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Speaker 1

Welcome! My name is Andrew Baron, and this is, “Well… It Depends!” The podcast where I present pros and cons of different financial decisions so that you, the audience, feel better informed when you are confronted with these decisions in your own life. In this episode, I ask the question How important is my asset allocation? But before we begin a short disclaimer, this is being recorded on April 13th, 2023.

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Speaker 1

The contents of this podcast are strictly for informational purposes only and nothing that is to be taken as investment, tax or legal advice is important to discuss your situation with the professional for making any financial decisions as a strategy as discussed may not be suitable for you. How important is my asset allocation? Well… It Depends! Asset allocation refers to dividing our investments between different asset classes, such as stocks, bonds or cash.

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Speaker 1

How it's divided plays a significant role in performance over time. Your asset allocation should align with your financial goals, your risk tolerance and your time horizon. Different goals require different asset allocations. Whether your focus is on growth, income or preservation. For example, if you're young with a long-time horizon, you may be focusing on growth. In this case, it makes sense to have a higher allocation of stocks and still provide you with a higher return over the long term, in exchange for volatility and risk to the downside, or maybe you are a recent retiree trying to generate income from your portfolio.

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Speaker 1

In this instance, it makes sense to have a higher allocation of bonds or other fixed income products. These types of investments provide a predictable income, however, have lower returns than stocks. Or maybe you are about to make college tuition payments over the next few years.

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Speaker 1

In this case, it makes sense to have a higher allocation of cash. That way the money is available when you need to make payments. However, cash has low returns and other asset classes. Now let's talk about performance. Studies have shown that asset allocation is one of the most important factors in determining a portfolio's performance. This means picking the right mix of stocks, bonds and cash can have a big impact over time.

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Speaker 1

However, this is for people who already have established wealth. While asset allocation is important. Your savings rate also plays a prominent role. Let's look at an example. Let's say you have a 6040 portfolio with 60% stocks and 40% bonds. If you were to contribute $5,000 a year to this portfolio, getting a 6% rate of return over 20 years, you can expect the account to grow to $205,000 approximately.

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Speaker 1

If instead we were to increase your contributions to $10,000 a year, keeping the same asset allocation of 60% stocks and 40% bonds with a 6% rate of return over that same 20 years, the account would grow to approximately $394,000. This is a show that even though both accounts had the same asset allocation, the effective saving $10,000 a year compared to 5000 hours a year is dramatic.

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Speaker 1

The impact of your savings rate on your portfolio's growth can also depend on the size of your portfolio. For example, if you have an account of $100,000 and you are saving $10,000 a year, that is 10% of the account. Regardless of how the account is allocated, your contributions alone will likely have a significant impact on the account's growth.

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Speaker 1

However, the effect diminishes as the account size grows relative to your contributions. For example, if instead we had a $1,000,000 account and we are still contributing $10,000, that's only 1% of the account. In this case, market performance will have a much higher effect than our contributions. This is true to the downside, as well as if we were to have a 20% market correction.

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Speaker 1

$10,000 is really just a drop in the bucket. To recap, as allocation refers to how we divide investments between different asset classes such as stocks, bonds or cash. It's important that our asset allocation align with our financial goals, whether they be growth, income or preservation. It's important to remember our savings rate also plays an important factor in performance.

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Speaker 1

However, this effect is reduced as the account size increases relative to our contributions, making the effects of asset allocation more important. So, to answer the question how important is my asset allocation? Well, it depends.

Speaker 1 – Andrew Baron, CFP®, EA – Senior Associate Advisor