Asset allocation and diversification

Getting them right

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While the terms "asset allocation" and "diversification" are sometimes used interchangeably, they are distinctly different strategies. Understanding each and how the pair can work together may help to reduce risk and with pursuing your long-term goals, even in today's challenging market environment. In applying an asset allocation strategy to your individual situation, you may also consider other assets, income and investments, including home equity, individual retirement accounts (IRAs), employer stock, and personal savings.

First things first
Think of asset allocation as the starting point for building your portfolio. Before you and your Financial Advisor select specific investments, you decide what percentage of your portfolio to allocate to each of the major asset classes—stocks, bonds and money market instruments. Because these asset classes have different risk and return characteristics, combining them may help reduce your portfolio's volatility over time.

Your specific mix of assets will depend on your goals, risk tolerance (financial and emotional) and time horizon. Stocks historically have generated greater long-term returns, along with more short-term volatility, than bonds or money market instruments.* If you will need to access your funds within five years, you may want to allocate less of your money to stocks and more to bonds and money market instruments. Conversely, if you have a longer time horizon, you may feel comfortable allocating more of your portfolio to stocks because you may be able to ride out their intermittent ups and downs.

Of course, the original allocation you choose won't always be appropriate. You'll periodically need to rebalance it as your circumstances or market conditions change.

Step two
Once you and your Financial Advisor determine your target asset allocation and risk tolerance, it's time to consider diversification. True diversification involves owning a range of securities within each asset class, knowing that different investments may be unlikely to respond to market news or economic developments in the same way. By diversifying, you create the potential for the top-performing investments to help compensate for underperformers.

For suitable investors, incorporating certain fixed income instruments into an investment portfolio may be an effective diversification strategy.

It's not surprising that asset allocation and diversification are sometimes confused, given that the two strategies form such a natural tandem. To be sure that you're taking full advantage of both, consult your Financial Advisor. With this understanding, your Financial Advisor can help you integrate your equity awards into an overall financial plan. And remember, you and your Financial Advisor should review strategies that you implement today and revise them on a regular basis as your risk and return objectives evolve.

* Past performance does not guarantee future results.

Asset Allocation and diversification does not guarantee a profit or protect against a loss in a declining financial market.

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