Dynamic vs. passive investment styles?

Generally speaking, there are three ways to think about asset allocation: passive, tactical and dynamic. Passive asset allocation is just simply identifying a broadly diversified portfolio of stocks and bonds, perhaps U.S., perhaps global, but leaving those exposures unchanged over time. Tactical asset allocation is more active, but it’s active with a relatively short horizon. Tactical asset allocation involves trying to identify what prices will be over the course of the coming months or quarters and then buying and selling asset classes in anticipation of those price changes. Dynamic asset allocation is longer term in nature and is based on fundamental analysis.

The fundamental analysis foundation determines intrinsic value and looks to benefit from the slow reversion of price to intrinsic value for each of the asset classes. Today many people talk about risk balanced portfolios. A risk balanced portfolio is much like a passive asset allocation except it’s a passive risk allocation. It’s a risk allocation to equities and a risk allocation to bonds that is maintained over time. An alternative and one that we prefer is to dynamically manage risk in response to opportunities as they evolve and in response to risks as they emerge. Over time, we feel that the dynamic management of risk in response to opportunities and in response to risk is a superior way to position a portfolio.

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