THE ART OF
Asset Allocation

How to Build Your Portfolio to Maximize Returns & Minimize Risk

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Foreword: Spread Your Eggs

Way back in the 1700s, a series of unfortunate horse-cart accidents among poultry farmers led to a severe egg shortage. This lead to some sage men advising: "Don't put all your eggs in one basket!"

Three hundred years later, the advice is still good: Don't put all your eggs in one basket. The only difference is that now we're talking about nest eggs – your savings, which you plan to rely on for the rest of your life.

As the maxim implies, diversity is the key to protecting your investments. It would be great to know whether stocks, bonds, gold, or real estate will perform the best (and which will fall) over the next few years – but that is impossible. However, you can distribute your investments (using asset allocation strategies that we are going to discuss in this e-book) in a smart way that will offer long-term upside yet protect you from catastrophic downside.

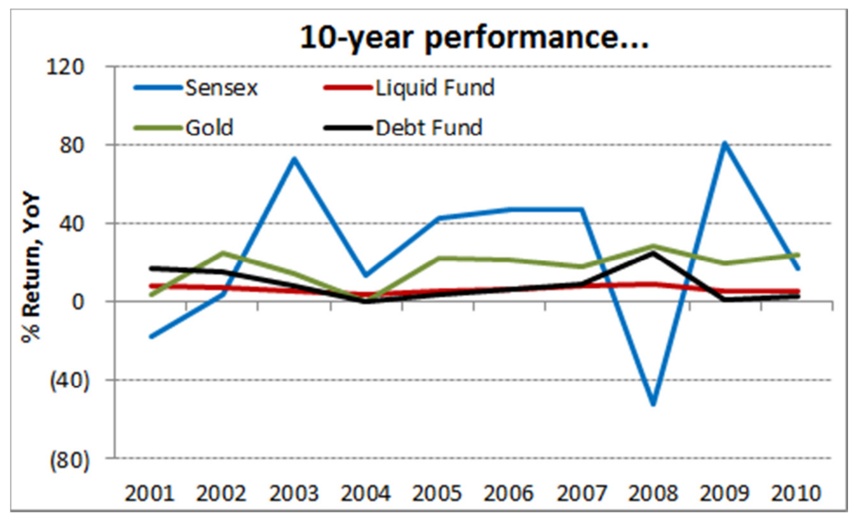
As an investor, your goal is *not* to find the very best allocation, because no one knows what that will be. Instead, you must try and choose an allocation that has performed well in various scenarios and won't give you a heart ache!

Asset Allocation: The What & Why

Here is what Wikipedia writes about asset allocation – *"Asset allocation is based on the principle that different assets perform differently in different market and economic conditions. A fundamental justification for asset allocation is the notion that different asset classes offer returns that are not perfectly correlated, hence asset allocation reduces the overall risk in terms of the variability of returns for a given level of expected return."*

In simple words, *asset allocation* is the practice of dividing your savings among different categories such as stocks, bonds, mutual funds, gold, real estate, and cash. The theory is that you, as an investor, can lessen risk because each asset class has a different correlation to the others.

For instance, when stocks rise, bonds often fall. Then, at a time when the stock market begins to fall, gold may begin generating above average returns. The amount of an investor's total portfolio placed into each class is determined by an asset allocation model (which we will discuss later in this report). These models are designed to reflect the personal goals and risk tolerance of the investor.



Historically, the returns of the major asset categories – like stocks, bonds, and gold – have not moved up and down at the same time (see above chart). Market conditions that cause one asset category to do well often cause another asset category to have average or poor returns.

By investing in more than one asset category, you'll reduce the risk that you'll lose money and your portfolio's overall investment returns will have a smoother ride. If one asset category's investment return falls, you'll be in a position to counteract your losses in that asset category with better investment returns in another asset category.

In addition, asset allocation is important because it has major impact on whether you will meet your financial goals. If you don't include enough risk (stocks) in your portfolio, you may not earn a large enough return to meet your goals.

