

Work!

## **[Step 5 - Allocate financial investments across the primary investment asset classes](#)**

**Category : Financial Planning -- 10 Personal Steps in the Right Direction**

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Allocate investments across the primary asset classes  
NOTICE: A much expanded and updated version of this article can be found on our [Financial Planner Pasadena California](#) website. Click here to find it -->> [Investment Asset Allocation](#) Step 5 of "10 Financial Planning Steps in the Right Direction" [CLICK HERE TO READ THE SKILLED INVESTOR'S OTHER ARTICLES ABOUT THESE "10 FINANCIAL PLANNING STEPS IN THE RIGHT DIRECTION](#) Appropriately setting your personal investment asset allocation in line with your personal investment risk tolerance is a critical decision for every individual investor. Because the average risk-averse investor holds the average portfolio asset allocation, this becomes the starting point in determining how a specific individual's portfolio might diverge from that average allocation. Asset allocation can be viewed as an extension of the diversification principle to multiple types of assets, such as equities versus fixed income securities. Asset allocation is also how you blend your personal risk preference assessment into your portfolio. Appropriately setting your personal asset allocation in line with your personal risk tolerance is a critical decision for every investor. The percentages that are allocated to various asset classes tend to change slowly over time, so it is important to get it right at the outset. An individual's risk preference relative to the average investor influences the asset allocation that will be chosen. Because the average risk-averse investor holds the average portfolio asset allocation, this becomes the starting point in determining how a specific individual's investment portfolio might diverge from that of the average investor's asset allocation. For mid-2004, *The Skilled Investor* performed a detailed analysis of personal financial asset ownership held directly and indirectly by institutions for the benefit of individuals to understand the overall asset allocation percentages of the major financial asset classes. Because the relative values of financial asset may change over market and business cycles, mid-2004 was chosen arbitrarily as roughly the mid-point of the most recent economic and market expansion. Concerning the average portfolio of the average investor, *The Skilled Investor* reviewed detailed data from the US Federal Reserve Bank which tracks total personal assets across all kinds of personal accounts including brokerage, tax deferred, pension, insurance, trust, and other accounts. The Fed's June 2004 Z.1 report indicates that total U.S. personal financial assets were approximately \$26.9 trillion dollars. In total in mid-2004, the percentage allocation across the major financial asset classes was 26.9% in cash and equivalents, 18.9% in fixed income, and 54.2% in equities.<sup>1</sup> For purposes of comparison, the Investment Company of America's (ICI) end of 2004 estimate of total US domiciled mutual fund assets, which is a subset of the personal assets that the Fed tracks, totaled \$7.5 trillion dollars.<sup>2</sup> The percentage allocation was 27.7% in cash and equivalents, 19.7% in fixed income, and 52.6% in equities. The mid-2004 Federal Reserve and the end of 2004 ICI numbers are remarkably similar. This gives confidence that these figures represent approximately the average asset allocation of the average personal portfolio. As such, these figures serve can serve as a baseline against which individuals can compare their asset allocation in relation to that of the average risk-averse investor at the mid-point of a business and securities market cycle. For a more recent comparison, we also looked updated ICI data for total U.S. domiciled mutual fund assets in November 2007. (U.S. domiciled mutual funds would include both domestic and international stock, bond, and cash investment assets.) The ICI reported that, at the end of November 2007, U.S. domiciled mutual fund

assets totaled \$12.1 trillion, which is about a 60% increase over total assets in mid-2004.<sup>3</sup> Even with this huge, \$4.6 trillion increase in total mutual fund value, the late 2007 percentage allocation was 25.7% in cash and equivalents, 17.0% in fixed income, and 57.7% in equities - again reasonably similar to mid-2005 with a moderate shift of value toward equities. The proportion of asset value in the equities asset class rose about 5 percentage points, as the business and securities market cycle advanced and matured. Meanwhile the proportion of asset value in both cash and debt securities declined modestly. Cash has been redeployed somewhat, and bond asset values have declined as debt instruments have come under pressure in the credit crisis of the second half of 2007. Nevertheless, the change in percentages has not been dramatic. These figures demonstrate that, overall, about 55% of total asset value is held in equities, about 25% in cash, and somewhat shy of 20% in bonds. These proportions represent the average holdings of the "average" investor across all personal financial assets held in U.S. personal accounts, either directly or indirectly through institutional holdings on their behalf. Depending upon your relative tolerance for investment risk compared to the "average investor," these average percentages are instructive concerning what your optimal asset allocation would be. For more information about personal investment portfolio asset allocation, see these articles on "[Asset Allocation and Personal Investment Risk Tolerance](#)."<sup>1)</sup> Federal Reserve Bank, Federal Reserve Z.1 Report. June 10, 2004. <http://www.federalreserve.gov>

2) Investment Company Institute. "2004 Mutual Fund Fact Book."

3) Investment Company Institute. "Trends in Mutual Fund Investing, November 2007"