Planning an Investment Strategy

VALUE LINE INVESTMENT EDUCATION

Value Line®

Smart research. Smarter investing.™

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Many people get overwhelmed by the topic of investing because they perceive it to be overly complex. On the surface, this may seem to be true, but with a little time spent on education and the right tools at your disposal, investing can be as simple or as consuming as you would like to make it. One of the founding principles of Value Line was to provide individual investors like yourself with the tools to become better investors. When you choose stocks, Value Line provides the guidance you need to make your selections.

APPROACHES TO INVESTING

There are many different approaches available to investors. You could take on every aspect of the process from buying stocks directly from the issuing companies (called direct purchase plans) and bonds from the U.S. Treasury, OR you could outsource everything by buying a single balanced mutual fund or exchange-traded fund (ETF) that owns a diversified collection of assets. Of course, there are countless variations between the two extremes.

Value Line suggests that you find a happy medium that allows you to enjoy the investing experience. After all, if you don't enjoy investing to some degree, it will become a chore and, perhaps, eventually fall by the wayside. Since you are the only person who can ensure your own financial security, it is important that you don't neglect this vital aspect of your life.

To help keep things "fun," it is advisable to focus on those areas that you find enjoyable and outsource the other functions. Outsourcing in this instance means paying someone else to handle a portion of your portfolio or some function of investing. For example, you probably don't want to bother with holding your own stock certificates or buying directly from companies. In this case, you should use a broker. Additionally, you may enjoy buying stocks but not bonds. If this is the case, you should purchase individual stocks for your portfolio, but buy a mutual fund or ETF that invests in bonds to round out your portfolio and provide additional diversification.

On the following pages, you will find a questionnaire designed to aid you in determining your personal "investor profile." We've included descriptions for each of the nine profiles in our model, which you should read to ensure that the one you've been assigned fits your personal situation.

Your profile, in turn, fits into one of nine broadly diversified portfolios. The general idea is simply to place your eggs in many baskets so that dropping any one basket won't do serious harm to your portfolio. We've created these portfolios using historical performance and correlations (similarities in price movements) between investment classes. It is important to remember, however, that historical performance is not a guarantee of future returns; another way of looking at it is to say that asset allocation is an art and not a science. These are broad guidelines that you should feel free to alter to your own situation.

For example, you may not want to segment your U.S. equity investing. In this case, you would simply merge the appropriate portions of the recommended portfolio (Large Cap Growth, Large Cap Value, Small Cap Growth, and Small Cap Value) to create one category for U.S. stocks. The potential future gains or losses this might involve will likely be negligible when compared to the emotional benefits you will receive from simplifying your investment approach to a level that suits your personality. It is better that you should have "fun" than turn investing into an easily neglectable chore.

That said, you should not compress things too much. The broad categories that you should maintain in some fashion include: U.S. Equities, Fixed Income Securities, and at least one additional form of diversifying asset class (for example, U.S. Small-Cap Value Stocks, Foreign Equities, Foreign Bonds, Emerging Market Equities or Gold/Natural

Resources—note that we include real estate and real estate investment trusts in the Gold/Natural Resources category).

While you could simply divide your portfolio into four equal parts, 25% U.S. Equity, 25% Foreign Equity, 25% Fixed Income, and 25% diversified assets, such as U.S. Small-Cap Value or real estate investment trusts (REITs), this would be a very aggressive portfolio that, while diversified, lacks individualization—that is to say that it is a useful example, but not likely appropriate for most investors.

Using the four equal part portfolio as a model, however, you might decide to handle the U.S. Equity portion of your portfolio and the Small-Cap Value (or REIT, if you chose that as your fourth asset class) segment using *The Value Line Investment Survey*, while "outsourcing" the rest by purchasing mutual funds you've selected utilizing *The Value Line Fund Advisor*. This leaves you primarily responsible for the day-to-day management of just half your portfolio. The other half would require just an annual or semi-annual checkup.

How much of your portfolio to handle personally is your decision. Our asset allocation model is open to any level of personalization on this front. Again, the goal is to handle as much as you feel comfortable with to ensure that you keep up with your finances. If you find that you have taken on too much, cut back. If you find that you want to do more, take on more. The level of your involvement is up to you and changeable at any moment. If we haven't stressed this enough already, the key is to make the investment process engaging and enjoyable.