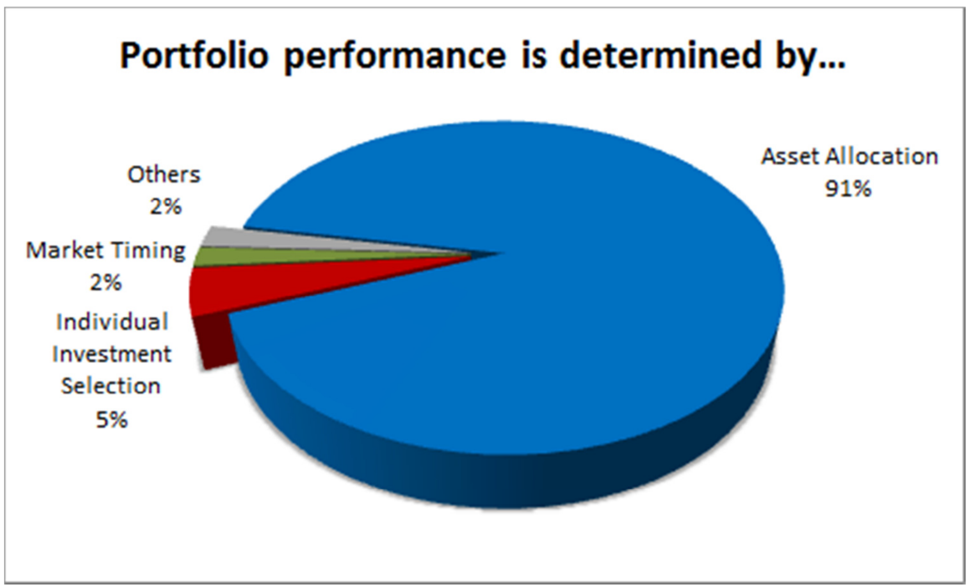
For example, if you are saving for a long-term goal (like 10-15 years), such as your child's education and marriage, or your retirement, you must include at least some stocks and equity mutual funds in your portfolio. On the other hand, if you include too much risk in your portfolio, the money for your goal may not be there when you need it. A portfolio heavily weighted in stocks or stock mutual funds, for instance, would be inappropriate for a short-term goal, such as for an upcoming loan repayment or saving for an upcoming family's function.

An important decision

The most significant decision you will make while building an investment portfolio is determining the asset allocation. Here are some data points to support this.

In the late 1980s, Gary Brinson, a noted money manager and financial analyst in the US, along with his colleagues, published two comprehensive research studies of 82 large pension funds. They concluded that asset allocation accounted for over 90% of the return variability among the funds (in other words, 90% of the difference in return among two pension funds was due to their asset allocation strategies), with a less than 10% contribution from market timing and actual stock and bond selection.

Another research done in 1996 pegged that a long term portfolio's performance is almost 92% determined by asset allocation and less than 7% by market timing and individual stock or bond selection combined (see chart below).



In other words, what these studies indicate is that *asset allocation policy is 10 times as important as stock picking and market timing combined*. In recent years, many observers and investment experts have suggested that the 90% figure is too high; perhaps asset allocation accounts for only 50% of return variability.

You see, such arguments completely miss the point. Market timing and selecting a good stock or bond is obviously important. The only problem is that nobody achieves long-term success in the former (market timing), and almost nobody in the latter (selection of a good stock/bond).

Asset allocation is thus the only factor affecting your investments that you can actually influence. Finding the right balance between high risk (like stocks) and low risk (like bonds or cash) investments is the key to managing risk in a portfolio. That's the power of asset allocation in your hands.

Types of Assets in Asset Allocation

The process of asset allocation involves choosing a portfolio by selecting combinations of investments to meet your specific needs and goals as an investor. This is done by dividing the portfolio among different asset classes. The five main asset classes that make up a typical portfolio include:

1. **Stocks:** Stocks represent equity or ownership in a business or company. If you own stock in a company, you own a piece of that company. Stocks have historically produced the highest returns. However, they also carry the most risk, with a tendency towards greater price swings – highs and lows – that makes them more volatile than either bonds or other debt instruments.

2. **Bonds:** Bonds are basically loans in which the borrower agrees to pay back principal, plus interest, by a certain time. The borrower's ability to repay typically impacts the bond's rate. Bonds are closely tied to changes in interest rates – i.e., when interest rates fall, bond prices rise – and are considered less risky than stocks in general.

3. **Cash:** Cash is the most liquid of all asset classes. It can mean cash under your mattress, or in your savings bank account, or in a liquid fund with a mutual fund company.

4. **Gold:** Gold has emerged as a key asset class over the past few years, and can be held in the form of jewellery, coins, or the new versions called gold ETF (exchange traded funds).

5. **Real Estate:** Real estate includes the property you have as your house or office. For small investors, it represents mostly the house in which they stay.

From time to time, as your life changes, and so do your financial and life goals, it is also important to re-evaluate your asset allocation mix. What makes the asset allocation approach, the approach to long-term investing is it eases the turbulence that happens while investing and empowers you to stay the course to achieve your life and financial goals. When it comes to achieving your life and financial goals, it should never be about market timing, it's about time and having the right asset allocation for you.

