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Spreading your money among different investments is the key to long-term financial success. In other words, don't put all your eggs in one basket.

By Alan S. Horowitz

In the world of gambling, "betting the ranch" may sound exciting—going all the way, putting it all on one surefire wager, not worrying about the risk involved. But the last thing you want to do is gamble with your retirement portfolio. Putting everything you have into a single investment vehicle—or even a limited few—can spell disaster.

Financial success depends on striking a favorable balance between risk and reward, and the strategy most widely acknowledged to achieve this is called asset allocation.

Asset allocation is, in a sense, the opposite of betting the ranch. It's a strategy in which your investment portfolio is made up of different asset types, most commonly cash, stocks, mutual funds and bonds. The philosophy behind asset allocation is that diversifying your investment mix reduces your exposure to risk because various asset classes tend to perform differently under given market conditions.

For example, large-cap U.S. stocks performed better during the late 1990s than small-cap U.S. stocks, which outperformed foreign stocks. This pattern significantly contrasted

with the mid-1980s markets, when foreign investments surpassed U.S. stocks. Conservative investments, such as money markets, generally don't perform as well as stocks, yet money markets recently have outperformed the stock market.

Boost Returns, Minimize Risk

Chicago-based Ibbotson Associates reports that, between 1926 and 2001(assuming all earnings were reinvested), large company stocks had an average annual return of 10.7 percent, while corporate bonds returned 5.8 percent and cash investments 3.8 percent. Based solely on this information, you would put all your money into stocks, and never put any into bonds or cash, to earn the greatest return. But stocks alone aren't consistent winners, and the chances of you identifying the next Microsoft are slim.

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Of course, most investors are realistic enough to know they are unlikely to pick the next great stock or do a good job timing the market. Savvy investors want to strike a balance between risk and reward. Asset allocation can help create a portfolio tailored to your risk tolerance and investment goals, while helping you to capitalize on potential market gains.

A solid asset allocation strategy can help boost your returns and lower your exposure to risk. A study of mutual and pension funds published in 2000 by Roger G. Ibbotson and Paul D. Kaplan in *Financial Analysts Journal* reports that 90 percent of a fund's volatility is the result of its asset allocation. The most critical variable in the successful performance of your investment portfolio is the overall mix of investments you pick, not the particular stocks or funds you buy or when you buy them.

Set Goals

Barry and Madeleine Rubin live in Miami, where he is a self-employed CPA and she is a high school special education teacher. He's 56 and she's 53, and they plan to retire in about 10 years. They're conservative with their money. Married more than 20 years, they started out accumulating cash, based on two goals: to have enough cash on hand to carry them through about six months of expenses should anything unexpected happen, and to have enough for a down payment on a home. About 18 years ago they purchased a townhouse and, as their net worth increased over the years, they began buying equities, primarily through stock index funds and large-cap mutual funds. Today, their portfolio is made up of stocks (30 percent), cash (50 percent) and real estate in the form of their primary residence (20 percent).

Note that the Rubins' goals dictate their asset allocation. A couple of years ago, when the stock market was riding high, cash accounted for about 30 percent of their portfolio, and

Types of Assets

The role of stocks

Stocks come in a variety of flavors: growth, value, large cap, small cap, cyclical, distressed, to name a few. As a class, stocks tend to be volatile, with price movements that are sometimes extreme. Stocks provide long-term growth potential.

Your tolerance for risk and your investment time horizon should dictate whether you invest in stocks. Fast-growing small-cap or international stocks are best for risk-tolerant investors. However, with a well-balanced portfolio, even cautious investors can allocate a portion of their capital to higher risk stocks.

The role of bonds

Bonds basically are an IOU from a company, government entity or other issuer promising to repay a given amount by a given date. They generally are less volatile and less risky than stocks and can reduce overall risk in a diversified portfolio. There are exceptions, such as high-yielding junk bonds. While the yield might seem attractive, junk bonds are extremely risky since the companies that issue them typically run a higher likelihood of default. Since stocks and bonds often move in opposite directions, the combination of the two can provide a nice balance to any portfolio.

The role of mutual funds

Mutual funds pool capital from customers to invest in a portfolio of securities. Typically, these securities are made up of stocks, bonds, or a combination of both. As such, they can provide the best route to one-stop diversification. While some funds strive for a well-balanced portfolio of holdings (check with the fund's prospectus for target weighting among asset classes), others are heavily weighted in certain sectors. These so-called sector funds should be combined with other funds or investments to achieve your desired asset allocation mix.