DIVERSIFYING AND MAINTAINING YOUR PORTFOLIO

Assuming that you handle some portion of your portfolio, it is important to discuss diversification. On a broad level, owning securities from many different asset classes creates a diversified portfolio—for example 25% U.S. Equities/25% Foreign Equities/25% Fixed Income/25% Small-Cap Value is diversified across four asset classes. However, on an asset class level, you still need to think about diversification. Using the same portfolio, you could fill in the asset classes by purchasing just three stocks and one bond. This might seem a ridiculous example, but it is important to point out that owning one stock or bond per asset class does not provide you with adequate diversification. (Note that, generally speaking, mutual funds and ETFs are structured to be diversified so that owning one would likely provide adequate diversification within an asset class.)

It is advisable that you own at least 15 different securities within many different industries (or maturities for bonds) for whatever asset classes you choose to handle. For example, if you were investing 25% of your assets in U.S. Equities, Value Line recommends that you own 15 or more stocks from at least 10 different industries. We include a number of stock screens in the back of each *Summary & Index* section in *The Value Line Investment Survey* that we believe will provide a good starting point for any investor. And our five Model Portfolios are another good place to start. Further, we suggest that you equally weight the stocks (at least at the time of purchase) and "rebalance" the positions in your portfolio at least annually. By rebalance, we mean evening out your positions. It is a form of pushing yourself to take some profits on winning positions and to maintain diversification.

Rebalancing is an important aspect of asset allocation. You should rebalance your entire portfolio back to your original allocations (your "model" portfolio) at least once a year. It is OK to do so more often, but not advisable to go much longer than a year (for taxable accounts, securities with gains should not be sold "just under" a year). That said, a few percentage points here or there isn't going to materially alter your portfolio's profile. So, if you were using a model of 50% stocks and 50% bonds, being at 52% stocks and 48% bonds would not be a material deviation. The logic for this is that you will be selling assets that have appreciated in value and buying ones that have sold off — the old Wall Street maxim of buying low and selling high.

Along with rebalancing, there is one more issue to consider when maintaining your portfolio: changes in your own life. At least every five years you should reexamine your life situation to ensure that the model portfolio upon which you have based your investments is still appropriate to your current situation. Indeed, five years is a long time and can be the difference between having children in school and children who have started their own lives. Such a change could make a significant difference to your financial life and would need to be addressed in your portfolio. In fact, material life changes are a good reason to revisit your portfolio structure any time they occur.

Although this is just a quick overview of the topic of constructing a portfolio, it is more than enough to get you started in the right direction.

At this point in time, please go through the Value Line Investor Profile Questionnaire. Once you have completed it and scored yourself, review the "profile" that you have been assigned to ensure that it fits you. We recommend that you actually read the other profiles as well to get a feel for your relative position in the model. Assuming that you don't need to go back and rethink your answers or simply change to a profile that feels more appropriate, examine the recommended portfolio and the expected volatility and performance (note that these are based on historical figures and are not intended to be predictive). Adjust the portfolio to suit your needs and temperament.

In the end, however, remember that you should strive to make investing enjoyable as well as profitable.

VALUE LINE INVESTOR PROFILE QUESTIONNAIRE

For many investors, determining risk tolerance levels and investment time frames is the most difficult component of the asset allocation process.

The following worksheet is designed to assist you in identifying your investment profile.

For the results of this survey to be meaningful, you must respond to every question or the numerical scoring may not reflect your situation.

For each of the following groups of three statements, check the box next to the number of the statement that most closely reflects your financial situation and/or investment philosophy:

Questions A through C refer to your investment philosophy.

A. ☐ ❶ I believe one can't be too careful.
☐ ❷ When in doubt, I err on the side of caution.
☐ ❸ Nothing ventured, nothing gained.

B. ☐ ❶ I put safety first and stick with risk-free investments.
☐ ❷ I don't put all my eggs in just a few baskets. Diversification is very important to me.
☐ ❸ I go with my strong suit. I emphasize my strengths and put most of my money into my best investment ideas.

C. ☐ ❶ I live for today. The future will take care of itself.
☐ ❷ I need to begin thinking about the future.
☐ ❸ If I save for a rainy day, I'll never get wet. I plan for the seemingly distant future today.

Questions D through J refer to your own investments.

