

# BUILDING AN INVESTMENT PORTFOLIO



**This article is an introduction to portfolio management and the important contributions you and your investment manager can make to creating a portfolio that meets your needs.**

A successful investment portfolio develops from a deliberate planning process tied to your specific goals, life circumstances and tolerance for risk, rather than a series of unrelated investment decisions. A partnership between you and your investment manager that merges your aspirations with sound investing is the key to successful management. Over time, your circumstances may change, so you and your portfolio manager should periodically reevaluate your goals and objectives and their implications for your portfolio.

## BUILDING A PORTFOLIO

- **Define your investment goals**

Is your aim to grow your assets, or are you more concerned with generating income? Are you investing with a particular need in mind, like preserving assets for your heirs, purchasing a business or financing an early retirement?

- **Recognize your risk tolerance**

What level of risk are you comfortable with? Some investors are able to tolerate wide swings in performance, while others are more interested in securities whose prices remain relatively constant.

- **Determine asset allocation**

What mix of stocks, bonds, cash and alternative investments is ideal? Your asset allocation will be determined by your investment goals and tolerance for risk, as well as by market conditions.

- **Select securities**

To fulfill your investment requirements and create a sound portfolio, successful security selection involves research, risk analysis and a level of diversification appropriate to portfolio objectives.

Investment goals, risk tolerance, asset allocation and security selection will vary depending on the type of account being managed. For example, a person's taxable investment accounts will generally have different characteristics than a retirement, education or trust account.

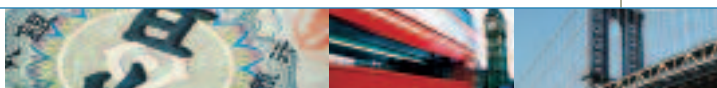
## Investment Goals and Objectives

Over the course of their lives, most investors will aim for one of three broad investment goals.

- **Accumulation** refers to building wealth, usually during one's working life, to fund long-term financial needs such as home purchases, children's educations and retirement.

- **Preservation** means protecting assets accumulated for long-term needs by utilizing tax-efficient investment and estate-planning techniques.

- **Distribution** is about transferring wealth to future generations or to charity.





Your investment goals help determine the structure and composition of your portfolio and investment objective. For the trustee of a family trust, for example, concern with generating income for retired beneficiaries may result in a portfolio whose objective is high income. Thus, the portfolio may contain fixed income or yield-generating securities.

For an individual or family whose goal is to maximize the transfer of wealth to future generations or to charity, a more growth-oriented objective may be appropriate to ensure higher long-term returns that can outpace inflation. For many older investors, the preservation and distribution of wealth may be the primary focus.

Once your investment manager has reviewed your goals, management of your assets will be based on one of the following investment objectives listed here, from more conservative to more aggressive.

- **High-income** portfolios consist primarily of fixed income securities. Emphasis is on regular income production and low volatility.
- **Income** portfolios are also made up of mostly fixed income securities with a relatively higher percentage of stocks. Emphasis remains on income production but with some regard for growth of principal.
- **Balanced** portfolios are managed for both income and growth of principal as well as preserving purchasing power of the principal.
- **Balanced growth** portfolios are managed with an emphasis on growth of principal, but with due regard for production of income.

- **Growth** portfolios are similarly managed with an emphasis on growth of principal, with some regard for production of income.
- **High-growth** portfolios are made up primarily of equity securities and are the most aggressive in seeking returns. High volatility is accepted.

### Standards for Trust Accounts

In the management of trusts and other fiduciary accounts, investment managers are held to a more stringent standard than would be applied to a discretionary investment account. The Uniform Prudent Investor Act requires that trustees and their delegates apply all investment tools available, using reasonable care, skill and caution. Under the act, trustees are required to manage assets based on modern portfolio theory principles.

For example, an asset is not evaluated separately, but by its contribution to the overall strategy, and risk and return considerations are primary concerns. In addition, investments have no absolute restrictions; an investment may be incorporated in a portfolio provided it fulfills investing requirements, and diversification is desirable.

### Risk and Return

Within a portfolio, the volatility of securities, along with their respective performance, determines their risk and return profile. A more conservative portfolio with lower risk, for example, will likely yield lower returns, while a more aggressive, growth-oriented portfolio will entail greater risk with the potential for higher returns. Additionally, an investor may take on a higher level of risk with some assets, while remaining well diversified and relatively conservative overall.

Investing always entails some level of risk, which may include market risk, country risk, and exchange rate risk. However, choosing not to be in the market is also a risk, as the value of cash and short-term investments is eroded by inflation.

Investors whose goals are long term can generally assume greater risk and can therefore hold more volatile securities in their portfolios. More cautious investors, or those with shorter time horizons, will generally prefer a greater proportion of relatively stable securities in their portfolios.

An efficient portfolio achieves the greatest possible returns given the investor's tolerance for risk, and is the goal of successful investment management. If efficient portfolios were plotted on a graph, the resulting line would represent what is called the efficient frontier.

### Asset Classes

Once your investment objectives and risk tolerance have been established, investment choices can be made from broad asset classes.

- **Cash equivalents** can take the form of Treasury bills, money market funds or certificates of deposit and may offer higher rates of interest than a typical checking or savings account.
- **Fixed income securities** or **bonds** include Treasuries, corporates, high-yield, non-dollar and municipal bonds. Portfolios with fixed income securities ideally have varied maturities to help to reduce interest rate risk.
- **Equity securities** or **corporate stocks** include small, mid and large cap stocks, representing different investment styles on the value-to-growth spectrum, as well as domestic, international and global investments.

- **Alternative** asset classes, such as hedge funds and private equity, allow for the creation of portfolios with higher returns for a given level of risk or lower risk for a given level of returns. They are often used to reduce dependence on traditional equity and fixed income investments and thereby facilitate greater diversification. They are generally appropriate for sophisticated investors.
- **Real estate** may include direct private purchases of property or real estate securities, including real estate investment trusts (REITs). A REIT invests in a portfolio of real estate investments and trades on exchanges like other securities.

### Security Selection

Your portfolio manager will choose asset classes and securities based on your financial goals, as well as research and analysis of markets, industries and economic trends. Developing a well-balanced portfolio with investments across multiple asset classes offers diversification, which is especially important considering that asset classes have not performed consistently over time.

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