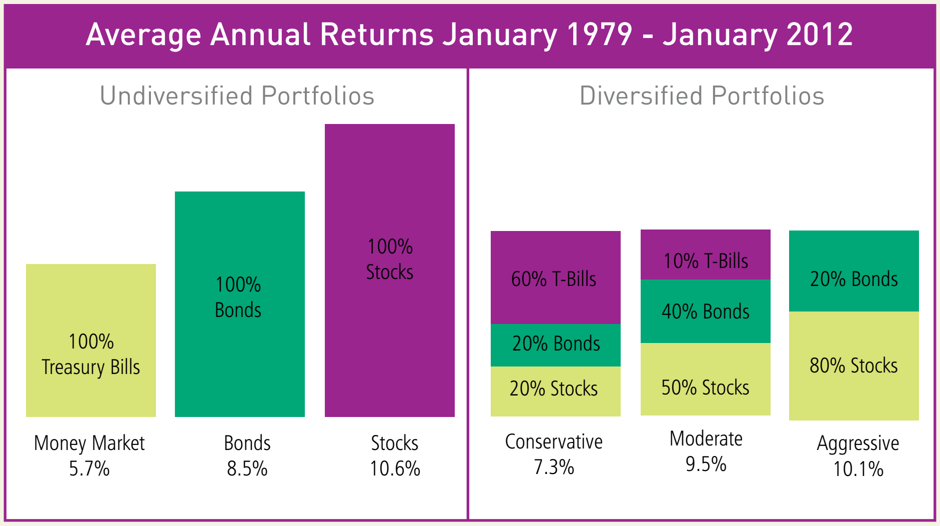
Diversification

Diversification: Lessen Your Dependence on Being in the Right Place at the Right Time

If one investment perfectly suited all your needs all the time, investing would be simple. Unfortunately, no investment does well all the time, for anyone. There is a way to invest that takes advantage of the best qualities of different investments while offsetting the risk of each investment. It's known as diversification. Different investments react differently to changes in the economy and the financial markets. While one investment is rising, another is likely to be declining, or holding steady. The more diversified a portfolio – meaning the greater the variety of investments – the less likely it is that you will be negatively affected by the poor performance of a single investment.



The chart on the left above shows the average annual returns for money market securities, long-term bonds and stocks from 1979 through 2012. Stocks performed best over the long term, with an average annual return of 10.6%. That's almost double the returns of long-term bonds and money market securities over the same time frame. That average, however, covers wide swings in prices. So what's an investor to do? One solution is to blend a number of investments, or to diversify. Diversification can help lessen some of the risk associated with investing in stocks and bonds. The chart on the right above shows three diversified portfolios over the same period of time. They range from conservative to aggressive. While in each case, you would have given up some return by limiting your investment in stocks, your average return would be more stable. Each of the diversified portfolios produced better returns than an all bond or an all-money market portfolio. By diversifying your investments, you can lessen your dependence on being in the right place at the right time.