

Vaccinate your portfolio

Maneesh Kumar

We have all met someone who claimed their portfolio was doing great—until it wasn't. The stories differ: market correction, aggressive trading, picking the wrong stock, getting out too early, and so on. Your portfolio needs several vaccinations to protect your portfolio from the changing seasons and vagaries of the market, so that it's not reduced to a feeble version of its healthy self. No guarantees, but they will defend your portfolio from attacks that financial markets may throw at it. You'd certainly be better off than if you didn't employ these strategies.

Vaccine # 1: Asset allocation

Studies show that 91% of portfolio performance is from asset allocation, and 9% of it from everything else. What is asset allocation? It means dividing your investment portfolio among different asset categories, such as stocks, bonds, and cash. The process of determining the mix is a very personal one. The asset allocation that works best for you at any given point in your life will depend largely on your time horizon and your ability to tolerate risk.

Why is asset allocation so important? By including asset categories with investment returns that move up and down under different market conditions within a portfolio, an investor can protect against significant losses. Historically, the returns of various asset categories have not moved up and down simultaneously. Market conditions that cause one asset category to do well often cause another category to yield average or poor returns. By investing in more than one category, you'll reduce the risk of losing money, and your portfolio's overall returns will be more stable. If one asset category's return falls, its losses will be

Like a baby, your investments stand a better chance of healthy and steady growth when they're protected from potentially crippling or fatal attacks

offset by better returns from another.

Vaccine # 2: Diversification

It's important to spread out your investments within an asset category. For example, when investing in stocks, one can invest in large, mid-sized and small companies. Be careful, however, not to over-diversify. Diversification doesn't necessarily mean a cocktail of all conceivable investments within an asset category. A good financial advisor can guide you to pick a few good investment ideas within each asset category. Because diversification is challenging, some investors find it easier to approach it through mutual funds, rather than individual investments in each asset category. A mutual fund pools money from many investors, and invests it in stocks, bonds, and other financial instruments. It makes it easy for you to own a small portion of many investments.

If you invest in narrowly focused



Bloomberg News

Prudent investors will use these strategies in tandem to protect their portfolio from financial market uncertainties

mutual funds, you may need to invest in more than one fund to achieve diversification. Within asset categories, that may mean considering, for instance, large company stock mutual funds as well as some small company and international stock mutual funds.



Reuters

Vaccine # 3: Rebalancing

It is essential to rebalancing your portfolio regularly, say, every six months or annually. It brings your portfolio back to its original asset allocation mix. This is necessary because some of your investments will grow faster than others. Rebalancing ensures that your portfolio doesn't overemphasize one or two asset categories.

Vaccine # 4: Hedging

In its simplest form, hedging means insurance. How can you ensure that your portfolio suffers minimal losses when markets are down? A simple way is through derivatives. Buying put options on a stock portfolio can provide that insurance. If the market continues to rise, you lose the premium on the put option but your stock portfolio increases in value as well. Another way to hedge is through futures. And a new and exciting way is to include structured products in your portfolio that can provide principal protection when the markets are down, but give you an upside if they go up.

Vaccine # 5: Inflation guard

Inflation can eat into your portfolio. So a portfolio should ideally include the types of assets that increase in value as inflation rises—gold, for example. On a fixed income portfolio, internationally, one can purchase TIPS (Treasury Inflation Protected Securities). These are meant to provide a yield that exceeds inflation.

To your health

Prudent investors will use these strategies in tandem to vaccinate their portfolio against financial market uncertainties that could harm their wealth.

Maneesh Kumar is Head, Wealth Management Solutions, ASK Wealth Advisors