Is Your Portfolio Out of Balance?

How would you rate your current portfolio? In an "up" economy, if you are like many investors, you'd probably have a hard time coming up with any negative adjectives. After all, when there's significant growth in the stock market, many investors may find themselves smiling. But, even when it's easy to give your current portfolio a big "thumbs up," it is also possible that your portfolio's composition may be out of sync with your goals and objectives. Here's why. . .

It All Starts with a Target

One of the fundamentals of sound portfolio management is the concept of **asset allocation**. This process involves dividing your portfolio among the three major asset classes—**equities, fixed-income securities,** and **cash**. The theory behind asset allocation rests upon the unique characteristics of each asset class, which rarely rise and fall at the same time. By combining different asset classes, you can help reduce risk and improve the overall return of your portfolio while maintaining consistency with your goals and objectives.

It is a simple and sound principle in theory, yet it requires *diligence* in practice. Formulating your own asset allocation mix is fairly straightforward. However, the true challenge comes in *maintaining* an asset allocation mix that reflects your personal objectives—that is, your tolerance for **risk,** your **return** and **liquidity needs,** and your **time horizon**. Persistence is required over time because a significant fluctuation in one asset class may alter the original composition of your portfolio.

For instance, suppose that you established your asset allocation target five years ago, with 60% in equities, 30% in fixed-income securities, and a 10% cash reserve. You felt confident that this asset allocation mix best reflected your investment personality at the time—somewhere in the middle of the road of risk tolerance. Now, your portfolio has an entirely different look. Stock market gains have boosted the equity portion of your portfolio so that it now accounts for 85% of your portfolio.

Regular Reviews Go a Long Way

Now it's time for reflection and reassessment. Are your goals and objectives the same as they were five years earlier? Does your current mix match your current needs? At first glance, you may be inclined to leave things alone. Things are going well, so why change now? You need to remember, however, that unless your goals have changed substantially, or you have had a dramatic change of heart regarding risk tolerance, you should rebalance your portfolio to its *original* allocation. Because, over the long run, an asset allocation mix that does not accurately reflect your investment personality has a higher probability of failing to meet your needs and goals. Don’t let lofty returns skew your expectations. Be prudent and readjust your portfolio by moving some of your equity gains over to fixed-income securities. This shift will rebalance your portfolio to reflect your target allocation.

It is a good idea to get into the habit of periodically reviewing your portfolio. Doing so at least once per year is probably enough for the average investor. Yet, some investors prefer to reassess their portfolios when one category increases or decreases by more than 5%.

Remain True to Yourself

As time goes by, and you move closer to meeting your desired goals, your asset allocation mix should slowly move from an equity dominated balance to one weighted toward fixed-income securities. Another wise step is to seek the assistance of a qualified professional, whose objectivity can be invaluable in helping you wisely assess your current portfolio. In the long run, being realistic about *who* you are and *what* you really want will go a long way in helping you attain the proper balance in your portfolio.

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