In my last Market Update June 21, I mentioned that I would send an article about Crypto Currencies and SPACS (Special Purpose Acquisition Companies), however before this I would like to provide a simple orientation concerning asset allocation which some of you may find interesting. I will send the Crypto Currency article in a weeks time.

A Short Guide to Asset Allocation

It is a widely accepted wisdom in the financial world that asset allocation is the most important factor when seeking investment growth. This has been the conclusion reached by several academic studies over the years.

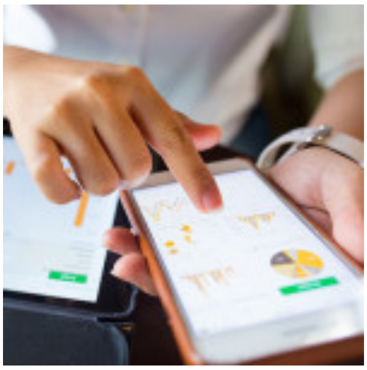
This indicates that the types of investment you hold will have a greater impact on your returns than the individual funds and shares in your portfolio.

So, what is asset allocation, and why is it important?

The Main Asset Classes

The main asset classes you can select for your portfolio are described as follows:

Equities



Equities, or company shares, allow you to own a portion of a business. The value of your investment will fluctuate in line with the company's value, and you will receive a share of the profits in the form of dividends.

Equities are the most volatile asset class as the price fluctuates, sometimes widely, on a daily basis. The price is not only dictated by the company's real value, but by investor perception, and the resulting demand for the shares.

But equities also offer the greatest growth potential over the long term. This can help to ensure that your portfolio achieves real returns which exceed inflation.

Property

Property funds buy and sell land and buildings, usually those designated for commercial use. Investors benefit from the capital growth as well as the accumulating rental income.

Property has been regarded as a useful diversifier against equities. It is generally more stable in value, but can still produce substantial capital growth over the longer term.

However, property is illiquid, which can mean it is difficult to sell. When investors wish to take their money out, fund managers may need to delay withdrawals or sell property at reduced prices to meet redemptions.

While many investors still opt to hold property directly, property funds have waned in popularity in recent years.

Bonds

Bonds, or fixed interest securities, are effectively a loan to a company or government. The loan has a fixed interest rate (or 'coupon'), and a maturity date when the capital will be paid back.

Bonds offer a guaranteed income, which in some cases is index-linked. The price is usually more stable than equities.

However, bonds do suffer price fluctuations, and are sensitive to changes in interest rates and inflation. When the price of a bond rises, this makes the income yield (which is fixed as a percentage of the original price) less attractive.

Bond prices often react differently to market events than equities. This can help to offset equity movements and stabilise a portfolio.

Cash

Cash is the most stable asset class as the value does not fluctuate.

However, with interest rates at an all-time low point, any holdings in cash are likely to be eroded, in real terms, by inflation. If you keep all your money in cash, your fund won't have the same purchasing power in ten years' time.

Additionally, cash within an investment portfolio can be eroded by charges.

The main use of cash is to provide short term liquidity in your portfolio. This means that any withdrawals or charges can be paid without encashing other investments.

Variation Within Asset Classes

Not all investments within an asset class are created equal.

Equities can include a wide range of different investment options, from well-known global companies such as Amazon or Apple, to start-ups in emerging markets. Some investors even hold private equity, which means that the shares are not listed on an exchange and are not publicly traded.

Similarly, bonds issued by the UK government will behave differently than those issued by smaller companies in the Far East.

Even within a single asset class, investments can vary widely in terms of risk and reward profile.

Risk and Reward

The amount of risk you should take within your portfolio depends on a number of factors:

- The returns you wish to achieve
- Your emotional tolerance for risk
- Your knowledge and understanding of investments
- The timescale of the investment
- The amount that you can afford to lose in a market downturn

If you are seeking high returns, have a long investment timeframe, and can cope with extreme volatility, a portfolio holding mainly equities will probably be for you. This is likely to include smaller company and emerging market shares, which can be more volatile than larger, established companies, but have higher growth potential.

If you are a more cautious investor, maintaining the portfolio's real value will be the most important objective. This might mean holding mainly bonds and some cash, which don't fluctuate to the same extent as equities. But it is still worth holding a proportion of equities in your portfolio, as this provides the best chance of keeping up with inflation.

The Benefits of Diversification

The purpose of asset allocation is not to decide which asset class is 'better' than the others, but to combine them in a way that offers the best chance of achieving your investment goals.

The various asset classes, and even the individual investments within an asset class, behave differently depending on market conditions.

The economic cycle is fairly predictable, with ups and downs, recession, and recovery.

But what we can't predict is exactly when the tide will turn, or how this will affect the investments in a portfolio. We know that the market generally moves in an upwards direction, with some bumps along the way, but anything beyond that is speculation.

The best way to hedge against this unpredictability is to hold as many different asset types as possible. Some will go up and some will go down, but not all at the same time. This allows you to capture the growth in the market, while smoothing out the worst of the volatility.

Our Tips for Constructing a Portfolio

Our top tips for building your portfolio are:

1. Invest widely across different asset classes, geographical regions, and business sectors.
2. Take an appropriate amount of risk.
3. Remember that achieving your goals is more important than beating any benchmark.
4. Avoid being driven by emotion or biases. Continually tweaking a portfolio is likely to be counterproductive.
5. Invest for the long term.

Please do not hesitate to contact me if you have any questions or comments about this article.

Thank you

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