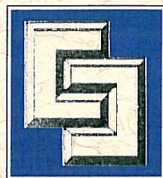




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Investor Notes 1/14/2009

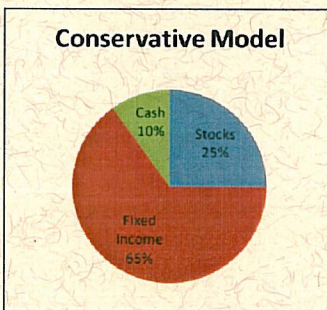
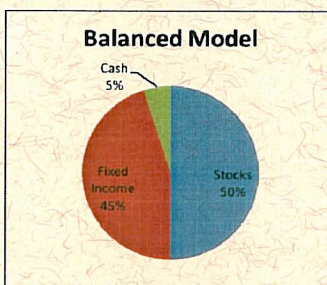
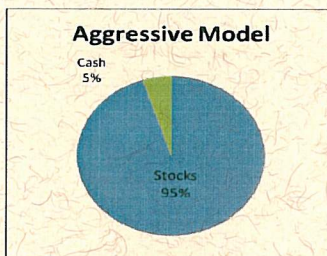
## What is Your Proper Asset Allocation?

During periods of market volatility, such as in 2008, having the proper asset allocation can help you sleep at night. The right asset allocation will depend on several factors of which determine how much risk you can afford to take both financially and emotionally.

What is asset allocation? Simply, it is not putting all your eggs in one basket; however, the more technical answer is how an investor distributes money into various asset classes in order to diversify risk. Asset allocation is based on the idea that no two asset classes will perform the same over time and that consistently guessing which asset class will have the best performance is very difficult. Each asset class reacts differently to economic events, therefore, each has its own risk / return characteristics that help determine how much of the asset is used in a portfolio. Conservative (risk adverse) investors will have less of a risky asset than an aggressive investor. While there are several asset classes to consider, I will only use the three major classes: stocks, bonds, and cash for illustration in this article.

Stocks generally offer the greatest return among these three asset classes with the highest degree of risk. The past 12 months have been a good indication of the perils of investing in stocks. Bonds have historically returned less than stocks with a lesser degree of risk while cash will offer the lowest return with little or no risk. Within each asset class, subclasses exist that will also have different risk / reward features. For example, stocks can be divided by region (domestic, international, and emerging markets) or size (large cap, mid cap, small cap).

The three basic asset allocation models are as follows:



Determining what asset allocation is appropriate for an investor begins with determining how much risk an investor is willing to assume. There are two factors to consider for determining risk tolerance. The first is how much risk an investor can afford to take financially. This is done by reviewing an investor's time horizon, age, income requirements, and overall financial situation. The greater the time horizon, the more risk an investor would be able to sustain. Investors with short time horizons (5 years or less) will need to have more exposure to safer assets. For example, if an investor has a time horizon of 2 years, it is not appropriate to have 100% of their portfolio in stocks. As the need for certainty of outcome increases, the

level of risk that an investor can afford to take is reduced.

The second factor to consider is how much risk an investor can handle emotionally. While no one likes to see their investments decline in value, they often do. Having an ability to stomach the ups and downs of the market will have an influence on an appropriate asset allocation strategy. For example, two investors with the same financial circumstances may have the same capacity to handle risk; however, their personal view of what risk is may be very different. If Investor A likes to gamble, his capacity to stomach risk may be high whereas Investor B, who is a staunch saver and doesn't spend money freely, will have a more conservative view.

Evaluating an investor's risk tolerance can be difficult. It is normally done with a series of questions to assess an investor's reaction to certain events. Questions should focus on both of the factors previously discussed in order to determine the proper asset allocation. Online brokers, 401k plans, and other "do-it-yourself" sites will have these profiling questionnaires as part of their services. Once the questions are answered, then a proposed asset allocation is provided. While useful, these questionnaires can be limited as to the scope of factors considered. It is always helpful to speak to a qualified financial planner in order to determine what asset allocation strategy is most appropriate.

For additional information about asset allocation in a portfolio, please give us a call at 504-835-1135 or e-mail me at [mnoobile@crescentsterling.com](mailto:mnoobile@crescentsterling.com)