Examples of Asset Allocation

Let's look at some examples of asset allocation.

If Investor A chooses to put all his money in a single stock such as Tata Steel, he has made two decisions. He has chosen to not diversify and he has chosen to allocate 100% of his money to stocks since Tata Steel is a stock.

If Investor B chooses to put all his money in a mutual fund such as HDFC Top 200 Fund, he has also made two decisions. He has chosen to diversify and he has chosen to allocate 100% of his money to stocks. The reason Investor B is diversified and Investor A is not is because by investing in the mutual fund, Investor B has chosen to invest in a diversified portfolio of stocks while Investor A has invested in only one stock. Nevertheless they are both 100% allocated to the stock market.

This leads to the logical conclusion that – "You can't make an investment decision without making an asset allocation decision."

Investing and asset allocation are one and the same. Asset allocation is nothing more than the slicing and the dicing of your money. Asset allocation is the percentage of your money that is allocated to different asset classes so that it adds up to 100%.

Asset Allocation: What You've Been Told All These Years…is All Wrong!

A time-honoured investment rule, and what you've been told all these years, is that your asset allocation should mirror your age. In simple words, you must allocate your money into stocks and bonds in a ratio of 60:40 at age 40, 40:60 at 60 and so on.

Ask any stock market expert or financial advisor for a proper allocation of your money, and he will tell you that you must simply subtract your age from 100 and invest that must proportion of money into stocks, and the rest into bonds or other safe instruments.

So if you are 25, you are advised to invest 75% (100-25) of your money into stocks. And as you age, your stock allocation must come down while that of safe investments like bonds must rise.

On the face of it, this logic of increasing an allocation to less-risky, less-volatile bonds as one gets older seems convincing. As investors approach and enter retirement, their ability to earn their way out of a stock-market plunge evaporates. So does their ability to outlive a market decline.

So what is wrong with the allocation rule and the advice based on it?

Plenty! Like many investment rules, this one strikes me as grossly simplistic at best, and dangerous at worst.

Why Benjamin Graham mocked such an allocation

The most striking thing about the father of value investing Benjamin Graham's discussion of how to allocate your assets between stocks and bonds is that he never mentions the word 'age'.

This is what sets his advice firmly against the winds of conventional wisdom – which holds that how much investing risk you ought to take depends mainly on how old you are. Unless you've allowed the proponents of this advice to subtract 100 from your IQ, you should be able to tell that something is wrong here.

Why should your age determine how much risk you can take?

A 90-year-old with Rs 10 crore in his bank account, a big enough house, and a gaggle of grandchildren would be foolish to move most of his money into bonds. He already has plenty of income, and his grandchildren (who will eventually inherit his stocks) have decades of investing ahead of them.

On the other hand, a 25-year-old who is saving for his higher education and a house down payment would be out of his mind to put all his money in stocks. If the stock market takes a nose dive, he will have no bond income to cover his downside – or his backside.

What's more, no matter how young you are, you might suddenly need to move your money out of stocks not 40 years from now, but 40 minutes from now.

Without any warning, you could face troubles in your life – like losing your job, getting divorced, becoming disabled, or suffering who knows what other kind of surprise. The unexpected can strike anyone, at any age. As such, everyone must keep some assets in the riskless haven of cash.

Also, as I've seen over the past many years, many people stop investing just because the stock market goes down. When stocks are going up 30% or 40% a year, as they did between 2003 and 2008, it's easy to imagine that you and your stocks are married for life.

But when you watch every rupee you invested getting crushed, it's hard to resist moving into the 'safety' of bonds and cash. Because so few investors have the guts to cling to stocks in a falling market, Graham insists that everyone should keep a minimum of 25% in bonds (or other similar safer instruments). He argues that such a cushion will give you the courage to keep the rest of your money in stocks even when they are sinking.

The Asset Allocation Process

Step 1: Answer – "Am I a Stock or a Bond?"

No, there isn't a mistake in the above headline. I am not asking whether you own stocks or bonds. What I am asking here is – Are 'YOU' a stock or a bond?

This is the very first question you must answer before you get down to investing in the stock markets. But before that, you must be very clear about these two basic questions:

- What is a stock?
- What is a bond?

A stock is a share in a company, and thus its performance is dependent on how the company's business does. In short, a stock's future performance is unpredictable. This is because it is backed by a company that has inconsistent earnings (in most cases) and subsequently inconsistent performance.

