Asset Allocation

Asset allocation decision is about dividing the available pool of money between different asset classes such as equities, bonds, real estate, commodities, art and international financial instruments. The principal reason for diversifying investments across different asset classes is to minimize the risk of a portfolio. It requires one to avoid investments whose returns tend to move too closely with each other.

The key considerations in choosing the asset classes are the level of return and the risk. Liquidity, transaction costs and ease of investment are the other considerations.

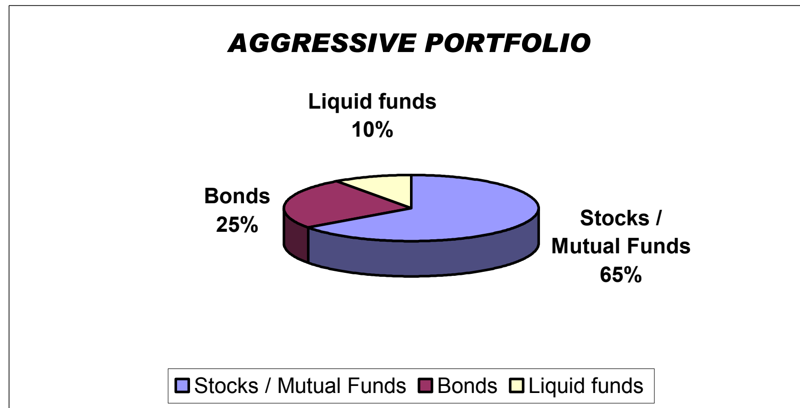
Asset allocation decisions involve ascertaining one’s attitude towards one important variable: Loss of Capital. The degree to which one can tolerate risk varies for different people. In today’s era of low global interest rates, there aren’t any asset classes that are considered safe and also generate high yield for its investors. Increasingly investors need to assume risks to generate inflation beating returns. Falling yields over the last decade in fixed income asset classes has attracted many towards Equity Markets.

Equity markets provide high returns opportunities but they come with a real risk of loss of capital. In order to generate return out of equities, one needs to be keeping oneself abreast of current happening in the world of finance and industry. If one enters in equities asset class at a wrong time or invests in a poor quality stocks, the chances are incurring loss are much higher than any other asset class. If one has chosen stocks portfolio with reasonable fundamentals, and give it a time frame of more than couple of years, equities are likely to generate high positive returns.

Depending on your personal circumstances like age, lifestyle and family commitments, your financial goals will vary. You need to define your investment objectives — buying a house, financing a wedding, paying for your children's education or retirement and then choose investment vehicle appropriate to the plan.

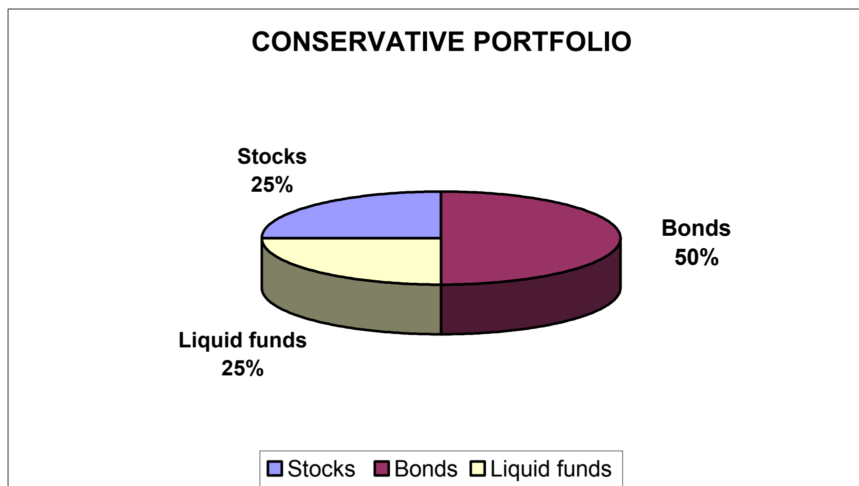
Here are examples of two sample portfolios that can give you a sense of how to approach selecting your own asset mix. Remember, these are general suggestions only. When reviewing the model portfolios, consider your own circumstances.

Aggressive portfolio:



This portfolio emphasizes on growth, suggesting 65% in stocks or equity mutual funds, 25% in bonds of fixed-income funds and 10% in liquid funds or cash equivalents. This allocation is recommend for people who have a long investment time frame. The portfolio provides for short-term emergencies and a mid-term goal such as building a home, but otherwise assumes the investor has long-term goals such as retirement in mind.

Conservative portfolio:



This portfolio suggests 25% in stocks, 50% in bonds and 25% in liquid funds or cash. This portfolio appeals to people who are very risks averse. Capital preservation is central idea of such allocations. Debt market allocation will balance capital erosion due to inflation, and the 25% equity component is intended to help investors to grow the capital.

Asset allocation plans must change with time. An asset allocation plan is just the first step of realizing your financial dreams. Regular review and timely rebalancing is also required. No matter what type of savings program you choose, it's important to review your portfolio every 6 months to assess your progress.