The role of annuities

Annuities allow your investment to grow on an income tax-deferred basis, while providing the potential for a stream of income that you cannot outlive. These characteristics make them an excellent retirement-planning tool. Fixed and market value-adjusted annuities also offer guaranteed rates of return, which can help to form a strong foundation for your asset allocation strategy. Variable annuities can offer you a potentially greater return on your investment, although, unlike with a fixed annuity, the return is not guaranteed.

The role of cash

Cash investments such as Certificates of Deposit, which are FDIC-insured, and money-market funds can provide fixed rates of return. Generally the most liquid type of investment, these cash reserves can play a vital role in any financial portfolio because the assets within these accounts typically are protected from market volatility.

Risks of Investment Types

Anticipated Return	Risk	Investments
► High	High	Small-cap, growth and foreign stocks, and mutual funds that invest heavily in these stocks
► Moderate	Moderate	Large-cap stocks and mutual funds
► Low	Low	High quality, short-term and intermediate-maturity bonds and bond funds, money-market funds, fixed and market value-adjusted annuities
► Minimal	Low	Deposit savings accounts, insured money-market accounts, Certificates of Deposit

stocks, 50 percent. Today, the value of their stock holdings has diminished while the value of their cash holdings has steadily grown. Rebalancing their portfolio now would mean moving cash reserves into other asset classes, defeating their goal of having enough cash on hand to carry them for six months.

Tom and Barbara Probert of Salt Lake City have taken a different approach to their investing. An engineer and corporate vice president, Tom is 54, and Barbara, a homemaker, is 52. Tom has studied investing and read about an asset allocation plan that he tries to follow: 35 percent invested in fixed income securities, 35 percent in large-cap equities, 10 percent in small-cap equities, 10 percent in foreign equities and 10 percent in real estate. According to Tom, this model should yield about 10 percent a year over the long term, plus or minus 9 percent in any given year. The Proberts have considered being more aggressive, but they're comfortable with the current risk-to-reward ratio.

Getting Started

There are two main factors to consider when planning how to allocate your assets.

First, consider your time horizon in relation to your goals. If your goal is to finance a child's education in 10 years, you'll want to protect some of your assets from the unpredictable mood swings of the markets. On the other hand, if your goal is to retire in 25 years, you can put more of your money in more aggressive, riskier investments. Theoretically, the further away the goal, the more volatility you can handle because there's more time to recover from any drops in value. Still, it's a good idea to have an asset allocation strategy in place for long- and short-term goals.

The second factor is risk tolerance. Determine how much risk you're willing to take before devising an asset allocation mix. Risk assessment isn't easy, but Allstate can help with its risk assessment calculator at *www.allstate.com/magazine*. Once you've completed this simple 12-question tool, which takes into account your time horizon and goals, the calculator will recommend a mix of assets that you may want to consider.

Taking Action

After these steps, you can put your plan into action by investing in the asset classes that provide the mix best suited to your style of investing.

Mutual funds are a mainstay of asset allocation, and Allstate provides access to several highly regarded fund families, including AIM Funds, Fidelity Investments and Putnam Investments. Together, these families offer hundreds of fund choices, making it possible for you to create a portfolio of funds that matches a wide range of asset allocation scenarios.

Annuities are another great vehicle to help you achieve your asset allocation goals. These allow your retirement savings to grow on a tax-deferred basis and may provide guaranteed rates of return.

A variable annuity combines the standard features of most annuities with a choice of investment subaccount options. The value of your annuity increases or decreases depending on your contributions and the performance of your investment choices.

Fixed annuities provide a guaranteed rate of return for a specific amount of time, and your principal is guaranteed by the issuing insurance company. However, you may suffer a loss of principal if you surrender the annuity within the first years of the contract.

Also consider market value-adjusted annuities. These allow you to divide your money over several different investment terms, each with its own rate of interest. During each contract period, you may choose to take cash from your

THE ALLSTATE DIFFERENCE

To make sure that your portfolio is striking the right balance between risk and reward, consider a financial needs analysis. Your Allstate agent can help.

