Asset Allocation: Investing by the Numbers

An Asset Allocation Formula is a long-range, semi-permanent, planning decision that has absolutely nothing to do with market timing or hedging of any kind. It is designed to produce the combination of Capital Growth and Income

Uno. Asset Allocation is an investment planning tool, not an investment strategy... few investment professionals understand the distinction. Investment strategies are used to implement the asset allocation formula that investment planning produces. Many investors incorrectly believe that investment planning and financial planning are one and the same. Financial planning is the broader concept, one that involves such non-investment considerations as: Wills and Estates, insurances, budgeting, trusts, etc. Investment Planning takes place within the Trusts, Endowments, IRAs, and other Brokerage Accounts that come into existence as a result of, or without, Financial Planning.

Zwei. Asset Allocation is a planning tool that allows the investor to structure his or her investment portfolios in a manner most likely to accomplish the goals established for each portfolio and for the investment program as a whole. It is the process of planning how the portfolio is to be divided between the two broad classes of investment securities: Equities and Income. Security sub-classes have little relevance, and should be avoided. K.I.S.S.

Tres. Equities are the riskier of the two classes of securities, but not because of the price fluctuations that are their basic character trait. They are riskier because they represent ownership in a business enterprise that could fail. The risk of capital loss can be moderated or minimized in the security selection process and with a management control activity called diversification. The primary purpose for buying Equities is to sell them for capital gains, not to save them as trophies to brag about in chat rooms. But, they can be screened and selected in a manner that can make them less risky than other, non-fixed income, investments and speculations.

Shi. Income securities are less risky than equity securities because they represent debt of the issuing entity, and owners of debt securities have a "superior" claim on the assets of the issuer. Stockholders have to rely on their salivating class-action attorneys to mitigate their losses if the company fails. With proper selection criteria and diversification, the risk of capital loss is negligible and price fluctuations can be mostly ignored except for the trading opportunities that they provide. The primary purpose of these securities is income generation, either for current consumption or for use later in life. Capital gains here should be taken... and bragged about in those chat rooms.

Cinque. An Asset Allocation Formula is a long-range, semi-permanent, planning decision that has absolutely nothing to do with market timing or hedging of any kind. It is designed to produce the combination of Capital Growth and Income that will achieve the long-range personal (pay those bills) goals of the individual. Thus, it must not be tinkered with because of expectations about anything, or rebalanced arbitrarily because of natural changes in the market values of one asset class or the other. An asset allocation mutual fund is an oxymoron.

Hat. Asset Allocation is the only proven cure for inflation. If properly managed using The Working Capital Model, it will almost certainly increase the level of portfolio income by more than the rate of inflation, which is a measure of the purchasing power of your dollars, not the dollar value of your purchased securities. Any 100%-equity investment portfolio, regardless of size, is less inflation proof than any same-size, more balanced, portfolio. This is because the income on equities, and the capital gains that they may produce, are not contractual, and too often ignored when they do make an appearance..

Sju. In addition to the potential of failing to keep up with inflation using an Equity Only asset allocation, regardless of your age, greed management becomes much more of a problem. In a rising market, evidenced by the presence of more profit taking opportunities than lower priced bargains, investors tend to take positions in lower quality issues, current story stocks, newer issues, etc... just to be in there. A 30% or so Fixed Income allocation can be a major focus factor, and it will keep the base income line moving upward.

Tam. Many investors, and even a large number of Investment Professionals, think that income securities have some claim to price stability in addition to their role in providing present or future disposable income. They just don't, and their prices may fluctuate in either direction in anticipation of changes in expectations about the direction of interest rates.

Isishiyagalolunye. If you focus exclusively on market value, dwell upon comparisons of your unique portfolio with the market averages, expect performance of some kind during specific time intervals, and listen intently when someone speaks about the future, any asset allocation work you do will be ineffective.

Desyat. Cash is not an investment and, therefore, is not a class of assets within an asset allocation model. Most entities that include cash or money market balances in their portfolio mix are using it as a hedge against market movements in one direction or the other... in the future. This is a market-timing effort that has no place in asset allocation planning or thinking. Asset allocation transcends both short-term market trends and long-term market cycles.

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