BUILDING BLOCKS FOR RETIREMENT

Diversification

A Word To Investors: Diversify

Just as football fans appreciate the value of a good defense, seasoned investors appreciate the value of diversification as a basic defensive strategy against economic and market uncertainties. The idea behind diversification is to spread your risk by putting your money in several investments rather than just one. When one investment loses ground, another may hold steady or gain, lessening the impact of the loss.

On Your Team

Can you rest easy once you have bought several stocks or several stock mutual funds? Probably not. It's not just the number of investments you own that's important, it's also the types of investments. Bonds, cash equivalents, and real estate are examples of other asset classes that might be represented in a well-diversified portfolio.

Not the Only Game in Town

A closer look at your financial picture might reveal additional areas of risk. As an employee, for example, you have a stake in your employer's financial health because you depend on your employer for income. By investing heavily in the industry that employs you — or in your company's stock — you may be putting too many eggs in one basket. A downturn in your employer's industry or your company's business could affect not just the value of your portfolio, but possibly your income as well. Also be careful about investing only in industries that have a significant presence in your geographic region. Why? An economic slowdown in your region could adversely affect the value of your portfolio and your home.

Your Tax Game Plan

Since the tax rate you pay on qualified dividends and long-term capital gains won't be any higher than 20% (plus an additional 3.8% surcharge on net investment income, if applicable), you might want to review how you have divided your investments between taxable and tax-deferred accounts. Would it make sense to hold dividend-paying stocks and investments with significant potential for capital gains in taxable accounts and use your tax-deferred retirement plan to hold bonds and other interest-bearing investments? It might, since all investment income distributed from tax-deferred accounts is generally taxed at your regular tax rate, which may be much higher than your tax rate on qualifying dividends and gains. On the other hand, if most of your investments are held in tax-deferred accounts, diversification and asset allocation principles — not taxes — will likely drive your decisions.

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