A bond, on the other hand, is a financial instrument that is issued when a person lends money to another person. By issuing a bond, the borrower promises to repay the money after a certain interval (without any default), and also promises to pay a certain interest on the borrowed amount.

So, a bond guarantees a regular income (in the form of interest) and a confirmed payout at the end of a predefined time.

Now, coming back to the same question – "Are you a stock or a bond?" The answer lies in understanding yourself – your life, and your career.

You are a bond if you have a stable job that is unaffected by the volatility of the stock markets. And you have many years left to work.

On the other hand, you are a stock if you have little years of work ahead of you, or if you work in a volatile and unpredictable field that could decline quickly with little notice (like the stock markets itself!).

What this stock/bond question answers is how you look to the idea of integrating your 'human capital' with your 'financial capital'. It answers how you can integrate your work outlook into our investing and financial plan. Human capital in this context is the current value of your long term earnings. When you combine that with your financial capital or savings, it equals your total wealth.

Total Wealth = Human Capital + Financial Capital

While answering this question must be the first step to starting out on a financial plan, few of us take our human capital into account when allocating our financial capital.

We all worry about the market risk, economic risk, political risk, and inflation risk. But we never give an iota of thought on what we can call the ‘personal risk’?

And what’s your ‘personal risk’? Well, it depends on two things:

1. Your age

Let’s talk about the age factor first. The younger you are the greater is your human capital (though your financial capital might be less). While many would see a young person as a ‘growth stock’ – full of energy with bursts of higher earnings (income) – he in fact has a better match with a ‘bond’. This is because he has many years of work ahead of him so he has a long time at his disposal to earn and save. His human capital is high.

To balance that out, as a general rule of thumb, a young person should hold his financial capital in more aggressive investments (like stocks and equity mutual funds).

On the other hand, a person close to retirement or one who is already retired is at the opposite end of the spectrum. He has used up his human capital and most probably has lots of financial capital to ride out the rest of his life. Given his low human capital, he should balance out his investments by investing in safer investments (like bonds and fixed deposits).

2. Your job (or work)

This is the second element that defines your human capital. What you do for a living also defines if you are bond or a stock.

Your Job Defines Your 'Human Capital'	
You are a 'bond' if you work as a...	**You are a 'stock' if you work as a...**
Banker, Doctor, Government employee, Teacher, Professor, Politican, Priest	Investment banker, Economist, Stock market analyst, Fund manager, Derivatives trader, Financial advisor, Small businessman.

If you are a banker, doctor, government employee, teacher, or a professor, you resemble more like a 'bond'. These jobs are relatively stable and are not generally impacted by whatever's happening to their financial capital (in times of a financial crisis). Even in times of stock market or economic turmoil, the incomes of those involved in these jobs are regular (like a bond). In effect, their human capital is high. So, to balance, they have the flexibility of making the rest of their portfolios (financial capital) a little more risky.

On the other side of this lie the 'stocks' – those working as investment bankers, economists, stock market analysts, fund managers, derivatives trader, financial advisors, or small businessmen. These people earn well when the economy is doing good. But a bad economy or stock markets can be a nightmare for them. And even if they consider them as bonds, they mostly represent junk bonds – having a high dividend yield (high incomes in good times) but with a significant default risk (when times turn bad).

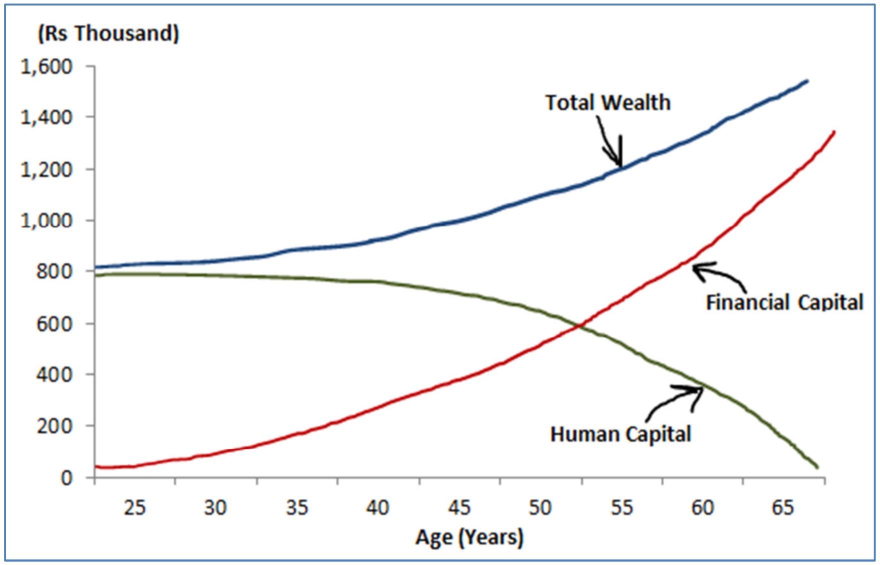
If you are one of these, or are working in an industry that is closely related to how the stock markets or small businesses do, you may want to make the rest of your portfolio a little less risky as a counterweight, by investing a greater share of your financial capital into safe instruments.

