EAFE	Lehman Brothers Aggregate Bond Index	Portfolio St Dev	Expected Return	Probability of Losing \$
10.00%	Not Feasible										
10.50%	Not Feasible										
11.00%	Not Feasible										
11.50%	0%	81%	0%	0%	0%	0%	11%	8%	20.18%	11.50%	28.44%
12.00%	0%	58%	0%	0%	0%	7%	27%	8%	18.27%	12.00%	25.56%
12.50%	0%	45%	0%	0%	0%	23%	23%	8%	16.84%	12.50%	22.89%
13.00%	0%	32%	0%	0%	0%	40%	20%	8%	15.58%	13.00%	20.20%
13.50%	0%	19%	0%	0%	0%	57%	16%	8%	14.54%	13.50%	17.65%
14.00%	0%	6%	0%	0%	0%	74%	12%	8%	13.75%	14.00%	15.44%
14.50%	0%	0%	12%	0%	0%	71%	9%	8%	13.27%	14.50%	13.72%
15.00%	0%	0%	34%	10%	0%	43%	5%	8%	13.38%	15.00%	13.12%
15.50%	0%	0%	58%	29%	0%	5%	1%	8%	14.12%	15.50%	13.62%
16.00%	0%	0%	83%	0%	9%	0%	0%	8%	15.56%	16.00%	15.19%

HOW TO READ THE MODEL

The table above shows an example of one of the tables represented in the Dresen Diversified Portfolio Model tool. For the purposes of this discussion, and generally speaking, you can use the same logic regardless of which table you use.

The model is intended to be used to help you determine the optimal asset allocation strategy for a given target portfolio return. The Model will tell you, based upon its statistical analysis, which target returns are not mathematically feasible based upon the parameters of the model. You can simply ignore those rows.

The remaining rows will provide the bulk of information as well as the most confusion. How do you decide which Target Portfolio Return to pick? Ultimately, the question is answered by each individual and his/her own personal preference and risk profile. However, to guide you in deciding which would be the best selection for you, you can use the following statements as a reference:

1. **Pick the portfolio allocation with the lowest 'Portfolio St Dev'.** In other words, pick the portfolio with the lowest variability. The portfolio with the lowest variability means the portfolio with the most stability statistically. In the example table above, the Target Portfolio Return of 14.5% has the lowest portfolio standard deviation.
2. **Pick the portfolio allocation with the lowest 'Probability of Losing \$'.** If you're most concerned about minimizing your risk of losing money, Target Portfolio Return of 15% would be the choice for you.
3. **Pick the portfolio allocation with the highest target return possible.** If you want to make the most money possible and are willing to take the risk, choose 16%.
4. **If you have a specific target return you want to use regardless of other influencing factors, use it.** But, use the Standard Deviation and Probability of Losing Money columns as guides to help you understand the implications of your decision based upon other opportunities which might be less risky.

Whatever allocation strategy you choose, be aware that the nature of these classes implies diversification within an individual class. So, it's not vital that you allocate your portfolio to include all possible asset classes. The strength of the model is its statistical analysis of the relationship between the various asset classes. So, know that whatever solution you choose is inherently diversified.

WHAT NEXT?

After you've selected a Target Portfolio Return and thus an asset allocation strategy, the next step is to choose your personal investments to best align with the asset classes used in the model. This will entail searching, reading, referencing, and contemplating the nuances of all the possible investment vehicles available to you. Two example portfolios can be seen on our website from the Support page.

Once you've identified the actual funds you are going to use, perform your normal portfolio rebalance to include the selected funds and use the percentages from the model to allocate your investments.

FINALLY

Sit back, relax, and know that your investment strategy is far more sound now than it was when you were selecting your assets by gut reaction and whatever propaganda your investment firm was able to get through your mail filters.