D. ☐ ❶ Receiving income on a regular basis is more important to me than growth of principal.
☐ ❷ Both income and growth are equally important to me.
☐ ❸ Growth is more important to me than current income.

E. ☐ ❶ I usually stick to the most conservative investments.

☐ ❷ Most of my investments are conservative, but I like to have a few aggressive investments in order to achieve some growth.

☐ ❸ Most of my money is invested for long-term growth.

F. ☐ ❶ Preserving at least 90% of the value of my investments at all times is more important to me than pursuing growth.

☐ ❷ Both capital preservation and growth are equally important to me.

☐ ❸ I believe in growth investing. I will risk 50%, or more, of my current capital in prudent investments in order to achieve good growth.

G. If someone whose opinion you respect told you the time was right to risk the loss of more of your principal in order to have the potential to realize substantially higher returns, you would:

☐ ❶ Refuse to take any more risk.

☐ ❷ Increase your risk a little bit.

☐ ❸ Increase your risk by a substantial amount.

H. If you won a contest and had a choice of receiving three alternative prizes (assume that there were no tax consequences):

☐ ❶ I would receive $500,000 in a lump sum today.

☐ ❷ I would receive $200,000 per year for the next five years.

☐ ❸ I would receive $2.5 million in a lump sum 10 years from now.

I. If a catastrophe were to demand $250,000 from you unexpectedly:

☐ ❶ I would have to liquidate the majority of my portfolio.

☐ ❷ I would have to liquidate at least 25% of my investments.

☐ ❸ I could handle it without significantly disrupting my investment program.

J. You can make an investment in a new type of zero coupon bond that will pay 20 times your initial investment in 10 years if the issuing company survives. The minimum investment is $100,000. You have determined that the company has a 70% chance of surviving that long. That gives you a 30% chance of losing your entire investment. You would:

☐ ❶ Not invest in this risky proposition.

☐ ❷ Invest $100,000.

☐ ❸ Invest $250,000 or more.

Questions K through O refer to your current personal situation.

K. ☐ ❶ I have no dependent children now, and my future plans call for having no new dependent children in my lifetime.

☐ ❷ I have at least one dependent child between 13 and 23 years of age, but I have no children younger than 13, nor do I expect to add to my family in the future.

☐ ❸ I either have at least one child who is less than 13 years old, or I expect to be starting a family or adding to my family sometime in the future.

L. ☐ ❶ I have no plans to buy a second home, or a business for the rest of my life and plan to retire in less than 10 years.

☐ ❷ I plan to buy a second home or business within the next 10 years.

☐ ❸ I have no plans to buy a second home or a business, and do not plan to retire any time in the next 10 years.

M. ☐ ❶ The principal earner in my family is retired, or very close to his or her probable retirement age.

☐ ❷ The principal earner in my family has between five and 15 years left before he or she reaches retirement age.

☐ ❸ The principal earner in my family has more than 15 years left until retirement.

N. ☐ ❶ Leaving a substantial inheritance is not important to me.

☐ ❷ Leaving a substantial inheritance is important, but not at the expense of my current lifestyle.

☐ ❸ Leaving a substantial inheritance is very important to me.

To calculate your investment profile, follow these simple steps:

1. Using the table that follows, add the numeric values (1, 2, or 3) of your answers to Questions A, B, E, F, G, I, J, and M. To this total, add the values of your responses to E, F, I, and M.

Question	Response (1, 2 or 3):
A.	________
B.	________
E.	________
E.	________
F.	________
F.	________
G.	________
I.	________
I.	________
J.	________
M.	________
M.	________
Total	________

2. If your total score is:

a) Between 12 and 17, your risk posture is conservative.

b) Between 18 and 24, your risk posture is moderate.

c) Above 25, your risk posture is aggressive.

3. Now, add the numeric values (1, 2, or 3) of your answers to questions C, D, E, F, H, K, L, and N. To that total, add the values of your responses to D, H, K, and L. Finally, add 2 more points if your answer to J was 2 or 3.

Question	Response (1, 2 or 3):
C.	________
D.	________
D.	________
E.	________
F.	________
H.	________
H.	________
J.	________
K.	________
K.	________
L.	________
L.	________
N.	________
Total	________

4. If your total score is:

   a) From 13 to 19, your time-horizon is short.

   b) From 20 to 29, your time horizon is in the mid-range.

   c) Above 30, your time horizon is long.