If you work closely with the stock markets, you might argue – “But since I am ‘in’ the market and if I know that the market is due to rise, shouldn’t I invest more into stocks and less into bonds?”

Well, your view that the markets are going to rise does not matter much here. This is even if you think you can emotionally stand the ups and down of stocks. You should instead be considering that if markets decline over a prolonged period of time, there is a greater chance you might lose your job, and be unemployed for a long time.

Remember that your human capital – with your monthly paycheques being the dividend on this capital – is already ‘in’ the market. You probably can’t afford to be all in.

Expected Financial Capital, Human Capital, and Total Wealth over the Life Cycle



So, if you want to maximize your investment returns and protect yourself and your family, you must learn to consider both your human capital and your financial capital while making your investment decisions. The nature and security of your career or job (or your human capital) must decide the choices you make with your financial capital. You must know whether you are a stock or a bond. Then, if you are a stock, make sure your savings and investments are tilted toward bonds.

On the other hand, if your job is secure and you are a bond, make sure your savings and investments tilt towards stocks. You see, the ultimate idea for you is to factor in your unique human capital. It not just adds a new dimension to your financial plan, it also leads you to the path of sound and effective investing.

Step 2: Create a Personal Investment Strategy

If you have been with Safal Niveshak for long, you know that my core idea here is to NOT enforce upon you what 'I believe is the right way of investing'…because there's no right or wrong way of investing. Instead, my idea is to help you understand 'yourself' better…so that you can frame your own investment strategy – one that is highly personalized to your style, habits, and what keeps you awake at night.

In effect, I am just acting as a facilitator to guide you towards self-realization as an investor. This article works in that very direction – to help you with some simple questions you must answer to better understand the kind of person you are…so that you can develop a personal investment strategy and subsequently an asset allocation mix that suits you.

There are basically three aspects that can help you create a personal investment strategy:

1. Your personal tolerance for risk
2. Your financial goals
3. Your time horizon

All the points we discuss below will revolve around these very aspects. So let's get started.

5 steps to creating your 'personal' investment strategy

These five steps are basically five critical questions that you must answer to formulate a personal investment strategy

Step 1: Am I a stock or a bond?

See the previous step.

Step 2: How strong am I emotionally?

We humans have a terrible design flaw. When it comes to investing, we aren't just built for it. We have a tendency to see order in randomness. We find patterns where none exist. While this trait might have helped a baby recognize its parents (thereby improving the odds for its survival), seeing patterns where none exist is harmful when it comes to investing.

Investing is a game of emotions – the less emotional you are, the better will be your long-term performance as an investor. So when someone asks me – "Do you think I should invest in stock markets?" – I ask back – "How strong are you emotionally?"

If you count 'patience' among your strengths, you are well-suited to long term investing where patience will earn your great returns. But if you are a nervous wreck – which I was till a few years back – you will be safe staying in the company of bonds, fixed deposits etc. But whatever you do as an investor, never try to go against your basic nature. Never try to suppress the real 'you' or you might end up with demoralizing results.

Step 3: How much risk am I willing to take?

Even after you know whether you are a stock or a bond, or how strong you are emotionally, you must also know your 'willingness' to take on risks that come with certain investments (like stocks and mutual funds).

One key factor that defines the level of risk you can take is your level of understanding about various investment options available. So while I might claim to be an expert on stock markets, my level of understanding on other avenues like fixed income and debt might be extremely weak. This is also true for you. Being a banker, you might know more about banking stocks than a fund manager managing a banking fund.

Or having burnt your fingers in dud equity funds (and 95% of them are real duds), you might believe investing in index funds is a safer strategy (which I believe is perfectly alright based on how you perceive things). So you need to be very clear about the level of risk you are willing to take, and about the type of investments that suit your risk profile.

Step 4: What are my life goals and when are they due?