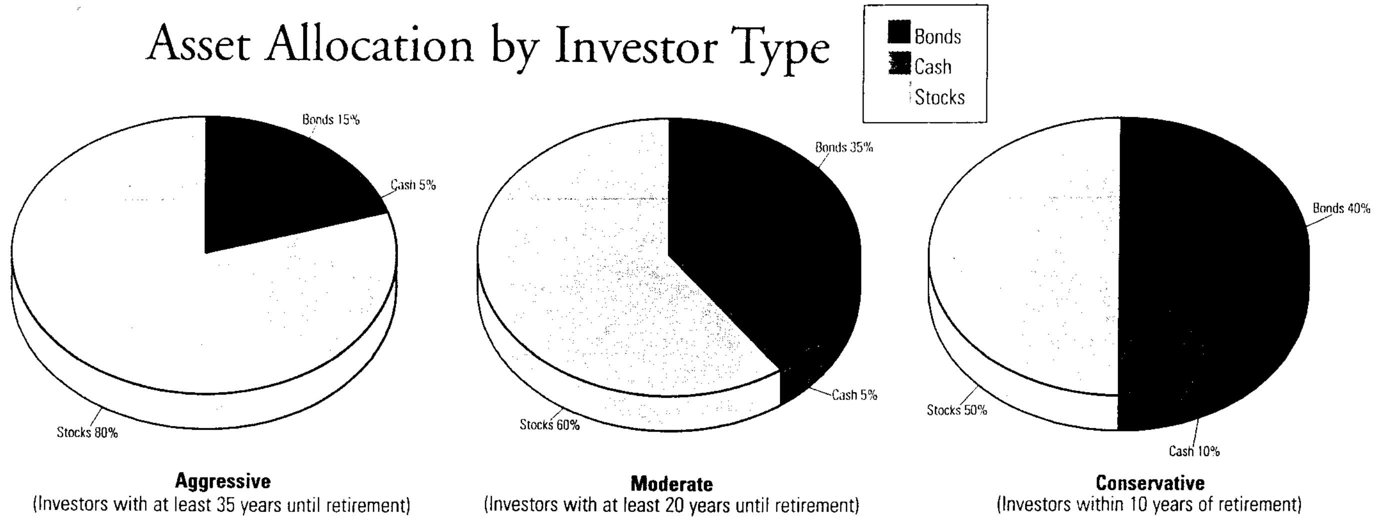
► For more information, contact your Allstate agent.

What's right for you?

What asset allocation is right for you? The truth is that it depends. No one formula is right for all investors, even if they share the same factors that typically define an asset allocation mix—goals, time horizon and risk tolerance.

An Allstate Personal Financial Representative, who may or may not be your Allstate agent, can help you assess your needs and help you decide which mix is right for you.

Below are samples of portfolio weightings by investor type. Again, your asset allocation mix may be different.



Aggressive
(Investors with at least 35 years until retirement)

Moderate
(Investors with at least 20 years until retirement)

Conservative
(Investors within 10 years of retirement)

annuity when prevailing interest rates are favorable for a withdrawal. Market value-adjusted annuities have a greater potential to provide higher interest rates than the traditional fixed annuity. Allstate offers a type of market value-adjusted annuity, which can be started for as little as $2,000. Check with your agent to see if it's available in your state.

For those who prefer the safety and security of a fixed annuity—with growth potential—there is the Allstate Treasury-Linked Annuity®. This annuity offers a guaranteed five-year interest rate with the opportunity to earn additional interest based on potential upside performance of the 5-year U.S. Treasury Constant Maturity Yield. Ask your Allstate agent for details.

Over time, your asset mix likely will change as assets increase or decrease in value. If your large-cap stocks rise relative to the rest of your portfolio, for instance, they will represent a greater percentage of your portfolio at the end of the year. For this reason, you may want to review your portfolio mix periodically or at least once a year.

Asset allocation can help create a portfolio tailored to your risk tolerance and investment goals, while helping you to capitalize on potential market gains.

If you need to rebalance, you can sell enough of the assets that did well during the year to generate proceeds that can be reinvested in other assets to restore your desired allocation. Since asset classes tend to move in cycles, this rebalancing also carries the advantage of buying low and selling high, as you sell some of your best performing assets when they might be near their top, and buying some of your poorest performing when they could be approaching their bottom. Another option is to invest in an annuity that offers automatic portfolio rebalancing.

Finally, no matter how the financial markets perform, it may be a sensible idea to keep at least 5 percent of your total assets or "core savings" in government guaranteed, FDIC-insured instruments, such as Certificates of Deposit (CDs) offered by Allstate Bank. Allstate Bank CDs and money-market accounts pay competitive rates of interest that have consistently topped the national average.

In addition to keeping your core savings secure, you may be seeking the safety and predictable return of a bank account as you approach a major financial or life milestone. By re-allocating funds from more volatile growth investments to Allstate Bank CDs or money-market accounts, you can help make sure that the nest egg it took you years to grow is there when you need it most. ■

Alan S. Horowitz is a Salt Lake City-based business and technology writer whose work has appeared in BusinessWeek, Cash Flow, Entrepreneur, Independent Business, Money Magazine's Your Company *and others.*