Our Approach to Asset Allocation

Executive Overview

Building and maintaining an investment portfolio that takes full advantage of the opportunities available in today’s markets has become increasingly challenging. This is especially true in an environment with literally thousands of different investment options, a global economy that is undergoing significant changes, and a marketplace subject to unforeseen fluctuations. Investors are likely to benefit from working with a team that has a thorough and repeatable process in place.

In The Private Client Reserve at U.S. Bank, our philosophy includes a commitment to strategic asset allocation which strives to produce consistent long-term results, reduce portfolio volatility, and manage risk exposure. We believe no component of the investment process is more important than determining which asset classes should be used within the portfolio and how much will be invested in each one. This technique is designed to provide stronger performance over the long term by capturing opportunities across multiple asset classes.

Our comprehensive approach blends together robust quantitative tools and the unique circumstances of each client to create an investment portfolio that is customized to reflect specific needs and objectives.

Our dynamic asset allocation process begins with a long-term view of asset class performance expectations. This view is based on an extensive understanding of, and insights into historical performance and long-term market expectations with regard to return, risk, yield and valuation. Based on these projections, we establish a range for each asset class and then determine the strategic mix of asset classes for a given level of risk.

This comprehensive approach to asset allocation offers clients what may be a superior opportunity to potentially achieve specific investment objectives. It utilizes the best the market has to offer from a historical perspective while also taking advantage of temporary fluctuations in the markets and economy to seek limited risk and round out a portfolio’s full performance potential.

We believe asset allocation decisions are key to driving long-term performance.
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“Science” of Investing Helps Shape Strategies

The “science” of designing a portfolio to seek specific performance objectives over the long term begins by looking at historical benchmark performances of various asset classes. Over time, it is often easy to distinguish between different types of investments based on their long-term performance.

Looking at the more basic asset classes, stocks have historically generated superior returns when compared to bonds, which have, over the long run, outperformed Treasury bills. Based on this assumption alone, portfolio structure might seem simple, but the long-term return averages of these different asset classes obscure the reality that over shorter periods of time, asset class performance can vary widely. Most notably, higher-returning asset classes have historically fluctuated the most over short periods of time, which may add significant risk to a portfolio. Lower-returning asset classes have historically been less volatile, but also may not have generated sufficient performance to, on their own, achieve stated goals. Asset allocation attempts to identify the combination of these assets that may work effectively together to potentially limit risk while generating desired returns.

Asset allocation is also an acknowledgement that performance of different investments tend to vary from year to year. The best-returning asset one year can be among the worst the next.

A strategic approach to asset allocation recognizes that historical performance data about each asset class may provide insights on how combinations of assets may work together to potentially achieve targeted return objectives for a given level of short-term volatility (risk). This forms the basis of our strategic portfolio construction process.

Our investment management team assesses historical return, risk and correlation relationships of a wide range of asset classes, including alternative investments. When designing our range of portfolio strategies, we take advantage of a wide spectrum of investment options, centering on four broad capital market asset classes:

- **Equities** – including large-, mid- and small-cap; domestic, developed and emerging international markets; alternative investment styles (when appropriate), such as hedged equity funds, structured equity notes, exchange funds, and private equity; active and passive management options are also considered.

- **Fixed income** – bonds, bills and notes with various maturities and tax status, from a broad range of domestic and foreign issuers. Also, alternative investment styles (when appropriate), such as structured notes and hedged fixed income funds; active and passive management options are also considered.

- **Real estate** – including outright ownership of properties, Real Estate Investment Trusts (REITs), direct real estate funds, and as appropriate, structured real estate notes. Both active and passive management options are also considered.

- **Commodities** – including outright ownership of mining, oil and natural gas properties, funds which invest in commodity exposures, and as appropriate, alternative investment styles, including structured products and private commodities. Active and passive management options can be utilized.

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### Total Return by Decade

<table>
<thead>
<tr>
<th>Decade</th>
<th>Small Capitalization Stocks</th>
<th>Standard &amp; Poor’s 500</th>
<th>Intermediate Term Treasury Bonds</th>
<th>Long Term Treasury Bonds</th>
<th>90 Day Treasury Bills</th>
<th>Consumer Price Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980-1989</td>
<td>14.5</td>
<td>14.7</td>
<td>6.7</td>
<td>8.7</td>
<td>5.1</td>
<td>-0.9</td>
</tr>
<tr>
<td>1990-1999</td>
<td>16.2</td>
<td>18.2</td>
<td>8.6</td>
<td>4.9</td>
<td>3.5</td>
<td>2.7</td>
</tr>
<tr>
<td>2000-2009</td>
<td>17.6</td>
<td>18.2</td>
<td>8.2</td>
<td>8.2</td>
<td>5.6</td>
<td>2.5</td>
</tr>
</tbody>
</table>