This is a very important question in the preparation of your personal investment strategy. You must be very clear of what your financial goals are and when are they due. In other words, your investment choices must always be driven by why you need the cash for and when.

So if you are looking to accumulate money to send your child for higher education in 3-5 years, allocate just a marginal amount of money (say around 10-20%) to stock markets. Keep the rest of your capital ultra-safe –

bonds, FDs, liquid funds, etc. On the other hand, if your financial goal – like child's education or buying a house – is 10-15 years away, employing a large portion of your savings in stock market is a 'safer' strategy than keeping them in bonds and FDs.

The thing is that the longer your investment horizon, the lesser you must worry about the short-term fluctuations in stock prices. After all, in the stock market, return and time are painstakingly related.

Step 5: How much can I afford to invest?

The answer is – You should only invest money you can afford to lose. A more constructive way to consider it is: "If I lost this money, would it affect my day-to-day life or expenditure?"

So the first thing to do before you start investing is to repay all your debts – at least ones that need to be repaid in the next 2-3 years. You also need some money for the proverbial 'rainy day'. A sensible rule of thumb is to set aside enough money for 8-10 months' expenditure in a high-interest savings account.

But you may feel happier setting aside more money if, for example, you have a number of dependents. After you do this i.e., repay your short term debt and create an emergency fund, start investing for wealth creation to meet your long term goals.

Why you need a personal investment strategy?

If there's one certainty about investing, it's the certainty of losing money by randomly picking investments on a whim. You are a very rare investor if you can consistently pick great investments solely through gut feel or intuition.

Alternatively, forming a set of sensible guidelines and having the discipline to stick to them should keep you involved in investments (and asset allocation) that are more suitable for you. Whether it's considering companies of a certain industry (your circle of competence), or keeping to index funds, remaining with what you know best and feel comfortable with should limit any investing heartache.

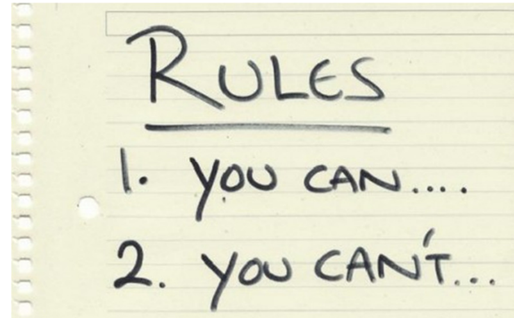
Always remember one thing – You can win the investing game only when you play according to your own rules…and not those set by a maverick, like the one you know as Vishal Khandelwal.

You must also remember that however hard you try to win the investing game, you will still fall several times in your journey.

Of course, I'll always be there to try and sort out matters for you…but I can only help you identify the stumbling stones where you can fall, so that you get 'less' hurt than most other investors. I hope that sounds fine. What do you say?

Step 3: Allocate Your Assets Based on These 4 Time-Tested Rules

Here are four time-tested rules of asset allocation that you can use to allocate your savings into different asset classes.



Rule 1: If you need the money in the next year, it should be in cash.
You don't want the down payment for your home to evaporate in a stock market crash. So keep it in a savings or liquid account.

Rule 2: If you need the money in the next 1-5 years, choose safe, income-producing investments such as fixed deposits, bonds, and recurring deposits.
Whether it's your kid's college money or the retirement income you'll need in the not-so-distant future, stay away from stocks. Shop around for the best rates; your local bank may not offer the best deal.

Rule 3: Any money you don't need within the next five is a candidate for the stock market.

Rule 4: Always own stocks.
Over the long term, equities are the best way to ensure that your portfolio withstands inflation and your retirement spending. According to Jeremy Siegel's Stocks for the Long Run, since 1802 stocks outperformed bonds in 69% of rolling five-year investing periods (1802-1807, 1803-1808, etc.). The percentage of the time that stocks whoop bonds only improves as you look over a longer horizon.

Holding Period	Stocks Outperform Bonds
3 Year	67%
5 Year	69%
10 Year	80%
30 Year	99%

Data from *Stocks for the Long Run*, by Jeremy Siegel

Risk drives return

Most people base their investment strategies on the returns they want, but they have it backward. Instead, focus on managing risk and accept the returns that go along with your tolerance for it. It'd be great if we could get high returns with no risk at all. But to achieve returns beyond a minimal level, we have to invest in things that involve some possibility that we'll lose money. So ask yourself: What would you do if your portfolio dropped 10%, 20%, or 40% from its current level? Would it change your lifestyle? If you're retired, can you rely on other resources such as pensions, or would you have to go back to work?

