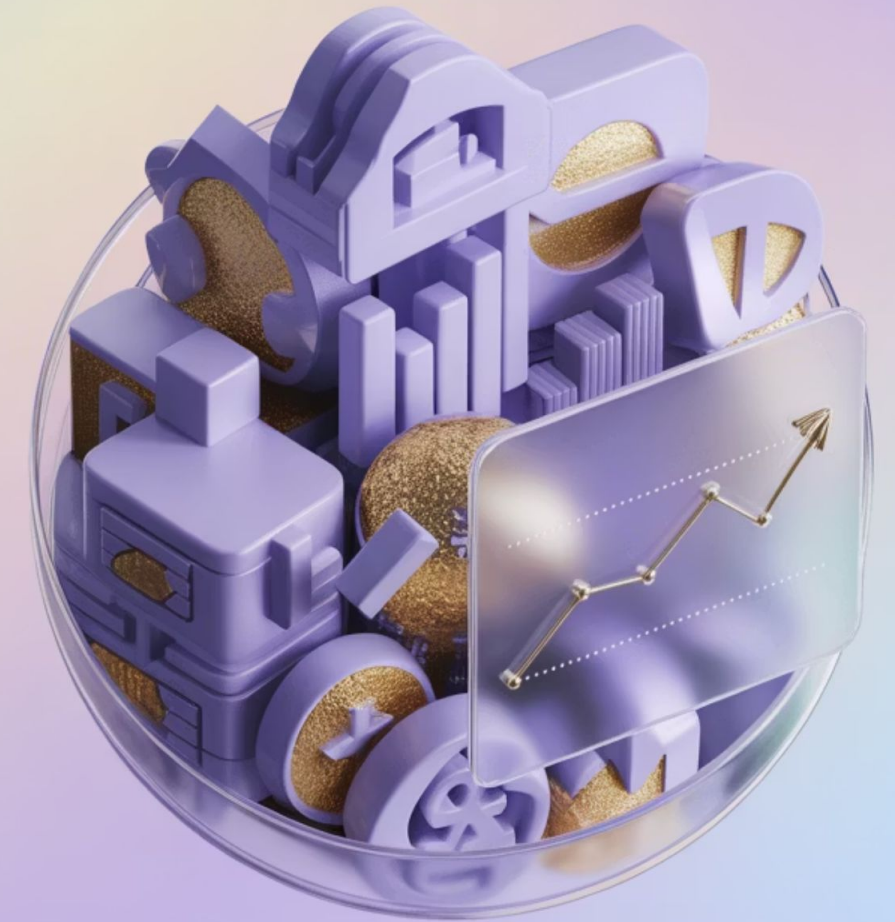


Asset Classes and Portfolio Construction

Welcome to Week 2 of our investment course. Today we'll explore the fundamental building blocks of investing: asset classes and portfolio construction principles. You'll learn how different investments work together, how to manage risk through diversification, and see examples of real-world portfolios.



Recap: Investment Fundamentals

Before diving into asset classes, let's quickly review the key investment concepts we covered last week:

- Risk vs. return relationship
- Time horizon considerations
- Compound interest power
- Importance of starting early
- Investment goals alignment

These fundamentals provide the foundation for understanding how different asset classes function within a portfolio and why diversification matters.





Asset Classes

Overview



Bonds

Debt securities where investors lend money to entities. Generally lower risk than stocks with more stable returns. Types include government, municipal, corporate, and high-yield bonds.



Real Estate

Property investments through direct ownership or REITs. Provides potential income and appreciation with moderate correlation to stocks and bonds.

Equities

Stocks representing ownership in companies. Highest historical returns but with significant volatility. Categories include large-cap, small-cap, growth, value, domestic, and international.

Investment Vehicles

Mutual Funds

Professionally managed investment pools that combine money from many investors to purchase securities. Benefits include diversification, professional management, and accessibility.

ETFs (Exchange-Traded Funds)

Similar to mutual funds but trade like stocks throughout the day. Typically have lower expense ratios and greater tax efficiency than mutual funds.

