Asset Allocation

Simply spreading your savings over various types of investments is called diversification. But what´s the best way to diversify? The answer depends on the risk you´re willing to take, the rate of return you require, and how long before you will need the money. With those specifics, you can spread your savings among different classes of investments to minimize risk and help you meet your goals. This is called **asset allocation**.

Investment studies have shown that asset allocation is the most important factor influencing the return on your portfolio. Asset allocation has been shown to account for over 90% of your total investment return. This means the selection of asset classes is more important to your total return than the specific securities themselves.

Knowing Your Asset Classes

Investments are classified in different groups called asset classes. The following is a list of some asset classes:

- **Cash Equivalents:** Money markets, CDs, Treasury Bills, and any other highly liquid securities with a known market value and a maturity of less than 12 months.
- **Fixed Income:** U.S. Government bonds and/or corporate bonds with mid (2 to 5 years) to long (over 5 years) duration.
- **Large Capitalization (Cap) Equities:** Common stock in companies whose capitalization - the value of all outstanding stock - is in the billions. Classic examples are blue-chip stocks such as General Motors and IBM.
- **Mid-Cap Equities:** Common stock in mid-sized public companies; capitalization is between $1 billion and $15 billion.
- **Small-Cap Equities:** Common stock in small public companies whose capitalization is about $1 billion or less.
- **International Equities:** Common stocks in companies based outside the U.S.
- **Real Estate:** Shares of trusts that hold and manage investment properties. These are called real estate investment trusts (REITs).

After determining your own circumstances and investment needs, it´s time to decide where to invest. But first you need to understand which classes of investments fit an investor of your profile.

Studies have shown that how you allocate assets among asset classes plays a greater role in determining your return than the specific investments you make.

Here are some example portfolios. Pay attention to the kinds of investors these portfolios would best accommodate.

Conservative: *Income With Some Growth*

This is a conservative strategy for the investor who is primarily income oriented, yet desires some ability for capital appreciation as a hedge against a loss of purchasing power. This investor is not typically a risk taker, but instead is willing to accept the possibility of a lower return in exchange for increased stability. Asset allocation in this account will be approximately 60-70% bonds and 30-40% stocks.

Moderate-Balanced: *Growth and Income*
This is a balanced strategy between growth and income and is designed for the investor who understands the relationship between risk and reward. Income and growth are of equal importance and this investor is sensitive to real (adjusted for inflation) returns. Asset allocation in this account will be approximately 40-55% bonds and 45-60% stocks.

Aggressive: *Growth*
This strategy is aggressive and is designed for an investor who is comfortable with risk, has a low need for current income, and can hold investments for longer periods. The primary objective for this account is capital appreciation with a secondary emphasis on income. Asset allocation in this account will be approximately 20-35% bonds and 65-80% stocks.

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