Market Decode: Balancing Risk and Reward with Asset Allocation

With

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Please see important information at the end of this program. Filmed on 11/15/18.

[ON-SCREEN TEXT]
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Asset allocation – An easily forgettable term that defines one of the most important aspects of investing.

Here's why it's worth remembering.

At its most basic level, asset allocation is about those pie charts we've all seen, showing how you might divvy up your investments into different slices of stocks, bonds and cash.

Seems simple enough. The key is to divide them up in a way that's most appropriate for *you.*

Just like we're all individuals when it comes to the sports we like, the shows we watch, or even our favorite kind of pie, it's the same with our **comfort with risk**, and how much excitement we want, or can stand, when the market zooms up and down.

We also have our own reasons for *why* we're investing. That can include different **financial goals**, like saving for a car, college, or retirement.

And these goals can have their own **time frame,** or time horizon, for reaching them.

We also have our own **"liquidity" needs**; meaning we might need access to funds for say, an unexpected expense.

So how does it work?

In a nutshell, your asset allocation is the sum of your choices about how your portfolio is divided into different types of investments, like stocks, bonds and cash.

Since each of these assets, in general, has a different level of risk associated with it, the amount of each that you own should be tied with your comfort level with market volatility, which can cause sharp swings in the value of your portfolio.

Cash, which could include CDs and money market funds, is usually thought of as the least risky asset.

Bonds can have varying degrees of risk.

For example, Treasury and investment grade bonds are considered safe, while lower quality bonds, less so.

Stocks, in general, are considered the riskiest, and can range from "blue chip" companies to lower quality ones.

So if safety and stability are important to you, you might consider having more cash and high-quality bonds in your portfolio.

The tradeoff, of course, is that while cash and many bonds can be fairly stable, they don't always generate a lot of growth.

On the other hand, if you're okay with taking more risk, and perhaps have a longer time horizon to invest, you might consider a larger allocation to stocks, which have historically offered the greatest potential for long-term growth.

The tradeoff here is that stocks are more prone to sharp price swings, especially in the short term.

Keep in mind, this is not a set-it-and-forget-it thing. Changes in the markets can cause your asset allocation to drift over time.

For instance, if the stock market has been doing really well for a while, it could leave your portfolio too heavily weighted in stocks and expose you to more risk than you intended.

At these times, you want to consider rebalancing your portfolio so it reflects your current preferences for stocks, bonds and cash.

The same principle applies when stock prices are falling; and you might have a larger slice of bonds than intended.

Major events, like marriage, kids and retirement, could also call for a change in your allocation too.

Finally, there's so much about investing that we ***cannot*** control, like inflation, interest rates, and volatility.

But having an asset allocation strategy is one thing we *can* control. Given how important it is to pursing your goals, it's worth keeping it top-of-mind.

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