

MANAGING INVESTMENT RISK THROUGH ASSET ALLOCATION

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How does an investor create an appropriate, long-term investment plan? Spreading assets over a variety of different investments is perhaps the most important rule one can follow. Because no single asset class performs best in all economic environments, the performance of a diversified portfolio is expected to fluctuate less as losses from some investments are offset by gains in others.

Asset allocation is the act of balancing the three common investment classes: stocks, bonds and cash reserves. Knowing the differences among them is important:

- **Common stocks**, which represent ownership rights in a corporation, entail more risk than other types of financial assets in the short run. But over longer holding periods, they have usually provided the highest returns and the greatest margin over inflation. Common stocks also have the greatest potential for short-term downturns.
- **Bonds** are IOUs issued by corporations, governments and federal agencies. They typically offer higher yields than cash reserves, but their value can fluctuate dramatically in response to changes in interest rates. Bonds generally offer higher current income with less volatility than stocks, but have limited potential for increased returns.
- **Cash reserves** include money market securities such as Treasury Bills and short-term certificates of deposit. Because money market securities have shorter maturities, they typically provide a stable investment value and current interest income. However, inflation can quickly erode the purchasing power of cash, leaving investors short of reaching their financial goals.

Diversification within Asset Classes:

As the stock or bond portions of your portfolio are refined, consider spreading investments among the various categories within a single asset class. For instance, diversification of the stock portion among several strategies to target growth stocks, value stocks, blue chip stocks and others.

A bond allocation may be diversified to include instruments characterized by specific maturities (short, intermediate, or long-term) or different types of bonds, such as U.S. government, corporate or tax-free municipal bonds. Also consider a mixture of domestic and international stock and bond investments.

What Should the Allocation Be?

How much emphasis should be placed on stocks for growth, bonds for income and cash reserves for safety and liquidity will depend in part on an investor's tolerance for risk and the time horizon for reaching financial goals. If the goal is the near-term purchase of a house or car, it may have a shorter time frame calling for lower- or moderate-risk investment approaches.

A goal like college education or retirement may have a longer time horizon that allows an investor to pursue more aggressive and potentially rewarding strategies because of the ability to wait out any short-term fluctuations in the market. Of course, the time won't matter if you misjudge your emotional response to a downturn. For this reason, an investor must always weigh the desire for higher returns against a willingness to tolerate market setbacks.

Stay on Course

An effective asset allocation helps balancing the risk assumed with the return earned. But it is still important to remember that the stock and bond markets are inherently volatile. By understanding what to expect, an investor will be able to stay on course and resist the urge to revise one's investment mix based on short-term market events.

Finding Your Mix

A few short questions can help you determine your individual profile and the asset allocation that makes sense for you.

Part 1

My Financial Life

Choose the statement that most closely describes your situation.

- A. I am able to save assets for my future and will continue to do so for the next 10 to 20 years. ***Proceed to Part 2, Section A.***

- B. I have built the core of my principal investment and no longer make regular contributions. My goal now is to preserve my principal and carefully monitor my investments. ***Proceed to Part2, Section B.***
- C. I am now using my investments to support or supplement my retirement through regular withdrawals and I expect to continue to do so. ***Proceed to Part 2, Section C.***

Part 2

My Financial Plan

Answer the questions that correspond with the statement you most identified with in Part 1.

<p>A. ASSET BUILDING phase of life.</p> <p>1. Do you plan to make regular contributions to your investment plan? a. Yes.....10 points b. No.....5 points</p> <p>2. How many years from now do you intend to make withdrawals from your plan? a. 5 to 10.....10 points b. 10 to 20.....30 points c. More than 20.....35 points</p> <p>3. How do you expect to take future withdrawals? a. Either lump sum or over a period of 5 years or less....5 points b. Spread gradually over 5 to 10 years.....10 points c. Spread gradually over 10 to 20 years.....15 points d. Spread gradually over a period of over 20 years ...18 points</p> <p><i>Proceed to Part 3.</i></p>	<p>B. ASSET PRESERVATION phase of life.</p> <p>1. When do you think you will start withdrawals? a. This year.....0 points b. Next year.....2 points c. In 2 to 3 years.....4 points d. In 3 to 5 years.....6 points</p> <p>2. How do you expect to take future withdrawals? a. Either lump sum or over a period of 5 years or less....5 points b. Spread gradually over 5 to 10 years.....10 points c. Spread gradually over 10 to 20 years.....15 points d. Spread gradually over a period of over 20 years ...20 points</p> <p>3. At what rate do you plan to make withdrawals? a. Less than 5% annually.....35 points b. 5% to 10% annually.....20 points c. More than 10% annually.....0 points</p> <p><i>Proceed to Part 3.</i></p>	<p>C. ASSET Access phase of life.</p> <p>1. How do you expect to take future withdrawals? a. Either lump sum or over a period of 5 years or less....5 points b. Spread gradually over 5 to 10 years.....10 points c. Spread gradually over 10 to 20 years.....15 points d. Spread gradually over a period of over 20 years ...20 points</p> <p>2. At what annual rate do you plan to make withdrawals? a. Less than 5% of my invested assets.....35 points b. 5% to 10% of my invested assets.....20 points c. More than 10% of my invested assets.....0 points</p> <p><i>Proceed to Part 3.</i></p>
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Part 3

My Financial Risk

- 1. What portion of your total assets are represented by your investment plan (not including real estate assets)?
 - a. Less than one-third.....13 points
 - b. Between one and two thirds.....8 points
 - c. More than two thirds.....3 points

- 2. Choose the statement that best sums up your ability to take risks in order to achieve potentially higher, long term performance.
 - a. I wish to reduce my chance of short-term losses. To do this, I acknowledge that I must accept potentially lower long term returns.....0 points
 - b. I wish to pursue growth of assets over the intermediate to long term. To do this, I know I have to accept some moderate risk, which may include losses.....12 points
 - c. I wish to pursue higher long-term wealth accumulation. To do this, I know that I have to accept moderate to high risk, which may include Losses.....24 points

Your Investment Profile Results

Please take a moment to total your points and match your score to the ranges listed below. Each range corresponds to your investor profile and asset allocation based on your responses. Your financial advisor can provide more detailed analysis.

YOUR TOTAL SCORE:

YOUR ALLOCATION:

	<u>Equity</u>	<u>Fixed</u>
Growth.....76 – 100	80%	20%
Balanced.....51 – 75	60%	40%
Moderate.....26 – 50	40%	60%
Conservative.....0 – 25	20%	80%

The above investor profile is not intended to represent a comprehensive portrayal of ones investment profile, or a specific recommendation. To find out about asset allocation and how a customized asset allocation strategy may assist in reaching your financial goals, contact your financial advisor.