NATIXIS
GLOBAL ASSET MANAGEMENT

Risk-efficient investment portfolios from AlphaSimplex Group

ALPHASIMPLEX

AlphaSimplex Group and LPL Financial

AlphaSimplex Group is working with LPL Financial to offer risk-efficient strategies available in Model Wealth Portfolios. Your LPL Financial advisor has a broad range of investment options to work with, and can help you choose a strategy that's consistent with your investment objectives and risk profile.

Model Wealth Portfolios attempt to meet your changing investment needs as your lifestyle and goals evolve. They can help you focus your wealth on what is most important to you, with thoughtfully constructed portfolios using professionally designed asset allocation strategies. AlphaSimplex Group places special emphasis on the risk-reward characteristics of the underlying investments.

"We're not taking risk off the table. Instead, we seek to stabilize risk within our strategies even as the level of risk in the markets fluctuates. Our goal is to be more efficient in our use of risk, which means our desired level of market exposure at any given time is inversely related to market risk."

Dr. Andrew W. Lo
Founder, Chief Investment Officer and
Portfolio Manager, AlphaSimplex Group

No strategy assures success or protects against loss. Asset allocation does not ensure a profit or protect against a loss.

What is a risk-efficient strategy?

A risk-efficient strategy makes managing risk the top priority. Like other strategies, it uses asset allocation to help manage risk, but does so more actively than traditional approaches in order to reduce investment market exposure when market risk is high and unlikely to be appropriately compensated by market returns. When market risk is normal or below average, and likely to be adequately compensated, it can increase investment exposure. This strategy is not intended to outperform stocks and bonds during market rallies, and may underperform during periods of strong market performance.

- The managers use trend-based forecasts to overweight assets that have been gaining value and underweight assets that have been losing value.
- When markets are highly volatile, the managers can reduce the total allocation to riskier assets, such as stocks and commodities, with the goal of keeping the portfolio risk at its designated target.
- When market volatility is lower, exposure to riskier assets may offer better opportunities for return, without taking on undue risk.

As market conditions change, the portfolios are rebalanced[1] to shift assets strategically between riskier asset classes and those that are less volatile or offer the greatest diversification.[2]

The rationale for risk-efficient portfolios

Asset allocation is the traditional approach to managing investment risk and optimizing the potential for return.[3] But it may have some shortcomings when financial markets are volatile.

In traditional asset allocation, portfolio risk climbs and falls along with the volatility of the markets. As a result, portfolios may become too risky when market volatility increases, exposing investors to the possibility of steep losses. Conversely, when volatility is lower, portfolios may have too little risk to achieve investment objectives because investors remain overly cautious. When portfolio risk is actively managed to an explicit target, it can allow investors to participate in the markets, but still provide potential protection on the downside. Staying invested over time is the most effective way for investors to pursue their long-term goals.

The potential benefits of a risk-efficient portfolio

In a risk-efficient portfolio, allocations are adjusted in response to evolving market conditions, a strategy that seeks to:

- Help reduce the severity of portfolio losses
- Offer the potential for more consistent returns over time
- Provide the potential for protecting portfolio value even in bear markets

1. Rebalancing may involve tax consequences.
2. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk.
3. Asset allocation does not ensure a profit or protect against a loss.

Who could benefit?

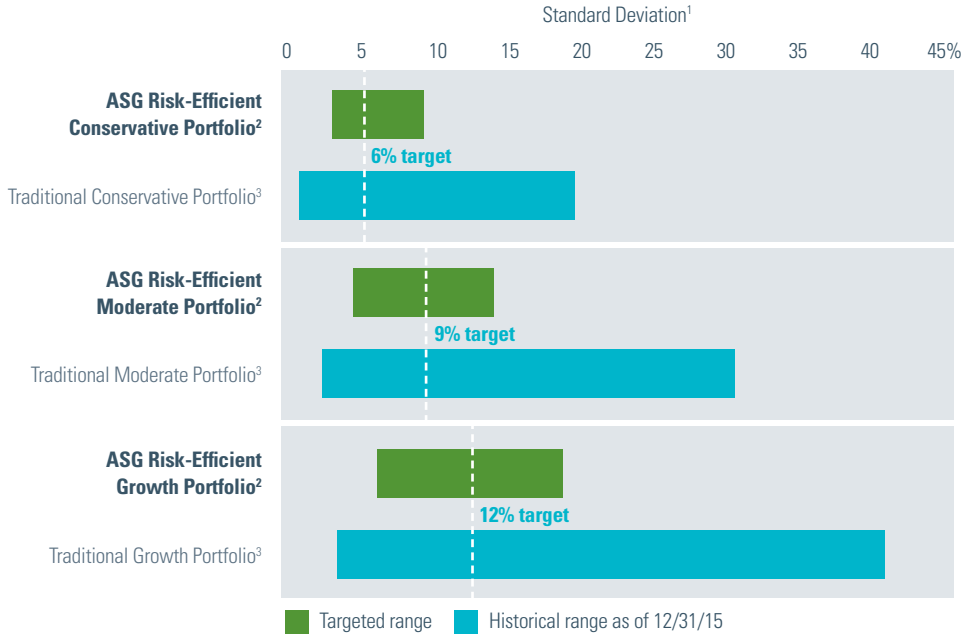
- Investors nearing or in retirement, who need enough risk in their portfolios to reduce the likelihood of outliving their savings, but who can't afford a large loss
- Investors saving for goals such as college or a vacation home, who have a shorter investment horizon but don't want to sacrifice return
- Cautious investors who are reluctant to re-enter the market after experiencing losses during the financial crisis and who want to reduce the potential magnitude of losses
- Investors looking to optimize the return on the risk they are willing to take

