ASSET ALOCATION

"Nowhere does history indulge in repetitions so often or so uniformly as in Wall Street. When you read contemporary accounts of booms or panics, the one thing that strikes you most forcibly is how little either stock speculation or stock speculators today differ from yesterday. The game does not change and neither does human nature."

-- Edwin Lefevre
Reminiscences of a Stock Operator (1923)

Nearly two years ago the market exhibited record valuation growth in the technology sector. Pundits declared that the "new economy" had replaced the old economy. Accordingly, few investors wanted to own bonds, or be stuck with cash. Investors chased the bubble, giddy with irrational exuberance, in utter disregard for the lessons of history.

Now, chastened by that experience many investors have been running in the opposite direction, gobbling up fixed income investments, causing prices to soar while driving yields down, or they're moving their entire portfolio into cash and stubbornly refusing to budge.

Yet the tide will surely turn once again, and the investor who follows the herd will be caught eating the dust of those running in front.

So how can the average investor tread the line between boom and bust, feast and famine, and not feel like a pendulum swinging back and forth from one extreme to the other with nothing but losses to show for his efforts?

Studies have shown that asset allocation, *not stock or bond selection* is the most important determinant of returns, accounting for nearly 90% of portfolio performance.

It is exactly this mix of investment classes – cash, income, growth and inflation hedge – based on the individual investor's objectives, risk tolerance, anticipated return and preferences, that offers the average investor the best promise of relative success.

And if that mix is well conceived, based on reasonable expectations over a reasonable period of time, then all that needs to be done is the periodic monitoring and rebalancing of that mix to preserve the original allocation through the thick and thin of market gyrations.

So where to begin when deciding upon an appropriate mix?

One popular rule of thumb, though by no means a scientific postulate, is that one's age is the numerical percentage that should be applied to the fixed income component of a portfolio. For example, a 25-year-old might choose to have 25% of his portfolio in fixed income, while a 60-year-old might choose to place 60%.

Another popular rule of thumb is to have 3 to 6 months of living expenses (mortgage, car payments, food, gas, utilities and entertainment expenses, etc.) in cash or other liquid vehicles, such as a money market fund.

Of course one size does not fit all; no one individual's circumstance exactly mirrors that of another. A thorough understanding of one's own situation (needs, goals, ability, time frame and comfort level) is crucial to determining the proper asset mix.

Depending again on the investor, a thorough evaluation of the portfolio can be conducted either quarterly or semi-annually. The rebalancing, or the redistribution of funds among the various asset classes that have deviated from their assigned parameters, can be done once a year.

Of course, if one's circumstances change because of marriage, divorce, an inheritance, a birth, a death, then the assumptions that created the asset mix have necessarily changed and then so too might the asset mix.

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