Derivatives

Financial contracts deriving value from underlying assets. Include options, futures, and swaps. Used for hedging risk or speculative purposes.





Portfolio Construction Basics

Define Investment Goals

Establish clear objectives (retirement, education, etc.), time horizon, and risk tolerance.

Asset Allocation

Determine the optimal mix of asset classes based on your goals and risk profile.

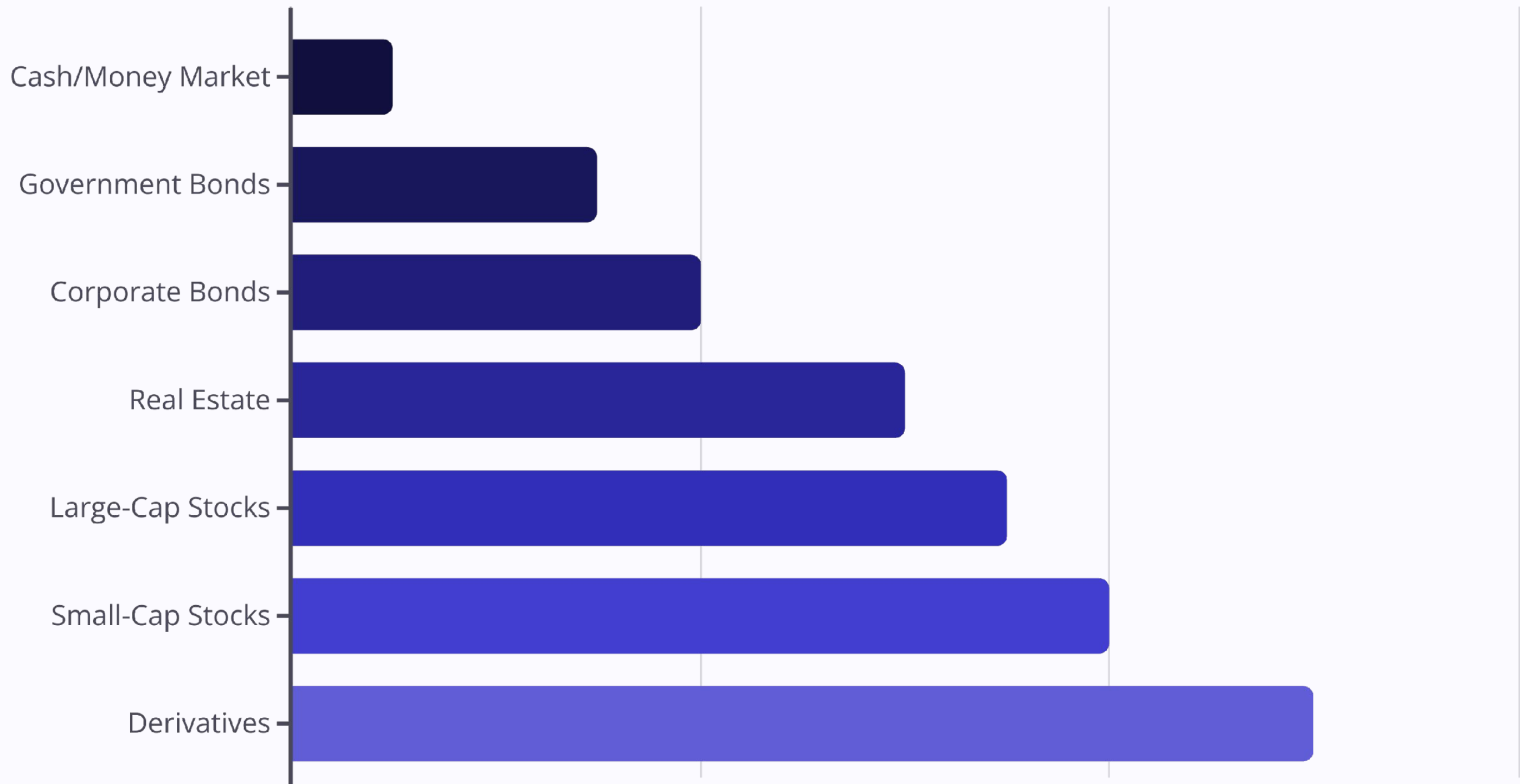
Security Selection

Choose specific investments within each asset class that align with your strategy.