5. Together, your risk posture and your time horizon combine to define your investor profile. Consult the grid below to identify the model portfolio suited for your profile.

Results of Safety Ranks in major market declines

	Time Horizon		
	SHORT	MID-RANGE	LONG
Conservative	1	2	3
Moderate	4	5	6
Aggressive	7	8	9

The above grid provides a sound starting point for investors in assessing what type of portfolio suits their goals and circumstances. Sample portfolio allocations are provided for each profile (except Profile 1). Descriptions of the type of investors likely to fit each of the nine profiles are provided on the following pages. These sample portfolio allocations show the percentages in each of 10 broad asset classes that, when used to construct a portfolio, generate risk and reward characteristics appropriate to those who fall into a particular investor profile.

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General descriptions for the profiles represented by each box of the grid are presented below. These profiles provide a basic framework for mutual fund or ETF investment decision-making.

1. Investors represented by Box 1 have a conservative risk posture and short time horizon. Typically, such individuals consider themselves to be part of the middle-income group; they are near retirement or already retired; and their current income is limited relative to the expenses and liabilities they anticipate incurring. With little margin for error, they should keep all of their investments in money-market equivalents.

2. These investors have a conservative risk posture and medium time horizon. Typically, they consider themselves to be middle-income; they are between five and 20 years from retirement; and they probably are at or close to their peak earning power. Box 2 investors recognize that some investment risk is necessary to provide for their family's future needs and tend to prefer income stocks.

3. A conservative risk posture and long time horizon characterize more U.S. investors than any other profile. These individuals are typically less than 70 years old, and they believe that they will maintain their peak earning power. Their aversion to risk leads them to err on the side of caution with their investments. At the same time, they realize that they must accept some risk if they are to achieve long-term growth of capital.

4. Investors who fit into Box 4 have a moderate risk posture and short time horizon. Typically, such investors are near retirement or already retired, and they have planned well enough for their financial future to be assured of meeting their projected expenses and liabilities. These investors need to provide just sufficient principal growth in equities to assure a steady stream of income for their retirement years.

5. With a moderate risk posture and medium time horizon, these investors are typically between five and 20 years from retirement. They are nearing their peak earning power, and they have enough of a nest egg to sleep fairly well at night. Through profitable experience, Box 5 investors understand that assuming a reasonable amount of stock market risk is desirable to achieve their family's shared goals.

6. The moderate risk posture and long time horizon of these investors are highly desirable for wealth accumulation. Box 6 investors are doing reasonably well financially at present and expect to be doing as well or better for the next 10 to 20 years. Since current needs are not overwhelming, and long-term growth is the number-one priority, stocks are generally the predominant investment vehicle for these investors.

7. This box characterizes fewer investors than any other in the grid. An aggressive risk posture and short time horizon typify older Americans who have planned their future well. These individuals have more money now than they expect their family to need. Since long-term growth is no longer an issue, those with this profile should invest in enough stocks, bonds, and cash equivalents to ensure continuity of income for the rest of their lives.

8. With an aggressive risk posture and a medium time horizon, these investors are typically between 40 and 60 years of age. They have earned the security not to be too concerned about their next paycheck, but they nevertheless seek to provide enough growth in their portfolios to take care of all future needs that may arise.

9. An aggressive risk posture and a long time horizon are a most desirable combination. Box 9 investors have successfully taken risks and have reached their current financial situation at a reasonably youthful age. In view of the fact that long-term growth is their sole priority, stocks are overwhelmingly their vehicle of choice, and they can include an allocation to riskier, high-potential issues.

Please note that these model allocations do not take tax considerations or specific income needs into account. They are intended as a general guide, to assist subscribers in their decision-making.

The Value Line Asset-Allocation Model

The Value Line asset-allocation models are designed to provide investors with a framework from which to build their own portfolio. There are nine models, each representing a hypothetical investor profile. The profiles are determined based on a combination of three investment time horizons and three levels of risk tolerance, for a total of nine models.

The portfolios are shown below, along with an appropriate asset allocation for each. Note that the first portfolio, Box 1, is not shown, because it is for conservative investors with short time horizons, and recommends all cash and short-term instruments.

Because asset allocation is generally regarded as a more powerful determinant of a portfolio's performance than individual security selection, it makes sense to focus at least as much attention on putting together an appropriate and well-thought-out asset mix as it does on choosing the individual investments. The models furnished here should provide a good start for investors.

