

Asset Allocation

Asset allocation is an investment strategy that seeks to reduce investment risk, while maintaining a desired rate of return, by spreading an individual's investments over a number of asset types. It takes advantage of the tendency of different asset types to move in different cycles, and thus smooth out the ups and downs of the entire portfolio. Stocks, bonds, and cash (or cash equivalents) are the investments normally used. Depending on individual needs or preferences, tangible assets such as real estate or gold may also be included.

The asset allocation process normally begins with an analysis of the historical levels of risk and return for each investment type¹ being considered. These historical values are then used as a guide to structuring a portfolio which matches the investor's individual goals and overall risk tolerance level.

A Personal Choice

There is no single asset allocation model to fit every investor, or for every stage of a person's life. The asset allocation decision is a highly individual one, and involves carefully answering a number of key questions:

- **Investment goals:** Why are you investing? Is the primary need for income, to pay current living expenses, or as a source of emergency funds. Or, are you accumulating money for a future need?
- **Time horizon:** When will the money be needed? At retirement, or sooner, to send a child to college, for example?
- **Liquidity needs:** How quickly do you need to be able to recover your investment and turn it into cash?
- **Risk tolerance:** How comfortable are you with the inevitable ups and downs of the financial markets?
- **Tax impact:** Will the investments add greatly to your income tax burden?
- **Economic conditions:** Inflation, interest rates, and the state of the economy are essential factors to consider.
- **International exposure:** How comfortable are you investing in foreign markets?

A Changing Choice

Over time, financial markets and an individual's goals and situation will change. Periodically, an investor must review his or her situation to ensure that past investment allocations are still appropriate. If not, adjustments should be made.

¹ Historical data, while useful as a general guide, cannot be considered an accurate indicator of future results. There is no guarantee that past performance is a predictor of future investment performance.