WHAT'S YOUR MIX? USING STRATEGIC ASSET ALLOCATION FOR LONG TERM INVESTMENT SUCCESS

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"Market timing and security selection are obviously important. The problem is that nobody achieves long-term success in the former, and almost nobody in the latter. Asset allocation is the only factor affecting your investments you can actually influence."

William Bernstein (author of "The Intelligent Asset Allocator")

We've long recognized that your asset mix – how your money is invested - is likely to be the key determinant to your long term investment success. By "how" your money is invested, we're referring to the proportion of your portfolio that is held in equities, bonds, and cash.

Before we delve any further into the subject of "strategic asset allocation", perhaps most important, you should know that you have an actual investment plan in place. By working with a professional portfolio manager, you have a strategic asset allocation strategy that is specifically designed to achieve your own unique investment goals.

This is contrary to almost every investor I've ever spoken with who does not work with an investment professional. Far too many seem to have no plan whatsoever when it comes to how to optimize the allocation of their money in order to best meet their investing objectives.

I've met young investors (in their late 20s!) who had the entirety of their retirement savings in guaranteed investment certificates (GICs) paying very low interest rates. "Guaranteed" alright! Guaranteed to lose money each and every year net of inflation AND guaranteed to fall short of their objectives. These folks were completely missing out on the long term growth of the stock market. GICs may be the right 'tool for the job' for short-term savers, but not for twenty-somethings who have decades to invest.

On the other extreme, I've met retired investors relying on their portfolio to fund the bulk of their monthly income needs, who had 100% of their money invested in equities. So during any (albeit always temporary) market downturn they'd be forced to sell stocks at an inopportune time in order to fund their cash flow needs. For any retiree with no money in cash or bonds, a prolonged stock market downturn/recession could be disastrous!

These scenarios are indicative of investors who don't really have any sort of a plan at all. When it comes to the achievement of your investment goals, it's clearly not enough to simply own investments. What is required is an actual investment plan. Your strategic asset allocation mix is the key component and provides the very foundation of that plan.

Why is strategic asset allocation such a key component of your overall investment plan?

I believe there are three main reasons:

- Your asset mix is likely to have a far bigger impact on your results and overall portfolio volatility, then other factors like security selection and market timing.
- Your overall asset mix seeks to optimize the risk/return relationship.
- The right mix should allow us all to sleep at night.

Allow me to briefly elaborate on each of these…

Most investors focus the bulk of their time and effort on other endeavors such as stock picking and market-timing. However, studies have shown it is your asset mix that will have a far greater impact on your portfolio than either of these. Here's a quote from a piece written by Raymond James on the subject of strategic asset allocation:

"One of the best kept secrets in investing is that asset allocation plays a much bigger role in overall portfolio performance than individual investment selection. The relative weight of the asset classes in your portfolio—the percentage of equities, fixed income securities, and cash—can make the real difference to portfolio performance, assuming the investor is adequately diversified within each of the asset classes."

In regards to optimizing the risk/return relationship, many investors would be surprised to learn that a portfolio consisting of 100% bonds encompasses more risk (AND of course, lower returns), than does a portfolio composed of 80% bonds/20% equities. Any "conservative" investor who might otherwise own bonds exclusively, can actually lower risk AND enhance expected returns by adding a component of stocks to their portfolio. This is just one example of how utilizing a strategic asset allocation strategy can optimize the inherent risk/return relationship in a portfolio.

As for the overly "aggressive" retiree who might otherwise own 100% equities;

"The whole point of holding bonds and cash is to provide income and safety to temper the risks elsewhere in your portfolio, like the risks of owning stocks. No matter how fat a dividend they offer, utilities and other high-yielding stocks are still stocks".

- Jason Zweig

Finally, and perhaps most important, through the prudent use of strategic asset allocation you have a portfolio that is designed to 'weather all seasons'. As any serious investor recognizes, the future is impossible to accurately and consistently predict. With the right asset mix, your portfolio will 'hold water' regardless of what the future holds.

On that note, I'll defer once again to William Bernstein, author of "The Intelligent Asset Allocator";

"Once you've learned the foundation, techniques, and historical success of asset allocation, you will never again lose sleep over interest rate hikes, stock market jitters, and other financial matters beyond your control."