The Value Line asset-allocation models are based on risk-reward optimization using the historical rates of return and covariance of 10 asset classes. The percentage allocations shown for each asset class in each model are those that would provide what Value Line believes is an optimum blend of risk and return, given each model investor's circumstances.

Value Line's asset allocation models are based on risk-reward optimization using historical rates of return, risks (measured by standard deviation* of returns), and correlations of 10 asset classes.

Investors are encouraged to modify these portfolios in accordance with their own preferences and circumstances. While no one can make guarantees as to how a particular portfolio, or even an entire strategy, will perform, we believe the kind of careful, quantitative approach we employ in determining these allocations provides a sensible basis for putting together a diversified portfolio that stands to help an investor achieve his or her investment goals.

2 CONSERVATIVE— Medium Time Horizon (BOX 2)

Asset Class	Pct.
Large Growth	5
Large Value	5
Small Growth	3
Small Value	2
Foreign Stock	10
Emerging Market	7
Domestic Bond	12
High Yield Bond	10
Foreign Bond	10
Gold & Resources	1
Cash & Equivalents	35
Expected Return	7.8
Standard Deviation	5.78

3 CONSERVATIVE— Long Time Horizon (BOX 3)

Asset Class	Pct.
Large Growth	10
Large Value	5
Small Growth	3
Small Value	5
Foreign Stock	16
Emerging Market	11
Domestic Bond	20
High Yield Bond	15
Foreign Bond	14
Gold & Resources	1
Cash & Equivalents	0
Expected Return	9.4
Standard Deviation	9.04

*Standard deviation shows the dispersion of returns around the average return (or expected return). A low standard deviation indicates that the annual returns are close to the mean; a high standard deviation indicates that the returns are often farther away from the mean. One standard deviation means that 68% of the returns will fall within Expected Return +/- Standard Deviation.

M O D E R A T E —
Short Time Horizon (BOX 4)

Asset Class	**Pct.**
Large Growth	4
Large Value	4
Small Growth	2
Small Value	2
Foreign Stock	8
Emerging Market	5
Domestic Bond	8
High Yield Bond	8
Foreign Bond	9
Gold & Resources	1
Cash & Equivalents	49
Expected Return	7.2
Standard Deviation	4.56

M O D E R A T E —
Medium Time Horizon (BOX 5)

Asset Class	**Pct.**
Large Growth	8
Large Value	7
Small Growth	2
Small Value	3
Foreign Stock	13
Emerging Market	10
Domestic Bond	17
High Yield Bond	14
Foreign Bond	13
Gold & Resources	1
Cash & Equivalents	12
Expected Return	8.8
Standard Deviation	7.83

M O D E R A T E —
Long Time Horizon (BOX 6)

Asset Class	**Pct.**
Large Growth	12
Large Value	12
Small Growth	8
Small Value	7
Foreign Stock	25
Emerging Market	16
Domestic Bond	6
High Yield Bond	5
Foreign Bond	9
Gold & Resources	0
Cash & Equivalents	0
Expected Return	10.8
Standard Deviation	12.26

A G G R E S S I V E —
Short Time Horizon (BOX 7)

Asset Class	**Pct.**
Large Growth	7
Large Value	6
Small Growth	2
Small Value	2
Foreign Stock	11
Emerging Market	8
Domestic Bond	14
High Yield Bond	12
Foreign Bond	11
Gold & Resources	1
Cash & Equivalents	26
Expected Return	8.2
Standard Deviation	6.6

A G G R E S S I V E —
Medium Time Horizon (BOX 8)

Asset Class	**Pct.**
Large Growth	10
Large Value	11
Small Growth	5
Small Value	5
Foreign Stock	21
Emerging Market	14
Domestic Bond	12
High Yield Bond	10
Foreign Bond	11
Gold & Resources	1
Cash & Equivalents	0
Expected Return	10.2
Standard Deviation	10.83

A G G R E S S I V E —
Long Time Horizon (BOX 9)

Asset Class	**Pct.**
Large Growth	7
Large Value	7
Small Growth	18
Small Value	14
Foreign Stock	33
Emerging Market	21
Domestic Bond	0
High Yield Bond	0
Foreign Bond	0
Gold & Resources	0
Cash & Equivalents	0
Expected Return	12
Standard Deviation	15.34

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