Overview

- Diversification and proper asset allocation are the keys for managing your portfolio
- Review and rebalance your portfolio regularly to ensure that it stays fit to cope with your ever-changing goals and circumstances
- Seek help from a trusted investment advisor, if you are unsure of how to do it yourself

Perhaps you will believe that a cash-only portfolio would be better in times of high volatility. Though cash may offer you a sense of security in uncertain environment, don’t forget that inflation will eat into your purchasing power in the medium-to long-term and may not help you to reach your financial goals.

Diversification could be your best way out

All investments involve some degree of risk. The reward for taking on more risk is the potential for achieving a greater return. However, risk also increases the chance that you could lose your nest egg. In general, financial instruments like equities and alternative investments have the greatest risk and highest potential returns among major asset classes. Bonds are less volatile than equities but offer more modest potential returns. Finally, cash and cash equivalents are the less risky options, but offer the lowest returns.

Various asset classes tend to perform differently under the same market conditions. Taking bonds and equities as an example, when bonds go up, equities tend to go down and vice versa. Long-term studies have shown a portfolio of a mix of asset classes with low correlation can help deliver returns in the long term. That's because the asset class that outperforms can counter the poor returns of the underperforming asset class. This allows the investor to achieve higher returns without taking on much more risk at different times.

…but it only works when you get asset allocation right

However, for diversification to work and help deliver your financial goals, you must follow a few guidelines. This includes proper asset allocation to spread out your investments across different asset classes, and within each asset category. Basically, the asset allocation of your portfolio is determined by your risk tolerance level and financial goals, which in turn are dictated by your age, investment horizon and liquidity needs. For example, if your long-term financial goal is a comfortable retirement and you can afford a relatively high degree of risk, your portfolio can be more growth-oriented with a larger tilt towards equities. Meanwhile, to meet a medium-term goal, like saving for a new car, you may allocate some investment to bonds and cash to balance the equity market risk.

Appropriate allocation within each asset class is also vital. For instance, buying different equities by capitalisation, country, or sector, and bonds with various credit ratings and maturities from different bond issuers, helps to achieve a more well-balanced diversification.
Mutual funds are a great way to diversify security risk

- It can be quite costly and complicated for an ordinary investor to construct and maintain a truly diversified portfolio. Instead, you may find it easier to diversify through investing in mutual funds. A mutual fund is a professionally managed type of collective investment scheme that pools money from many investors for investing in equities, bonds, money market instruments, and/or other financial instruments.
- With the broad range of mutual funds being offered in the marketplace which are invested across different asset classes, different countries and different companies, you can enjoy the benefits of instant diversification. You can also tailor-make an investment portfolio that best suits your changing needs. Mutual funds offer economy of scale. The money you invest buys a pool of assets, which is cheaper and more convenient than buying each security individually. With one investment, you can save on multiple transaction and commission charges. Besides, mutual funds can offer you a high degree of liquidity as you can buy and sell your funds and avoid doing all the administrative and research work on your own by letting professional fund managers to work for you.

Knowing your investments prevents over-concentration

Even with a bundle of mutual funds, you may still end up facing over-concentration risk without you even knowing it if their underlying assets are too similar in nature.

For example, a combination of an emerging market equity fund, an Asian equity fund and a commodity fund may give you a false sense of diversification. Many emerging market equity funds can have as much as 50% of their holdings in Asia ex-Japan region, and they can also have considerable exposure to commodity companies. On the flipside, the same is true for global equity funds which can invest over 50% of its assets in the US, and you end up with an over concentration in a single country. By understanding what your investment products invest in, you can better fashion a portfolio that is suitable to your risk-return objectives.

Diversification requires discipline

In order to establish a well-diversified portfolio, you may consider putting together a “core and supplementary” portfolio and allocate your assets based on the principle of an investment pyramid. The core portion consists of core funds such as global equity and bond funds, which are less volatile and aim to offer a consistent return over time, through most market conditions. Supplementary funds refer to high-beta, volatile funds such as single country equities and sector funds which allow you to make strategic investment on markets or sectors that you have positive views. The typical supplementary portion usually accounts for less than 30% of the value of the overall portfolio, but it may vary depending on your risk appetite.

![An investment pyramid](image)

The core and supplementary strategy works best only when you can maintain your investment discipline. Investors have a tendency to trade constantly, or simply buy and hold but forget about their existing portfolios. Neither strategy is optimal. Regular review and rebalancing are required to keep your portfolio in good shape.
There are multiple factors affecting asset allocation decisions. As time goes by, the goals that you have established at the very beginning are likely to change. Conducting a health check regularly helps to ensure that your investments stay fit to meet your goals. Besides, under ever-changing market conditions, gains or losses in any asset class in your portfolio will change your original asset allocation mix leading to an over concentration in a particular asset class. Therefore, change in economic conditions might require adjustments in asset allocation.

If unsure, speak to a trusted investment advisor

In case you need help on portfolio construction and maintenance, you can always talk to your investment advisor to seek for professional advice. Quality investment management companies have seasoned investment expertise, broad research coverage and prudent risk management policies, which can always provide you with excellent investment services and consistent return potential.

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