Investment Planning

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Investment Planning – Where to Begin?

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People can increase their assets by either *saving* or *investing*. Saving is a relatively passive approach of wealth accumulation. By strict definition, saving refers to the act of setting something aside for future use, accumulating something, or preserving something. Saving does not involve any element of risk for its very definition implies preservation of assets. While the savings might earn a small amount of interest, the earnings are nominal at best.

In contrast, *investing* is a more active approach to wealth accumulation. By definition, it means committing capital for the purchase of different assets such as stocks, bonds, money market instruments etc., with the expectation of earning a profit. An investment is thus a working asset that has been purchased with the intent of earning a return.

A popular misconception about investment success is the notion that it's all about choosing the right stock, bond, money market instrument etc. Nothing could be further from the truth! Studies have shown that by far the most important component of investment portfolio performance is "asset allocation".

In fact, the asset allocation decisions you make will account for as much as 90% of your portfolios performance! This means that the individual securities selected are secondary in importance. This is a substantially different perspective then what the financial services community and the media would have you believe.
Asset allocation is the process of determining the appropriate balance or percentage of different asset classes such as equities - stocks, and debt instruments - bonds etc. In effect, it means matching your objectives and risk tolerance to a suitable asset mix.

For most investors, the range of appropriate asset allocation mixes is 35/65 debt/equity for the aggressive investor to 65/35 debt/equity for the conservative investor. Asset allocation today also includes global diversification. Research has shown that global diversification will substantially enhance portfolio performance.

An investment portfolio by design should reflect an investor's objectives and constraints based on risk tolerance and preferences. There are several methods and models of asset allocation in use, based on investors' age, income level, risk tolerance, etc. The following table illustrates three different models, which represent portfolios of low, medium and high risk.

Type of investment	Low-risk	Medium-risk	High - risk
Cash	15%	18%	20%
Debt instruments	55%	37%	15%
Equities	30%	45%	65%

When developing a personal strategy it is important to understand the relationship between risk and return. The key questions to consider are: What asset mix will create the best potential return for an acceptable amount of risk? Or conversely; what amount of risk must I assume in order to potentially achieve a target rate of return? What type of assets should I have in my portfolio? How much of each should I own?

To learn more about investment planning i.e. diversification, dollar cost averaging etc. visit www.allainassociates.com

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