

Portfolio Performance: it's a matter of balance

When making investments, many people look first at the actual investment itself when making their decision. However, the spread of investments across different areas is an essential process, known as asset allocation, which should be undertaken before any individual investment decision is taken. Chris Budd looks at the issues involved.

Asset allocation is quite simply the balance of investments in a portfolio. It can apply to different types of assets, for example, property, stocks and shares (equities), Government gilts, corporate bonds, etc. Within each of these asset classes are sub divisions, for example equities can be split into UK, Europe, US, Far East, etc.

In 1986 a study of 91 pension funds, ranging in size from \$100m to more than \$3bn, demonstrated that the right choice of assets was the major contributor to long-term performance, along with stock/fund selection.

This widely acknowledged research was further supported by Paul Myners' report in 2001 to the Chancellor of the Exchequer. He identified that asset allocation is still, "an under-resourced activity", in the UK institutional investment market.

People accumulate a variety of assets and investments during their lives, yet comparatively few have a clear plan to ensure these assets can fund their financial goals.

Investing into assets that are not correlated, such as equities and gilts, means that all of your investment portfolio will not move in the same general direction at the same time. So, if equities take a dive the fixed interest element of the portfolio should protect your portfolio and minimise the damage.

Bearing this in mind, it is safe to say that one of the most effective ways to reduce the degree of risk in your portfolio is to have an adequate amount of diversification among different assets and asset classes.

It is no longer enough to think that you have a diversified portfolio just because you have both North American and UK shares. In an increasingly global market it is true to say that major stockmarkets often move together, so the investor needs to look further afield for diversification.

Diversify to reduce risk

In addition to gilts, another option is to diversify into commercial property. The average investor usually holds property as an asset class through their own private residence, or occasionally through holiday homes abroad or a second home in the UK.

There are far fewer investors that have any investment in the commercial property sector, however there are many funds which offer access to this sector without the usual costs and commitments that can be involved.

It used to be the case that risk, and therefore exposure to equities, should reduce in retirement. This was based on the principle that the whole of a pension fund would need to be encashed and used to purchase an annuity. This is no longer necessarily the case, and therefore investment risk remains a very personal issue.

Many people look to consolidate funds in retirement, and reduce risk, others maintain their level of risk in retirement as they look to maximise the estate to be left to their beneficiaries. However, given that the ability to earn income reduces in retirement, it is a general rule of thumb that the overall level of risk does tend to reduce. This often means reducing equity exposure in favour of lower risk areas, such as those mentioned above.

Diversifying your assets is the key to investing. Because situations change and markets change, portfolios can become unbalanced and once again exposed to one asset class if left unattended. Like unattended baggage, the value of your portfolio is at risk if you do not take proper care of it. So, make a date to review your portfolio annually; a review will find out which of your investments are meeting your needs and, importantly, which are not.

Take a few days to think about how your own thoughts and requirements may have altered over the past 12 months, then review your portfolio either yourself (if you manage your own affairs) or with an independent financial adviser.

Call us and benefit from a free initial consultation, on 0117 942 4333.

This article is for general information only. Remember past performance is not a guide to future performance and investments can go up as well as down. If you have any doubts in respect of your own personal circumstances you should have a full review with an independent financial adviser to get their help and remember, don't leave it to the last minute next year!

Ovation Finance Limited is authorised and regulated by the Financial Services Authority.

This article appeared in Mature Times, December 2005 edition - website www.maturetimes.co.uk

email: enquiries@ovationfinance.co.uk **www.ovationfinance.co.uk**

Registered address: [Ovation Finance Limited](#) 4 The Courtyard Woodlands Bradley Stoke Bristol BS32 4NB VAT no. 742 1527 53

Company registration number 3830502. [Ovation Finance Limited](#) is Authorised and regulated by the Financial Services Authority