



Asset Allocation Reduces Investment Risk

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Many investors spend considerable time trying to pick the right mutual fund or investment security. But emphasis on securities selection should not be at the expense of your asset allocation strategy, which is the most significant factor in determining a portfolio's return.

Academic studies have shown that asset allocation can account for more than 90% of an investment portfolio's return. Which specific stocks, bonds, or mutual funds you buy is not nearly as crucial as maintaining the right mix of asset classes. Institutional investors have applied asset allocation techniques for years. Individual investors are now employing these concepts to meet their long-term financial goals.

What is Asset Allocation?

Asset allocation is a systematic approach to diversifying a portfolio of investments. You start with your overall allocation between stocks, bonds, and money market securities. Then within each category, you select assets that react differently to the same economic condition. This effectively reduces risk and increases returns over the long term. Returns may be less during bull markets, but asset allocation tempers the impact of unpredictable market swings, thereby increasing your probability for long-term financial success.

A portfolio diversified both within and among asset classes is the best effective way to manage the risks inherent in investing. For example:

- Including both domestic and foreign stocks in your portfolio may moderate the effects of a slow domestic market if foreign stocks are performing well.
- Allocating some of your assets to domestic bonds usually lessens the risk of stock investments and can help stabilize income if that is one of your objectives.
- Smaller companies are likely to lead the market at the beginning of a market expansion.
- Large-capitalization companies generally perform better when the economy is slowing.

Why Allocate Assets?

In effect, proper asset allocation helps you meet your investment objectives while reducing the risk associated with those investments. Your age and financial goals largely determine how best to allocate your assets.

Using an asset allocation strategy must be preceded by financial planning. You need to set goals and priorities, establish a timetable, understand your risk tolerance, and investigate your investment alternatives. Your strategy can then serve as an important source of discipline and organization in your path to financial success.

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