Rebalancing

Periodically adjust portfolio to maintain target allocation as market values change.

Risk Levels Across Asset Classes



Correlation and Diversification

Correlation measures how investments move in relation to each other:

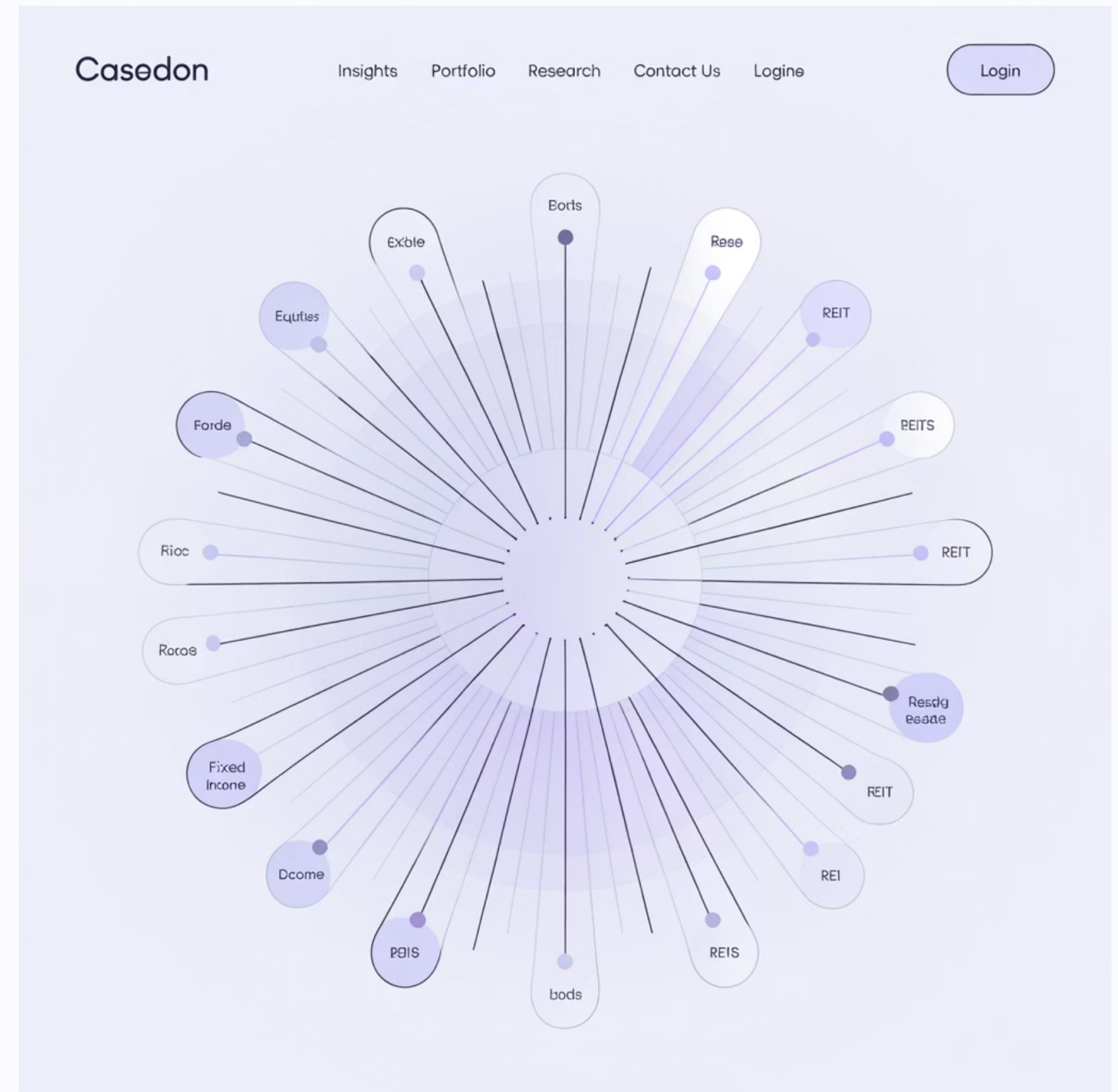
Positive correlation (near +1): Assets move in same direction

