# Asset Allocation: A Sound Investment Strategy

Every investor has an asset allocation. Some people just let theirs happen. Others choose theirs somehow. The best allocations are those that are chosen wisely, and designed to fit specific investment needs. Here's what you need to know to start thinking about yours.

Asset allocation starts with the universe of investments. That universe is made up of different types, called asset classes. Some asset classes give you the potential for strong returns, but also carry the possibility of significant volatility. Others may be very consistent in value, but produce relatively little return. Any combination of asset classes can serve as ingredients in investment portfolios.

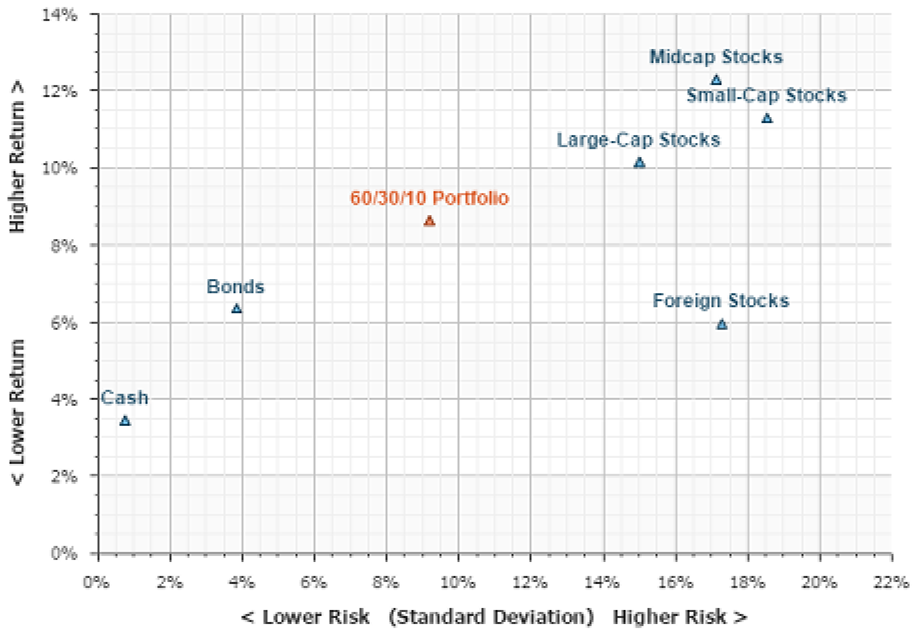
Asset allocation is the art and science of choosing these ingredients. Your allocation will define which investments you choose to emphasize, and how much of each you plan to use. Research suggests that this decision may be the most fateful choice you can make for building a portfolio to meet your needs.[1]

### The Main Asset Classes: Stocks, Bonds, and Money Markets

Here's a closer look at each:

- **Stocks** -- Well known for fluctuating frequently in value, stocks carry a high level of market risk (the risk that your investments' value could decrease). However, stocks have historically earned higher returns than other asset classes by a wide margin, although past performance is no predictor of future results. Stocks have also outpaced inflation -- the rising prices of goods and services -- at the highest rate through the years, and therefore carry very low inflation risk.
- **Bonds** -- In general, these securities have less severe short-term price fluctuations than stocks, and therefore offer lower market risk. On the other hand, their overall inflation risk tends to be higher than that of stocks, as their long-term return potential is also lower. Bond returns may also be influenced by changes in interest rates. Rising rates are associated with falling prices, and vice versa.
- **Money market instruments[2]** -- Among the most stable of all asset classes in terms of returns, money market instruments carry very low market risk. At the same time, these securities don't have the potential to outpace inflation by as wide a margin through the years as stocks.

## How They Performed (1987-2016)




## From a Bunch to a Pattern

The process of creating an asset allocation begins with a goal and a time frame for reaching that goal. Goals that are further in the future allow you to take larger risks in pursuit of greater rewards. Goals that are more immediate require you to give greater emphasis to assets that can help you preserve what you have. In practical terms, that suggests:

- A young person saving for eventual retirement might have a larger proportion of stocks and relatively smaller portions of bonds and money market instruments;
- Retirement savers in the middle of their careers might want to shift some portfolio emphasis to bonds from stocks; and
- Those nearing retirement might want less in stocks and bonds, and more in money markets or their equivalents.

To be sure, asset allocation is no assurance against risk of loss. What's more, portfolio allocation plans can be very personal, so individual portfolio recipes can differ. Among the other factors to consider are your investment judgements and your comfort with risk. But regardless of the asset allocation strategy you choose and the investments you select, keep in mind that a well-crafted plan of action over the long term can help you weather all sorts of changing market conditions as you aim to meet your investment goals.

Different investments offer different levels of potential return and market risk. Unlike stocks and corporate bonds, government T-bills are backed by the full faith and credit of the United States, although money market funds that invest in them are not. Past performance is not indicative of future results.
Source: ChartSource®, DST Systems, Inc. For the period from January 1, 1987, through December 31, 2016. Large-cap stocks are represented by the S&P 500 index. Midcap stocks are represented by a composite of the CRSP 3d-5th deciles and the S&P 400 index. Small-cap stocks are represented by a composite of the CRSP 6th-10th deciles and the S&P 600 index. Bonds are represented by the Bloomberg Barclays U.S. Aggregate Bond index. Cash is represented by a composite of the yields of 3-month Treasury bills, published by the Federal Reserve, and the Bloomberg Barclays U.S. Treasury Bill 1-3 Month index. Foreign stocks are represented by the MSCI EAFE index. The "60/30/10" portfolio is composed of 60% stocks (S&P 500 index), 30% bonds (Bloomberg Barclays U.S. Aggregate Bond index), and 10% cash (a composite of yield on 3-Month Treasury Bills and the Bloomberg Barclays U.S. Treasury Bill 1-3 Month index). It is not possible to invest directly in an index. Index performance does not reflect the effects of investing costs and taxes. Actual results would vary from benchmarks and would likely have been lower. Past performance is not a guarantee of future results. 

**Source/Disclaimer:**

**Asset allocation and diversification do not ensure a profit or protect against loss.**

[1]A landmark study shows that about 90% of the variability of returns earned by balanced mutual funds and pension plans over time was the result of variation in asset allocation policy. Source: Financial Analysts Journal, "Does Asset Allocation Policy Explain 40, 90, or 100 Percent of Performance?," January/February 2000.

[2]An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other federal government entity. Although the fund may seek to preserve the value of your investment at $1.00 per share, there can be no guarantee that the fund will maintain it. It is possible to lose money by investing in a money market fund. A fund's yield will vary.

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