BAKING A CAKE

Have you ever baked a cake? When I was a kid I used to help my mom bake cakes. As an aside, let me say, real men know how to cook, sew, iron, do their laundry, make their bed and clean up after themselves.

So mom taught me all these things but baking cakes was the most fun, probably because I got to lick the spoon. But the real goal was to be able to clean out the bowl. My sisters and I would "fight" for the bowl. Mostly I got the spoon.

But baking a cake is much like constructing an investment portfolio. A cake is not just flour and neither is an investment portfolio just a stock (or just bonds). With a cake you have flour, salt, chocolate, baking powder, water, eggs, milk, butter, and sugar (at least). So, as you can see, there are many ingredients to baking a tasty, satisfying cake.

Investing is quite similar. You might have stocks, and different kinds of stocks - large, medium and small, U.S. and foreign. You might also have bonds, again perhaps different types of bonds -short-term bonds, high yield bonds, municipal tax free bonds, etc. But you might also have what is called alternative investments like real estate (in the form of tradable real estate investment trusts - REITS), and other forms of alternative investments. So you have all these ingredients for your investment portfolio much like for a cake.

But do you use the same amount of each ingredient? For instance, do you use equal amounts of salt and sugar, flour and baking powder, eggs and milk in your cake mix? Probably not!   You generally wouldn't have the same amount of every investment ingredient either. Remember, it's a pinch of salt and a cup of sugar, not a cup of salt and a pinch of sugar.

The quality of your cake has a lot do to with the proportion of each ingredient. May I suggest the quality of your investment experience may also have some relationship with the amount of each investment ingredient?

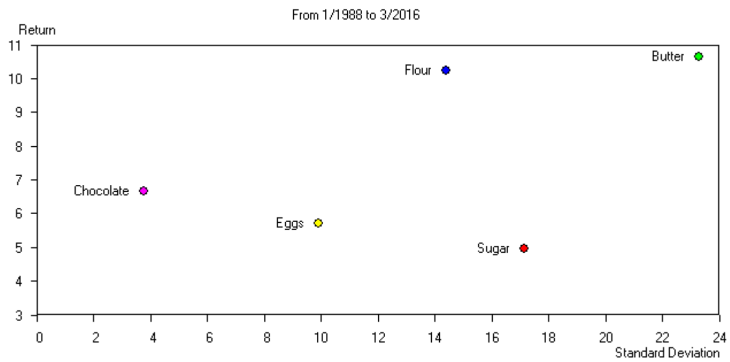
But there's more.

Your experience of eating a cake is not eating each ingredient one at a time no matter how properly proportioned each is. You don't eat a hand full of flour, then a cup of sugar, then a pinch of salt, then a cup of water, etc. etc. You experience cake eating by mixing all of these ingredients together and when you eat a slice of cake it is the baked combination that you enjoy.

Investing is quite similar. Each ingredient has its own characteristics. Individually an ingredient might have very risky or very conservative characteristics by itself. But when added to a portfolio of many other ingredients can actually enhance the overall risk-return profile of the portfolio. Odd but true.

For illustrative purposes only see below.

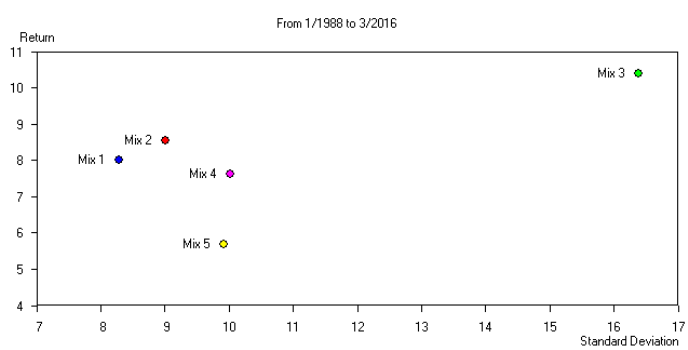
EXAMPLES: To mix a metaphor, below are several investment indexes I've renamed as cake mix ingredients. It attempt so show 100% of any one ingredient alone as in 100% sugar would alone taste different from 100% butter, etc.



	Return	Risk		Return	Risk
Flour	10.23%	14.41%	Chocolate	6.65%	3.77%
Sugar	4.95	17.17	Eggs	5.69	9.93
Butter	10.63	23.30			

SOURCE: Frontier Analytics FACTMASTER

Now if we mix all these ingredients differently we find different results.



	Return	Risk		Return	Risk
Mix 1	8.02%	8.29%	Mix 4	7.63%	10.02%
Mix 2	8.56	9.01	Mix 5	5.69	9.93
Mix 3	10.39	16.39			

Which cake mix would you want?

The above graphs represent a hypothetical illustration and are not intended to reflect the actual performance of any particular security. Future performance cannot be guaranteed and investment yields will fluctuate with market conditions.

The point is you can take the same investment ingredients, mix them differently and get different risk and return characteristics and potential. Depending on your objectives, finding the right mix is essential to managing your investment wealth.

This is what we do. And you get to lick the bowl!

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