Negative correlation (near -1): Assets move in opposite directions

No correlation (near 0): Assets move independently

Diversification Benefits:

- Reduces portfolio volatility
- Smooths returns over time
- Protects against single-asset risks
- Provides multiple growth sources

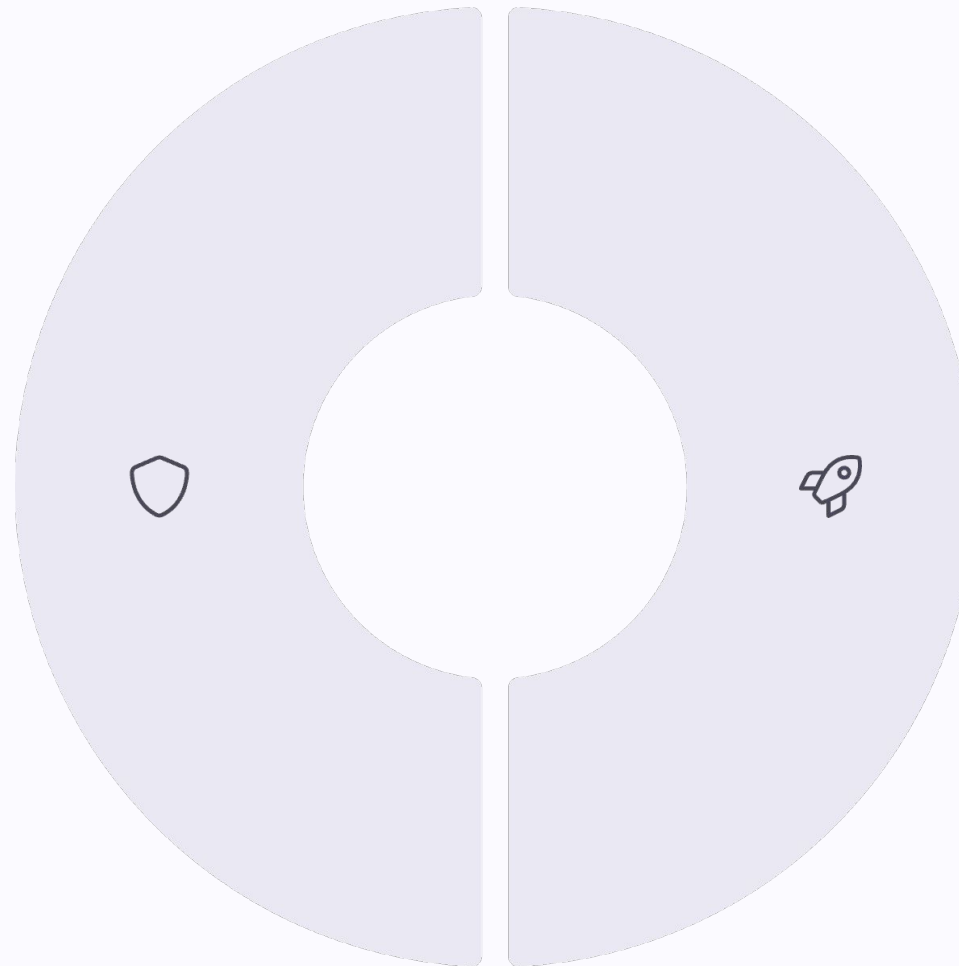


Portfolio Examples: Conservative vs Aggressive

Conservative Portfolio

Designed for capital preservation and income

- 40% Government Bonds
- 20% Corporate Bonds
- 20% Large-Cap Stocks
- 10% Real Estate
- 10% Cash



Aggressive Portfolio

Designed for maximum growth potential

- 60% Stocks (domestic and international)
- 15% Real Estate
- 15% High-Yield Bonds
- 10% Alternative Investments