BUILDING BLOCKS FOR RETIREMENT

Diversification

Diversification: A Tool to Temper Risk

Market volatility is a given in the investment world, so employing strategies to cope with fluctuating market values should be a priority. Diversification -- spreading your money among many different investments and investment types -- is one such strategy.[1] Although you can't eliminate volatility, diversifying your investment portfolio may help you manage it.

A First Step: Asset Allocation

Different asset classes often respond differently to similar market conditions, so investing in a mix of stock, fixed-income, and cash investments is the first step in creating a diversified portfolio. Investing across all three of the major asset classes -- a strategy known as asset allocation -- reduces the possibility that a decline in any single investment or asset type would put your entire portfolio in jeopardy.[2] For example, including fixed-income and cash investments in your stock portfolio may help moderate losses if the stock market suffers a decline.

Taking It to Another Level

In addition to allocating your investments among stocks, bonds, and cash, you may want to diversify within each investment type. For instance, holding a variety of small-, mid-, and large-cap stocks and investment-grade bonds with varying maturity dates may help reduce your risk of loss. Similarly, you may want to consider investing in a variety of stocks from different market sectors.[3] A market sector is a segment of the economy that includes companies or industries offering the same or similar products or services. Investing across several market sectors may help control risk and provide greater portfolio diversification than investing in only one or two industries.

Cyclical Versus Defensive

Some industries are notably affected by economic highs and lows. Cyclical stocks come from industries such as housing, transportation, and technology, that typically are sensitive to the health of the economy. Consumer demand for their products and services tends to rise when the economy is flourishing and decline when the economy experiences a downturn. Defensive stocks come from industries such as utilities, food, and other staples where demand tends to be relatively steady. Investing in both cyclical and defensive stocks from different industries may further improve your portfolio's diversification.

Traveling Abroad

You can provide another layer of diversification and add exposure to new markets by including investments from different countries and regions of the world in your portfolio.[4] International markets may respond differently to various economic conditions than U.S. markets do. Investing overseas may help cushion your portfolio when U.S. markets are underperforming.

Not a One-Time Undertaking

Periodically checking your portfolio for changes to your investment mix can help you maintain your desired asset allocation and level of diversification. If market conditions have altered your asset mix, the risk level in your portfolio may have shifted, and your investments may need to be rebalanced to return to your original asset mix and risk level.

In the Long Run

Your portfolio's asset mix can help prepare you for the uncertainties of market performance. So it is important to select investments carefully and invest with a long-term perspective.

Source/Disclaimer:

1 There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not ensure against market risk.

2 Asset allocation does not assure a profit or protect against a loss.

3 Investments in specialized industry sectors have additional risks, which are outlined in the prospectus.

4 Foreign investments involve greater risks than U.S. investments, including political and economic risks and the risk of currency fluctuations, and may not be suitable for all investors.

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