

RETHINKING RISK

Asset Allocation: Building a Portfolio That's Right for You

No matter what you do with your money, there are risks involved. If you invest it, you could suffer losses. But if you stay in cash, inflation can erode the value of your savings.

While you can't eliminate risk, you can design your portfolio so that the risk you're taking is appropriate for you. The key is asset allocation.

What's asset allocation?

Asset allocation refers to the mix of investments inside your portfolio – how much of your portfolio is in stocks, bonds, cash and other asset classes. It also refers to your investments within each asset class. For example, how much of your stock allocation is in U.S. versus international stocks? How much of your bond allocation is in corporate bonds versus government bonds?

The objective is to find a mix of investments that can potentially grow your money while keeping your risks at a level that's appropriate for you.

Asset allocation vs. diversification

Sometimes, the terms "asset allocation" and "diversification" are used interchangeably. However, not all asset allocations provide the same level of diversification.

For example, a portfolio that is divided evenly between U.S. stocks, Canadian stocks, Japanese stocks and European stocks won't offer investors much protection if stock markets slump worldwide.

True diversification means investing in a mix of assets that perform differently in various economic environments. This is an important component of risk management. If stocks fall worldwide, for example, other assets such as bonds and cash may help buffer your portfolio until stocks recover.

Finding your mix

The concept behind asset allocation is very simple: Don't put all your eggs in one basket. But the implementation is complex. The mix of assets you choose depends largely on:

- Your time horizon – the length of time you have to invest before you retire, buy a house, send your kids to college, or reach other financial goals. If you have several financial goals, your portfolio may need to accommodate varying time horizons.
- Your risk tolerance – your financial ability and emotional willingness to take risk in pursuit of reward. Calculating your risk tolerance requires an in-depth examination of your income, your assets, your responsibilities and more. When you're pursuing financial goals as a household, your spouse's or partner's risk tolerance must be analyzed as well.

Clearly, finding your ideal asset allocation is a complicated endeavor. A financial advisor can help you articulate your financial goals, assess your time horizon and risk tolerance, and develop a financial strategy that includes an appropriate asset allocation.

Rebalancing act

Once you calculate an asset allocation that's right for you, it's something that needs to be regularly monitored. A portfolio that starts out with 60% stocks and 40% bonds, for example, may shift to a 50/50 split if bonds outperform stocks for a length of time.

When your asset allocation gets out of alignment, you can rebalance your portfolio by selling assets in one category and buying some in another, or by making all new purchases in the underweighted categories. A financial advisor or tax advisor can help you determine any transaction fees or tax liabilities that may result from rebalancing.

Changing course

As you get closer to your financial goal, your ideal asset allocation will change. Generally, the less time you have before you reach your goals, the more conservative your asset allocation should be.

Additionally, life changes such as having children or caring for aging parents should trigger an examination of – and perhaps a change to – your asset allocation. Consult your financial advisor:

- If your financial goals have changed due to events such as having a baby.
- If your risk tolerance has changed due to events such as experiencing a layoff or inheriting a windfall.

Even if you haven't experienced any major changes, you should visit your advisor annually to determine if your investments are still on track with your financial goals.

Intentional InvestingSM

Intentional Investing is the science and art of investing with purpose, prudence and diligence. It's about thinking carefully, planning thoughtfully and acting deliberately.

We believe this philosophy is vital to the task of asset allocation. Assessing your risk tolerance, building a well-diversified portfolio and refining your strategy over time all require careful planning and intentional action. Talk to an advisor to make sure your asset allocation plan is right for you.

NOT FDIC INSURED | MAY LOSE VALUE | NO BANK GUARANTEE

Note: Not all products, materials or services available at all firms. Advisors, please contact your home office.

Asset allocation/diversification does not guarantee a profit or eliminate the risk of loss.

All data provided by Invesco unless otherwise noted.