ARE YOUR ASSETS REALLY DIVERSIFIED?

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You've heard the old investment adage, "Don't put all your eggs in one basket." It's good advice. A diversified portfolio should be at the core of any well-planned investment strategy. While a worthy goal at any age, it's especially desirable as your net worth grows over the years.

The basic purpose of diversification is to reduce your portfolio risk and volatility. It's primarily a defensive type of investment policy. Depending on your investment goals and tolerance for risk, your strategy may emphasize one type of investment over another. But overall, your portfolio should be diversified. That's because no single type of investment performs under all economic conditions. A diversified portfolio is capable of weathering varying economic cycles and improving the trade-off between risk of loss and potential return. Of course, diversification cannot entirely eliminate the risk of investment losses or cannot guarantee a profitable investment return. Diversification can lower the risk of a portfolio.

Forms of Diversification An investment portfolio consisting of twenty different construction industry stocks is not generally considered to be diversified. Diversification means dividing your investments among different classes of assets, such as stocks, bonds, real estate, savings accounts and tangible assets. For instance, suppose your portfolio consisted entirely of bonds. Your money would be at significant risk if interest rates rose since bond prices generally fall when rates go up.

It's also important to diversify by owning several stocks in different industries. Suppose you held just 1,000 shares of a major company's stock from September 30, 2007 through September 30, 2009, and you suffered a loss of $40 per share when the stock fell from 100 to 60. A diversified portfolio consisting of many different stocks in various sectors may have cushioned the blow of the loss.

A prudent investor managing his own portfolio might diversify his holdings by selecting some stocks for their rising earnings or accelerating "growth" potential while buying other stocks because they offer "value" by temporarily being out of favor. In addition, an investor may buy individual securities for other reasons, such as income or a certain situation in the marketplace. An alternative to selecting and managing individual stocks and bonds is to invest in mutual funds. Some mutual funds offer diversification by holding many securities within the portfolio. However, some other funds may not be diversified across industries or asset classes and may focus on a single sector. Mutual funds may offer several other features, including:

- Shareholders receive periodic reports reviewing the fund's results and performance.
- Funds are managed by full-time professionals.
- Fund families allow investors to allocate investment dollars among a combination of funds with varying investment objectives.
- Mutual funds may provide immediate diversification.

Funds have clearly defined investment objectives and strategies, which are detailed in the fund's prospectus.

An investor should carefully consider the investment objectives, risks, charges and expenses of the investment company before investing. Read the prospectus carefully before investing or sending money. The investment return and principal value of an investment will fluctuate with changes in market conditions so that an investor's shares when redeemed may be worth more or less than the original amount invested.

Diversification also means not tying up all your funds in long-term investments. You'll need to keep a certain amount easily accessible -- that is, in money-market accounts, savings accounts or short-term certificates of deposit (CDs) -- for on-going expenses, emergency needs, and short-term goals such as saving to buy a car or pay taxes. And through dollar-cost averaging, a process of buying stocks and bonds from time to time instead of all at once, you can spread the risk over both good and bad markets. Using this dollar-cost averaging investment method involves continuous investment in securities regardless of fluctuating price levels of securities. Therefore, investors should consider their financial ability to continue purchasing through periods of fluctuating price levels. Dollar cost averaging does not ensure a profit and does not protect against a loss in declining markets. Diversification is also important because CDs may be FDIC-insured (e.g., subject to FDIC limits) and typically offer a fixed rate of return while investments such as stocks and bonds are not FDIC-insured and their value will fluctuate with current market conditions.

Sample Portfolio Your specific investment decisions will depend on several factors: your age, tax bracket, risk tolerance, liquidity needs, investment time horizon and investment goals. In general, however, a well-diversified portfolio might include:

- Cash Reserves for short-term needs -- checking accounts, money-market accounts, savings accounts and shorter-term CDs.
- Longer-term, taxable investments that are relatively liquid, such as:
    - Stocks – Common or preferred
    - Bonds – U.S. Government or corporate
    - Mutual Funds – Bond funds, growth funds, balanced funds, international funds
- Tax deferred and tax-free investments, such as:

    - Annuities – Fixed, variable and indexed
    - Qualified Plans – 401(k), 403(b), Roth, IRAs, SEPs, SARSEPs, etc.
    - Municipal bond funds
- Real estate – Commercial or residential
- Tangible asset exposure through mutual funds – Precious metals funds, natural resources funds, etc.

You may want to consult an advisor regarding designing a portfolio that is right for you and your time frame, risk tolerance and potential return on investment.

Diversify Beyond Investments Diversification alone may not be sufficient to protect your investments. By taking a broader view, a financial planning strategy can put safeguards in place to help protect yourself and your family.

For instance, purchasing disability income insurance provides protection for your ability to earn a living. Life insurance is another form of protection. It can help preserve your estate assets and reduce the risk that your death could wipe out your family's standard of living. Life insurance can also provide the necessary cash for your survivors to pay estate taxes and other expenses, or to carry on a family-owned business.

A properly planned estate can also be a part of your overall strategy. Simply having a last will and testament may not be enough. You may need to coordinate your will with trusts for your children, life insurance and estate tax planning. Estate planning can help preserve and direct the distribution of your assets after your death.

A diversified financial planning strategy will not eliminate risk or guarantee success. But it does offer a sound approach to help accumulate, preserve and protect your assets, reduce risk and potentially grow assets over time. Talk with a qualified professional about how to put an effective financial planning strategy in place.

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