Source: Crandall, Pierce & Company
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The primary goal of our strategic asset allocation process is to select a combination of investments that, based on history, may be expected to demonstrate efficiency in striving for a desired return for a given level of risk. Perhaps the greatest benefit of an effectively structured strategic portfolio mix is to potentially meet expectations in relation to the portfolio’s exposure to market volatility. With history as a guide, our investment professionals can determine ways to utilize a broad range of assets that, in combination, may work effectively to limit volatility and still seek to potentially obtain a more competitive return.

The asset allocation mix designed for each client can incorporate existing holdings, and determine how best to position those assets with other investment options. This strategic approach serves as the foundation of every investment recommendation we make.

Our investment leadership team, ranging from the chief investment officer to regional investment managers and senior portfolio strategists, assess the environment regularly to help fine tune the portfolio selection process. Strategic models are reviewed annually to update assumptions about specific asset class performance.

The “Art” of Asset Allocation – Tactical Adjustments

While a portfolio structured using an asset allocation strategy is designed as a long-term solution, the reality of the markets and economy in today’s environment is that specific events and trends have the potential to affect performance. Short-term, tactical adjustments to a portfolio may be effective at limiting downside risk and potentially enhancing returns of a long-term portfolio. Tactical strategies are designed to be complementary to strategic allocation solutions.

Portfolios are continuously assessed in light of current economic and market conditions and the performance of existing assets and other factors, such as our reading of market sentiment and momentum as they affect specific holdings. Our investment leadership team may implement a change in our strategic strategies due to a shift in relative value between asset classes, or introduce a new source of diversification that may be able to provide additional return to portfolios without disrupting long-term asset allocation plans. Portfolio managers make tactical recommendations on a case-by-case basis. This is not a matter of chasing performance. The insights of our investment professionals are leveraged to help make changes in a portfolio mix (typically affecting no more than 10% to 20% of all holdings) that may help position a portfolio more effectively for current market conditions and potential future developments. This is a continuous process that incorporates the “art” of asset allocation into a client’s strategic portfolio mix.

A Personalized Solution

The more sophisticated a client’s investment needs, the more important it is to work with a team that can generate personalized solutions. Our asset allocation process is designed to work on an individual level, resulting in client-specific portfolio recommendations. There are several key components:
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**Assessing goals and risk tolerance**
The process begins with an in-depth conversation designed to identify current holdings, specific investment objectives (for instance, long-term accumulation or current income), views on market risk and other factors that could impact the structure of the portfolio. The benefit of this thorough process is to attempt to manage the level of investment risk incorporated into the final recommendation. We conduct an interview with questions designed to help quantify a client's risk tolerance level. But we also recognize that any number of variables can affect attitudes toward risk, and will incorporate those factors into the process as well. Because we emphasize the importance of getting to know specific requirements of each client, we enhance the potential to create a portfolio that will truly reflect their investment desires.

**Investment holdings**
Other personal factors come into play as well. Some clients have significant dollars invested in a specific asset class – such as real estate or in a concentrated stock holding (i.e., an employer’s company stock). A personalized asset allocation strategy will address the impact of such holdings and determine how best to strive to manage the risk associated with assets that have a significant impact on the portfolio.

**Tax considerations**
Another factor that can vary depending on the client is the impact of taxes on investment return assumptions. Our recommendations are structured to determine the best mix of assets (seeking optimum return for an acceptable level of risk) on an after-tax basis. If taxes are a crucial issue for the client, they will be factored into the recommended portfolio mix. If tax laws change, clients may expect that portfolios will be adjusted if necessary.

In circumstances where portfolios are not directly affected by taxes (such as qualified plan dollars or investments by a non-profit corporation) the asset mix will be structured appropriately.

**A commitment to long-term success**
The process of shaping a portfolio does not end once the actual investment mix is put into place. The process continues as long as the client is actively investing in the market. Tactical changes are part of the ongoing process. So is the concept of rebalancing an asset allocation mix.

