The Perfect Storm for Traditional Allocation Models: An analysis by Ali Hashemian, MBA, ChFC®, CFP®, president of Kinetic Financial

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The definition of a perfect storm is a critical or violent situation that arises from a rare combination of adverse and unpredictable factors. In meteorology, a perfect storm is often created by combining a hurricane, a cyclone, and a tropical storm.

In the financial world, we are seeing the signs of a perfect storm though the combined effect of increasing inflation, rising interest rates, and a higher tax environment. This is particularly concerning for people with a classic allocation model for their investment and retirement portfolios.

Most investors have created a portfolio that is primarily made up of traditional assets like stocks, bonds, and cash equivalents. Even if they have their accounts professionally managed inside a fund or by an advisor, the underlying holdings are heavily weighted in these three categories. The balance in each bucket may vary depending on a person's risk profile. Nonetheless, most people have a portfolio made of just three buckets: stocks, bonds, and cash equivalents.

Here is the problem with that traditional approach to allocating assets in our current financial environment:

1.) **Tax policy changes might cause some serious corrections in stock portfolios.** Between the potentially higher tax rates for corporations and the proposed increases in capital gains taxes for higher net worth people, there is a possibility of a significant sell-off in the stock market.
2.) **Increasing interest rates might cause a discount in bond portfolios.** Bond prices have an inverse relationship with interest rates. As interest rates rise, the price of bonds goes down. This can be especially concerning for people that have bond portfolios with longer maturities as those bonds are particularly sensitive to interest rate changes.
3.) **Higher inflation rates might cause assets held in cash equivalents to depreciate in purchasing power.** This can create an issue for investors because the cash bucket of a portfolio is meant to act as a risk hedge to stocks and bonds, providing protection when the other two buckets experience volatility.

So, what can people do to avoid the perfect financial storm that traditional allocation models might be facing? The answer is almost an oxymoron. Investors need to innovate one of the most classic and effective investment strategies: diversification.

While diversification is still the answer, we need to evolve the way we look at diversification and include alternative asset classes that were previously overlooked or not available altogether. Many of these alternative allocations are not negatively correlated to higher interest, inflation, and taxes. Now might be the time to start looking at currencies, commodities, derivatives, real estate, business ownership, insurance products, digital assets, and the variety of other asset classes available in the marketplace today.

Diversification has historically helped investors weather financial storms. However, with all the new technology and access to alternative options, a traditional diversification strategy may be out of date for the next perfect storm. That is why it is so important for people to reevaluate their current positions on an ongoing basis. Remember, it is always better to see the storm coming and prepare than get caught in it without a plan.

About the Author
Ali Hashemian is a CERTIFIED FINANCIAL PLANNER® professional, a CHARTERED FINANCIAL CONSULTANT®, and he holds a Master's in Business Administration from the University of San Diego. He is also the bestselling author of *OVERTAXED: Six Powerful Tax-Free Investment Strategies* **—** *and How to Use Them to Lower Taxes*, and he is the host of the television show, *Spot on the Money*.

As the Founder and CEO of Kinetic Financial, Ali works with individuals, families, and corporations in developing and implementing detailed strategies for financial plans, taxes, retirement plans, asset protection, and estate plans. He applies his experience with strategic planning to each case, Ali works diligently to create lasting relationships with the people he interacts with on both a personal and professional level.

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