

The Asset Allocation Puzzle

Possessing a considerable amount of knowledge about stocks, bonds, and cash is only a small part of the investment planning process. Many investors are under the false notion that the greatest determinant of portfolio performance is the specific investment choices they make. Actually, the biggest decision you will make is how much to allocate to different investment categories. Asset allocation is all about finding the mix of investments that is right for your situation. Goals, time horizon, and risk tolerance are some of the key factors that should be considered when allocating assets.

Goals

Determining what asset allocation is appropriate depends largely on the goals you seek to achieve. Are you saving for retirement, college education for your children, or a vacation home? Each goal must be considered in creating the appropriate asset mix.

Time Horizon

Time horizon is the length of time a portfolio will remain invested before withdrawals are made. If your investment horizon is fairly short, you'd likely want a more conservative portfolio—one with returns that do not fluctuate much. If your investment horizon is longer, you could invest more aggressively.

Risk Tolerance

Everyone has a different emotional reaction to sudden changes in their portfolio value. Some people have trouble sleeping at night, while others are unfazed by fluctuations in the market and can endure the uncertainty associated with more risky investments.