Rebalancing, by definition, involves making adjustments to a long-term portfolio to account for performance variations between asset classes. For example, if small-cap stocks, over a certain period of time, have performed well above expectations, while large-cap stocks have lagged in performance, the portfolio might eventually drift out of balance. Small-cap stocks may now represent a larger position in the portfolio than was intended, while large-cap stocks may be under-represented. Rebalancing is designed to adjust for this discrepancy, bringing the portfolio allocation back in line. In this example, a portion of the small-cap position would be sold while holdings would be added to the large-cap position. This helps maintain a consistent risk exposure in the portfolio, which may avoid being suddenly caught in a position where the portfolio is taking undue risks.

Our ongoing commitment to portfolio success also incorporates frequent reviews of investment progress in relation to a client’s ultimate financial objectives. A well-managed asset allocation approach takes into account the potential that circumstances in a client’s life may change. If that's the case, it is likely that portfolio adjustments will be required. The process followed by our professionals reflects any individual issues in a client’s situation that could require portfolio adjustments. This is important in helping clients stay on track with their ultimate investment objectives.
Conclusion

We believe the most effective portfolio solutions take into account a combination of factors, including:

- historical market performance and the relationship of different types of assets invested in combination with each other.
- individual financial objectives and risk characteristics that can impact the structure of a portfolio. This includes a complete accounting for client perspectives on risk and tax considerations.
- current market and economic trends that could affect the outcome of a strategic asset allocation mix. Investment professionals put their knowledge of the markets to work to help fine-tune a portfolio to potentially capitalize on current trends and the potential future direction of the market.
- changes in a client’s specific circumstances that could affect the optimum portfolio solution that is most applicable for a client.

All of these factors are woven into creating and maintaining a comprehensive asset allocation solution for our clients. We believe this approach provides the best foundation for clients to reach their long-term goals.

Dynamic asset allocation can offer a flexible portfolio solution, which is critical in today’s environment.
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IMPORTANT DISCLOSURES

This information was prepared in June, 2010 and represents the opinion of U.S. Bank. It does not constitute investment advice and is issued without regard to specific investment objectives or the financial situation of any particular individual. The information presented is for discussion purposes only and is not intended to serve as a recommendation or solicitation for the purchase or sale of any type of security. The factual information provided has been obtained from sources believed to be reliable, but is not guaranteed as to accuracy or completeness. U.S. Bank is not responsible for and does not guarantee the products, services or performance of third party providers. U.S. Bank and its representatives do not provide tax or legal advice. Individuals should consult their tax and/or legal advisor for advice concerning their particular situation.

Based on our strategic approach to creating diversified portfolios, guidelines are in place concerning how investments should be allocated to specific asset classes based on client goals, objectives and tolerance for risk. Not all recommended asset classes may be suitable for every portfolio. Hedged equity and hedged fixed income investment strategies are typically available via hedge funds which may not be appropriate for all clients due to the speculative nature and high degree of risk involved in these investments.

**Equity securities** are subject to stock market fluctuations that occur in response to economic and business developments. Stocks of **small- and mid-cap companies** pose special risks, including possible illiquidity and greater price volatility than stocks of larger, more established companies. **International** investing involves special risks, including foreign taxation, currency risks, risks associated with possible differences in financial standards and other risks associated with future political and economic developments. Investing in **emerging markets** may involve greater risks than investing in more developed countries. In addition, concentration of investments in a single region may result in greater volatility. **Investment in fixed income debt securities** are subject to various risks, including changes in interest rates, credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications, and other factors. Investment in debt securities typically decrease in value when interest rates rise. This risk is usually greater for **longer term debt securities**. Investments in **real estate securities** can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates and risks related to renting properties, such as rental defaults. **Alternative investments** very often use speculative investment and trading strategies. There is no guarantee the investment program will be successful. Alternative investments may not be suitable for every investor, even if the investor does meet the financial requirements. It is important for investors to consult with their investment professional prior to investment in these investments. There are special risks associated with an investment in **commodities**, including market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes, and the impact of adverse political or financial factors. **Hedge funds** are speculative and involve a substantially more complicated set of risk factors than traditional investments in stocks or bonds, including the risks of using derivatives, leverage and short sales, which can magnify potential losses or gains. Restrictions exist on the ability to redeem units in a hedge fund. **Structured products** are subject to market risk and/or principal loss if sold prior to maturity or if the issuer defaults on the security. Investors should request and review copies of Structured Products and Pricing Supplements and Prospectuses prior to approving or directing an investment in these securities. **Private Equity** consists of investors and funds that make investments directly into private companies or conduct buyouts of public companies that result in a delisting of public equity. Potential investors should remember that investments in private equity are illiquid by nature and typically represent a long-term commitment. The investments made by private equity funds are not readily marketable and the valuation procedures for these positions are often subjective in nature.