Diversification - Your companion to get through market difficulties

Why diversification pays off

Now back to the basics. The most effective way of weathering the effects of market volatility is by spreading your principal among a number of different types of investments, or asset classes, including stocks, bonds and cash. This process, known as asset allocation, is based on the fact that most asset classes not only produce positive returns in different ways, but do so at different times. A well-diversified asset allocation usually provides exposure to areas of various potential returns, thus helping to mitigate the effects of volatility in any one area.

For example, the strongest stock returns tend to occur in periods of strong economic growth and political stability. In contrast, the strongest bond returns tend to occur when interest rates are high or when the political or economic future is uncertain. Diversification also eases the psychological effect of market ups and downs, essentially taking the emotion out of investing and allowing for rational decision making, which is the key to long-term investment.

Fund investment enhances diversification with more choices

The percentages of your portfolio that you allocate to various asset classes will depend on your age, your occupation, your time frame for attaining your financial goals, your risk tolerance, and the changing economic picture. To avoid high transaction costs, fund investment is always your choice when you diversify market volatility by spreading into international stocks or bonds with ease.

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201706 (AP612)