

# Cost of Asset Allocation in Equity Market – How Much Do Investors Lose Due to Bad Asset Class Design?

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**Abstract** Most investors employ asset allocation, even though most of them are not really concerned about how their asset classification schemes affect the investment performance. In this paper, the two most widely employed within-stock classifications, style and industry classification, are extensively examined. In order to explicitly measure the performance levels of current classifications, we introduce the concept of optimal asset classification, which provides the performance upper limit of any classification schemes. We find that style and industry classification are very costly; furthermore, factor analysis reveals that the immediate cause of exorbitant cost lies in the method that classification focuses only on diversification benefits rather than on excessive returns.

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