Asset diversity

Why you need to diversify your assets to maximize return and minimize risk

INTERVIEWED BY MARK SCOTT

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Diversification is a critical component for any sound investment plan, but it requires regular monitoring to ensure it's still producing the desired results in good and bad times.

"Whether you are managing your own money or working with a financial professional, you need to review things regularly," says Raymond N. Sussel, CLU, a financial professional at AXA Advisors, LLC. "We have clients we meet with every quarter. Other clients ask to meet every few years because not much has changed in their life."

The challenge for some investors is understanding diversification.

"People think their portfolio is diversified," Sussel says. "And when we review their holdings, we'll see they own 100 to 300 different individual stocks and bonds. They might be missing small cap stocks or emerging markets as an example."

Smart Business spoke with Sussel about keys to effectively diversifying your assets.

How has the definition of assets changed?

Traditionally there were three different kinds of asset classes: stocks, bonds or fixed income, and cash. The landscape has changed. It used to be that stocks and bonds moved in opposite directions. Recently, the correlation has become more positive, meaning they move in similar directions. In 2008, both had a rough time in terms of investment returns.

Today, the words 'alternative investment' are used a lot, especially for higher net worth individuals as a way to diversify into other asset classes that have negative correlation. The traditional asset classes of stocks, bonds and cash have been augmented by alternative investments, which can include commodities, real estate, different types of fixed income including domestic and overseas, currencies and long and short funds to bet against the market. It is by utilizing these assets that we seek to help manage risk.

What are some key strategies to achieve healthy diversity?

First, understanding what your financial goals are is important. Time horizon is critical as well. If you were considering a three- to five-year period, you should not invest aggressively. Conversely, if you're looking at a 30-year period, you probably don't want a lot of money sitting in bonds. Most of our clients think of their investments in terms of buckets. Money that is needed in the next few of years should be in a short-term bucket. Perhaps funds are in a bank or a money market account and earning a little bit of interest. But the risk level is low as is the return.

Some clients fall into the middle-term category. Perhaps you are going to buy a second home, or are getting ready to put the kids through college. The hard part is figuring out how to invest that money so you are satisfied with the return, but not taking on additional risk. It really comes down to your tolerance for risk. If you can't stomach a couple down days in a row, or if you see your $100,000 is suddenly worth $90,000 and you are very concerned, you are probably investing too aggressively. You should also consider the amount of money invested. A financial professional is going to invest $25,000 differently than $2.5 million. You can't diversify $25,000, or even $250,000 as easily. The larger the amount of money, the more you are able to diversify, not only with asset-class diversification, but advisor diversification; hence utilizing multiple advisors or investment companies.

Any other tips for helping to manage the ups and downs of the markets?

The average investor should not look at their investments every day. Because of technology, there is a lot of information available at our fingertips. It gives the average person access to things to which 15 or 20 years ago they didn't have access. Success in the market requires patience. You should also consult with a financial professional to make sure you are on the right track, and continue to review and monitor your investments at regular intervals. ●