The Asset Allocation Puzzle

- As this article summarizes, the asset allocation decision is central to your portfolio's return and risk.
- COMPASS drafts an Investment Policy Statement for each of its clients in order to structure an appropriate asset allocation.

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 that they make. In reality, 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 taken into consideration 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 your portfolio will remain invested before withdrawals need to be taken. If your average investment horizon is fairly short, you will most likely want a more conservative portfolio—a portfolio with returns that do not fluctuate too much. If your investment time horizon is longer, you can most likely 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 because they are too busy worrying about how their portfolio is performing. Other investors are unfazed by fluctuations in the market and can endure the uncertainty associated with more risky investments.

As you can see, the asset allocation decision is not an easy one and it may be best to work with an investment advisor who can piece together a plan that is right for you.

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