

WHY IS ASSET ALLOCATION IMPORTANT FOR INVESTING?

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Diversifying your portfolio is critical in reaching your investment goals. Asset Allocation, how you distribute your investments among various asset classes, is important because it allows you to diversify risk and thus more safely seek higher potential returns. Why is this so? Different asset classes typically perform differently under the same market conditions. For instance, when stocks experience a down turn, bonds often perform better. Diversifying your investments among the various asset classes, allows you to soften losses and move toward your ultimate financial goals.

Asset Allocation goes beyond just allocating investments among stocks, bonds, and cash. Assets can be further distributed across different sub-classes (large-cap versus mid-cap versus small-cap, domestic versus international), sectors (technology, energy, health care, consumer goods, financial), or styles (growth versus value versus alternative investments). The less concentrated your portfolio is in any one area, the more protection you have from market volatility. When determining your asset allocation, critical factors to consider are your risk tolerance, time frame, liquidity and income needs, return expectations and tax situation.

Your risk tolerance is the amount of potential loss that you are willing to accept in exchange for potential gain. Be realistic when evaluating your risk tolerance or you may be in for an unpleasant surprise.

Your time horizon will also affect your risk tolerance. A longer time horizon will allow you greater opportunity to make up for any losses. As a result, you may be more comfortable investing in higher risk asset classes because you will have more time to recover from any down turns.

The goal of your Asset Allocation strategy should be to build an efficient portfolio. One that will provide you with the greatest possible return for the lowest risk based on the factors outlined above. You should also keep in mind the tax implications of various investments on your finances.

Determining your Asset Allocation strategy is an important step in developing an investment portfolio that will help you achieve your financial goals.