Your answers to those questions will lead you to your risk tolerance. The lower your tolerance for portfolio ups and downs, the more bonds you should hold in your portfolio. As an extra aid in determining your mix of stocks and bonds, consider the following table, from William Bernstein's *The Intelligent Asset Allocator*:

I can tolerate losing ___% of my portfolio in the course of earning higher returns	Recommended % of portfolio invested in stocks
35%	80%
30%	70%
25%	60%
20%	50%
15%	40%
10%	30%
5%	20%
0%	10%

So, according to Bernstein, if you can't stand seeing your portfolio drop 20% in value, then no more than 50% of your money should be in stocks. Sounds like a very good guideline. Isn't it?

A Few Suggested Allocations

The process of asset allocation is a personal one and varies from investor to investor. If you don't include enough risk in the portfolio (by way of investing in equities), your investments may not earn enough money to meet your long-term financial goals. On the other hand, if too much risk is included, your money may not be there when you need it! The key is finding the right balance between risk and reward that works within your time horizon and risk tolerance.

Here are some suggested allocations that you can consider as starting points for creating your own asset allocation matrix. These allocations are based on whether you are single, or married (with no kids, or with 2 kids).

Single

Assets / Age	<30	30-45	45-55	>55
Property	40%	35%	25%	25%
Stocks/Equity Funds	30% - 45%	35% - 45%	45% - 50%	30% - 40%
Debt Funds/Bonds	5% - 10%	5% - 10%	10% - 15%	10% - 15%
Gold	5% - 10%	5% - 10%	5% - 10%	5% - 10%
Cash	5% - 10%	5% - 10%	5% - 10%	15% - 20%

Married – No Kids

Assets / Age	<30	30-45	45-55	>55
Property	50%	45%	30%	30%
Stocks/Equity Funds	30% - 45%	30% - 45%	40% - 50%	30% - 40%
Debt Funds/Bonds	5% - 10%	5% - 10%	10% - 15%	10% - 15%
Gold	5% - 10%	5% - 10%	5% - 10%	5% - 10%
Cash	0% - 5%	0% - 5%	5% - 10%	10% - 15%

Married – 2 Kids

Assets / Age	<30	30-45	45-55	>55
Property	50%	40%	30%	30%
Stocks/Equity Funds	30% - 45%	35% - 45%	40% - 50%	35% - 40%
Debt Funds/Bonds	5% - 10%	5% - 10%	10% - 15%	10% - 15%
Gold	5% - 10%	10% - 15%	5% - 10%	5% - 10%
Cash	0% - 5%	0% - 5%	5% - 10%	10% - 15%

Changing Your Asset Allocation – The Art of 'Rebalancing'

The most common reason for changing your asset allocation is when your time horizon for your financial goals changes. In other words, as you get closer to an investment goal, you'll likely need to change your asset allocation.

For instance, most people investing for retirement hold less stock and more bonds and cash equivalents as they get closer to retirement age. You may also need to change your asset allocation if there is a change in your risk tolerance, financial situation, or the financial goal itself. But smart investors typically do not change their asset allocation just based on the relative performance of asset categories. For example, they would not increase the proportion of stocks in their portfolio when the stock market is hot. Instead, that's when they would "rebalance" their portfolios.

What is 'rebalancing'?

Most financial advisors you would meet would end their discussion on asset allocation by suggesting you how you must allocate your assets. They do not touch upon an equally important concept of *rebalancing*, which simply means bringing your portfolio back to your original asset allocation mix.

Rebalancing is as important as designing your asset allocation because, over time, some of your investments may become out of alignment with your investment goals. You'll find that some of your investments will grow faster than others (like stocks do in a bull market). By rebalancing, you'll ensure that one asset category does not form a very large part of your total portfolio, and you'll return your portfolio to a comfortable level of risk.

For example, let's say you have created an asset allocation mix that suggests that stocks (plus equity funds) should represent around 70% of your portfolio. However, after a stock market rise, your stocks represent 80% of your portfolio. Now you need to rebalance to bring your stock allocation back to 70%. So you'll need to either sell some of your stock investments or purchase investments from under-weighted asset categories (like bonds and gold) in order to reestablish your original asset allocation mix.

When you rebalance, you'll also need to review the investments within each asset allocation category. If any of these investments are out of alignment with your investment goals, you'll need to make changes to bring them back to their original allocation within the asset category. One important thing about rebalancing your portfolio is that you must always stick with your plan, and not shift money away from an asset category that is doing poorly in favor of an asset category that is doing well.

