



Asset Allocation

Do you know the two most powerful words in the investment dictionary? The two words which have the greatest impact for success or failure?

The two words that would have protected you from losing a fortune in 2008 and saved the investors of Enron, World Com and Lehman Brothers from the loss of their entire fortunes?

The two words? Asset Allocation - otherwise known as the art of diversification. Let's see how asset allocation works so you can learn some simple ideas to put to work immediately.

First, there are only two types of investments. Investments where you loan money and investments where you own something.

Invest in real estate or stocks? –Own something.
Invest in a CD or municipal bonds? - Lend money.

These types of investments (own and loan) translate into Stocks and Bonds. Since owning and loaning are very different, Stocks and Bonds are excellent "diversifiers." For example, we know stocks have the high potential rate of return and can be extremely volatile, while bonds have a lower return (think CD's) and don't go up or down quite so much. Therefore, the first and most important decision you will have to make is: How much do I put into stocks and how much into Bonds. Since this decision will have the greatest effect on your future return, it should be chosen very carefully. You can find many tools on-line which will advise you on the proper mix for your age and risk tolerance.

But wait, there's more. Not all stocks are the same, so breaking them down a little more can add to your diversification.

There are large companies, mid size and small companies. These different size companies tend to rise and fall at different times - so investing in them will help you diversify and may increase your rate of return and reduce volatility. In addition, adding

international stocks which also rise and fall at different times may also increase the possibility of a higher return with reduced volatility.

Getting to the final point, segregating your purchases among these different categories will give you a level of diversification which may help you dodge extreme movements in the markets. Protecting yourself from market extremes is one of the most significant ways to become a successful investor.

Fortunately, all of these categories can be found through the purchase of mutual funds and if you have money in a 401k plan, many plans now offer a range of investment alternatives exactly along these lines.

Remember, if you spend some time becoming a knowledgeable asset allocator, you will be greatly rewarded for a small amount of effort.

For more information to help you learn the techniques of asset allocation, take a look at *Asset Allocation for Dummies*. This book is easy to understand and does a terrific job of taking you through the steps necessary to succeed on your own. If you need further help, contact a Certified Financial Planner in your area to help you.