Unravelling asset allocation

This is the third part of a series of nine articles on "Globalising Your Ringgit," brought to you every Saturday by CitiGold. The series aims to educate and empower the investing public on off-shore investing opportunities, made possible by the recent liberalisation of foreign exchange administration rules.

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MANY retail investors pay little attention to such details as the basic principles of strategic asset allocation, simply because not all investment rules are easily understood or can be interpreted in layman's terms.

Sometimes, retail investors are misled. They think the successful investor is one who is able to pick the right stock, bond or property at the right time and at the price.

But research debunks this. Wealth accumulation and conservation for the long term are more dependent on how one invests one's money (excluding those put in properties and business assets) in different asset classes. This is the essence of strategic asset allocation.

What is strategic asset allocation?

Strategic asset allocation means investing money in various asset classes or markets. The CitiGold Strategic Asset Allocation Model (*Visual 1*) was built on this philosophy and is reflected in a pyramid structure identifying three key asset classes required for a balanced portfolio: short-term, liquid and long-term assets.

To some retail investors, strategic asset allocation is no more than "not putting all the eggs in one basket."

While this definition is not wrong, investors should understand that strategic asset allocation is a long-term guide for wealth management and preservation, regardless of market cycle.

In strategic asset allocation, consideration is given to such factors as investor's objective, risk profile, liquidity and age. These all are crucial to creating a balanced portfolio.

A balanced portfolio is analogous to the food pyramid (*Visual 2*) in two ways.

First, the food pyramid recommends a daily balanced diet while the balanced portfolio calls for a good mix of short- and long-term assets and cash.

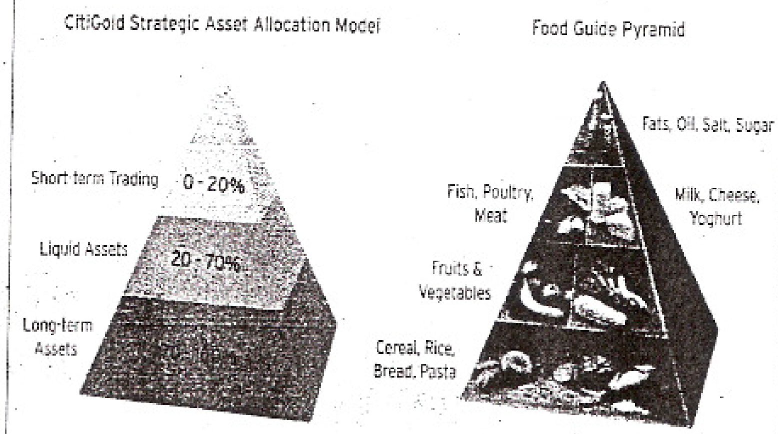
And second, the food guide stresses the consumption of energy-producing food and less of fat, oil, salt and sugar, which are needed in smaller quantities.

Similarly, the CitiGold strategic asset allocation model emphasises the importance of long-term assets and investments against holding short-term and liquid asset.

Long-term assets include mutual funds, structured products and real estate investment trusts (REITs). Liquid assets are time deposits and money market products, among others.

Short-term assets generally comprise stocks, which tend to be slightly riskier and, in general, provide potentially higher returns in a short time.

Strategic asset allocation principles closely resemble the model dietician food guide pyramid



VISUAL 1 : Strategic Asset Allocation Model

VISUAL 2 : Food Guide Pyramid

Importance of strategic asset allocation

Each component in the strategic asset allocation is important, particularly for investors who want to invest abroad.

Long-term assets, which generally account for between 30% and 60% in the allocation model, will determine financial stability and wealth preservation in the long run because they potentially offer more steady and consistent returns.

Liquid assets, or easily accessible savings, have the widest allocation range of 20%–70% in the allocation model.

Short-term instruments, given up to 20% allocation, can help investors make quick gains from short-term business cycle or trends.

Long-term assets

Although in general the strategic asset allocation model means diversification of investments and healthy mix of assets, its main focus is on long-term investments. This is quite simply because stable returns are preferable to quick gains

Investors should always aim to have elements of growth and income in their investment portfolios because the two respond differently to changing economic factors. A good mix of assets, promising growth and income, will fortify and, at the same time, shield your portfolio from adverse circumstances, be they economic, political or natural disasters.

Malaysians who depend on their fixed deposits and their Employees Provident Fund (EPF) during the retirement days must realise the impact inflation has on cash deposits. A recent Citibank research shows real returns from cash fixed deposits fell from an average 4.2% in the 1980s to 3.2% a year in the 1990s. Thereafter, they fell further to 2.4%, and are reckoned be to in the negative in August this year.

Failing to take heed of these evolving trends and statistics when allocating assets may result in an erosion of personal wealth and pose a threat to long-term sustainability of an investment portfolio.

In a nutshell

A strategic asset allocation model can be tailored to suit even the most conservative or aggressive investor.

For retail investors, periodic review and rebalancing of asset allocation is vital because investments must be in line with an individual's age and life-stage (single to married through to having children).

Finally, there is no "right or perfect time' to start allocating your assets. It is never too early to make the first move.

Next week, we will explore how new post-liberalisation retail products can be added to the strategic asset allocation model.

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