The shortest distance between two points is a straight line, right? Well, not always. When it comes to investing, the most efficient path to reaching your financial goals may actually be a curve. Believe it or not, people like economic Nobel Prize winners Drs. Sharpe and Markowitz have devoted much time and research to determining the most effective way to invest assets over time to achieve the desired financial goal. Their work resulted in what is known as the efficient frontier—a curve that represents the ideal balance of risk and reward in an investment portfolio.

When we talk about achieving a balance of risk and reward, we consider two important factors: 1) the amount of risk that you’re comfortable with, and 2) the amount of return you need to reach your financial goals. These factors must be balanced because they are generally at odds: Investments that carry greater return potential often carry greater risk, and vice versa. The goal of every investment strategy is to place assets in a mix of appropriate vehicles that, when combined, offer both a risk level and return potential that you’re comfortable with over the length of time you plan to invest.

Your entire portfolio—all your investable assets and the investment vehicles in which they are placed—should be designed to take you from where you are today to where you want to be financially in the future. And the efficient frontier is designed to represent the optimal path for getting there.

**Optimized Portfolios on the Efficient Frontier**

This chart illustrates an example of several optimized portfolios, represented by stars, using the concept of the efficient frontier. These portfolios are considered efficient because:

- Each offers a fair trade-off between risk and return.
- Each has been appropriately calibrated to an investor’s risk tolerance, return requirements, investment goals and time horizons.

An optimized portfolio will not perform the same way as an investment in a single asset class. That means an optimized portfolio may have lower returns in the short term and will not protect against every risk. No investing strategy can overcome all market volatility or guarantee future results.
Efficient Frontier

Using the efficient frontier to develop an asset allocation strategy allows your financial advisor to construct a portfolio that contains a mix of asset classes and investment styles in the proper proportion so that, when placed in this scientific model, it lands on the curve. If your portfolio is on the curve, it should provide the most effective way to reach your goals based on your risk tolerance and specific needs. If your portfolio, when analyzed according to this model, doesn’t land on the curve, it’s considered less efficient—meaning you may be taking on more risk than you need to reach your goals, or you may not be exposed to enough return potential to reach your goals.

Non-optimized Portfolios on the Efficient Frontier

This chart illustrates a portfolio (asterisk) optimized along the efficient frontier according to one client’s risk tolerance and return requirements. It also shows the positioning of four non-optimized portfolios that lie outside the efficient frontier. Below are comparisons of each numbered portfolio’s risk/reward profile versus the client’s preferences, as well as explanations as to why each portfolio is considered to be non-optimized.

Portfolio #1
- This portfolio has less risk and lower returns than the client prefers.
- Its returns may be too low with respect to its level of risk.

Portfolio #2
- This portfolio has more risk and lower returns than the client desires.
- Its returns may be too low with respect to its level of risk.

Portfolio #3
- This portfolio has more risk than the client prefers, but higher returns.
- While its returns may be higher than expected for its level of risk for a period of time, it is not expected to maintain those returns at that risk level.

Portfolio #4
- This portfolio has lower risk than the client prefers, but higher returns.
- While its returns may be higher than expected for its level of risk for a period of time, it is not expected to maintain those returns at that risk level.

Talk to Your Financial Advisor

Your financial advisor can construct a portfolio that functions as efficiently as possible, while taking into consideration your unique needs. Because these needs change over time, portfolio optimization also requires regular assessment and rebalancing. The aim is to expose you to the maximum reward projected for your preferred risk level—an approach that should increase the probability of reaching your financial goals. For more information, please contact your financial advisor.

Past performance does not guarantee comparable future results. This chart is for illustrative purposes and does not represent the performance of any AIM fund.

Consider the investment objectives, risks, and charges and expenses carefully. For this and other important information about AIM funds, obtain a prospectus from your financial advisor and read it thoroughly before investing.