Always remember, your investment portfolio is like an automobile. If you want your car to perform over the long haul, you take care to practice regular maintenance. It's the same with your portfolio, and one of the most critical facets of regular portfolio maintenance is rebalancing. Rebalancing wisely, and at the right time, is a great way to make sure you're getting the most out of your portfolio.

Afterword: 7 Steps for Planning Your Financial Life

I am a strong believer of managing one's own money and finances. The simple reason is that it's your money at stake, and your financial future that's being planned. Nobody cares more about your money than you do. So if you are not motivated to improve your financial situation, nobody else is going to do so either…not even the best financial planner around.

I manage my own finances and see no reason why anyone else can't do that on his or her own. This is not to say that using the services of a financial planner is not worth it. In fact, if you can find a good, ethical, trustworthy financial planner, supplementing your financial skills with his knowledge can work wonders for your financial life. Also, being your own financial planner works only if you have the time and energy to put into the job.

There will always be some areas where you would need some professional help, like tax planning. Go ahead and take help here, but make sure you understand what you are being offered, do your own research and ask questions. Anyways, here are 7 simple steps I use to manage my own finances. You can use these to manage your own finances as well.

Step 1: Spend less than you earn. In short, save some money every month.

It's very important to set aside your savings every month before you use the money for other things, including paying of bills. Always pay yourself before anything else.

The standard rule of thumb is to save at least 10% of your income. In this period of consistently high inflation, I believe a better goal is to aim for 20%. Also, if you're young, you can follow this rule of thumb – Save 10% of your income for your basic needs, 15% for comfort, and 20% to escape wherever you want.

Step 2: Create an emergency fund. The fund should ideally be around 6-10 months of your household expenses.

Step 3: Buy medical insurance. Health is wealth, but bad health must not destroy your wealth.

Step 4: If you have dependents, buy term insurance. No ULIP, no Endowment, no Money-Back, no Child Plan…just term insurance.

Step 5: Divide your financial goals into "less than 5 years" and "more than 5 years" and allocate your investments based on the duration of your goals:

- For money required in less than 5 years (like for debt repayment, child's education fee, foreign holiday, new car purchase), allocate your investments among "stocks plus equity mutual funds" and "bonds plus other capital-protection investments" in a ratio of 30:70.
- For money required in more than 5 years, allocate your investments among "stocks plus equity mutual funds" and "bonds plus other capital-protection investments" in a ratio of 70:30.

Step 6: Write a Will. If you don’t want to leave you family in the lurch after you’re gone, write a Will. It’s much simpler than what you could imagine.

Step 7: Review your financial goals and investments every 6 months. Review to check if all is well, not to change everything that has already been done.

References:

- Wikipedia
- Fool.com
- The Intelligent Asset Allocator by William J. Bernstein
- IMF
- www.safalniveshak.com

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I hope you enjoyed reading this E-book and got the value that you expected of it.

Now I'd like to ask you a small favour.

Provided you've liked what you've seen in this E-book, kindly share it with your friends and colleagues who might be interested.

You can also invite them to sign up for my free E-letter on investing and personal finance – *The Safal Niveshak Post*

You can also send them to sign up for my free 20-lesson course on Value Investing – *Value Investing for Smart People*

Thank you again for being there!

About Safal Niveshak

Safal Niveshak is a movement to help you, the small investor, become intelligent, independent, and successful in managing your investments and personal finance.

My name is Vishal Khandelwal, and I am the founder of *Safal Niveshak.* Before starting work on the idea of *Safal Niveshak*, I was working as a stock market analyst for eight years.

During this period, I felt the pain of seeing small investors lose large amount of their hard earned money, for reasons ranging from:

- Scams…where companies simply vanished, to
- Speculation…to earn fast money, to
- Bad decisions…mostly backed by insensible and short-term advice from self-centered brokers and self-proclaimed stock market experts.

While the probability of a stock market analyst to work on a social cause is miniscule, here I am driving this movement called *Safal Niveshak* – to help you become intelligent, independent, and successful in your stock market investing decisions.

Through my experience in the stock markets, I have come to believe that:

- You alone are the most capable person alive to manage your money.
- Investing in the stock markets is not a rocket science. You just need to form the right habits, and behave yourself.
- Being smart about your money can be a lot of fun.
- You can create a lot of wealth for yourself doing it.

You can write to me at vishal@safalniveshak.com to know more about this initiative and how you can benefit from it and/or support it.

With respect,
Vishal Khandelwal
Founder, Safal Niveshak