Conservative, moderate or growth

The ASG Risk-Efficient Portfolios follow a strategy designed and managed by AlphaSimplex Group. Each of the three model portfolios uses a dynamic allocation approach that seeks to participate in up markets and to protect in downturns, in an effort to outperform their respective benchmarks over time. The strategy is not intended to outperform stocks and bonds during market rallies, and may underperform during periods of strong market returns. The portfolios are intended to be durable, with core strategic allocations to AlphaSimplex risk-managed funds and actively managed stock and bond mutual funds run by specially selected investment managers.

In addition to the durable strategic core, each portfolio employs a tactical allocation strategy using exchange-traded funds that seeks to maximize return and minimize risk. Depending on prevailing market conditions, allocations to ETFs are made either opportunistically or to tactically manage risk.

HYPOTHETICAL RISK ANALYSIS



Risk analysis of hypothetical portfolios

Analysis of traditional portfolios, those which seek to manage risk through a strategic asset allocation of stocks and bonds, reveals that portfolio volatility or risk can exhibit a wide range of outcomes.

For example, an asset allocation mix associated with a traditional conservative portfolio with an average portfolio standard deviation of 6% has experienced a wide range of volatility, as high as 17%. This is why the ASG Risk-Efficient Portfolios seek to explicitly constrain volatility to a more narrow range than may be experienced by constructed portfolios.

Data source: Ibbotson Associates and internal calculations • This is a hypothetical example and is not representative of any specific investment. Your results may vary.

1. Risk is measured as 24-month rolling volatility as measured by Standard Deviation which is a statistical measure of historical volatility. The higher the standard deviation, the more risky the asset. **2.** The Risk-Efficient Portfolios seek to target a relatively stable level of annualized volatility (as measured by standard deviation), but the targeted volatility is subject to change. There is no guarantee that the target will be achieved, and the realized volatility level of the Portfolios can be higher or lower than its target volatility at any given point in time. Volatility is not an indicator of expected return or a measure of protection against loss. **3.** Volatility of the traditional portfolios represents a historical standard deviation based on the returns of the following static asset allocation portfolios: **Conservative** = 25% stock / 75% bond; **Moderate** = 45% stock / 55% bond; **Growth** = 62% stock / 38% bond. Stocks are represented by the S&P 500 TR Index (1926–2015); bonds are represented by the Barclays Intermediate Government Bond TR Index (1926–2015). The **S&P 500 Index** is a widely recognized measure of U.S. stock market performance. It is an unmanaged index of 500 common stocks chosen for market size, liquidity, and industry group representation, among other factors. **The Barclays Intermediate Government Bond Index** is a sub-index of the Barclays Government Bond Index covering issues with remaining maturities of between three and five years. Indices are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. Past performance is no guarantee of future results.

Rebalancing may involve tax consequences. There is no guarantee that a diversified portolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk. Asset allocation does not ensure a profit or protect against a loss.

Managed by AlphaSimplex Group

AlphaSimplex Group (ASG) is a registered investment advisor that specializes in risk-managed investment strategies. The firm was founded in 1999 by MIT professor Dr. Andrew Lo, who continues to serve as chairman, chief investment strategist and a portfolio manager.

Dr. Lo is a recognized financial thought leader and the author of the Adaptive Markets Hypothesis (AMH) – a framework for understanding financial market dynamics. It provides the foundation for AlphaSimplex's investment philosophy and for managing the ASG Risk-Efficient Portfolios. The AMH is premised on the idea that markets are made up of people whose judgments are based on a broad set of factors that are not always easily measured and the relative importance of which are subject to change. As a result, the interplay between market risk and return is often based on investor perceptions rather than actual market risk. This misalignment can cause investor expectations and experience to deviate sharply at times.

AlphaSimplex addresses this challenge by creating risk-managed portfolios through a proprietary mechanism called AdaptiveVolatility Management™. Rather than passively accepting whatever level of risk the markets may offer, AlphaSimplex actively adjusts market positions to be more consistent with the amount of risk investors expect. By doing so, AlphaSimplex seeks to help investors to stay invested even through volatile markets in order to achieve their long-term goals.

▶ AlphaSimplex Group: Creating long-term investors in short-term markets

The risk-efficient portfolios are managed to a standard deviation target, but have flexibility to be within a range around the target depending upon market conditions. There are no guarantees standard deviation targets will be achieved. Targets correspond to historical average volatility for comparable asset classes and weightings. A portfolio's realized volatility levels can be higher or lower than its target volatility at any given point in time. Volatility is not an indicator of expected return or a measure of protection against loss.

RISK-EFFICIENT INVESTMENT STRATEGIES FROM LPL FINANCIAL AND ASG

Work with your LPL Financial advisor to create a risk-efficient investment strategy that is aligned with your vision for the future and your feelings about risk, savings, and wealth.

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