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What is asset allocation?

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WHAT DOES IT MEAN?

Asset allocation is the act of portfolio management, including determining how much each asset class is to be allocated in an investment portfolio.

There are different methods to calculate the portfolio composition, often following simple rules of thumb. For example, an asset allocation may be a targeted fixed allocation of 50 per cent in a unit trust and 50 per cent in Singapore savings bonds.

WHY IS IT IMPORTANT?

Asset allocation is important because it is the implementation of an investment strategy. For an investor who is working and saving for retirement, an optimal asset allocation can make a large difference in the portfolio value at retirement. An asset misallocation may cause investors to either overexpose themselves to risk, or receive sub-optimal expected returns for a given level of risk.

One of the most important decisions for investors saving for retirement is deciding whether to adopt an active or passive asset allocation. An active approach involves trading securities between the inception of investment and the end of the investment horizon. A strictly passive approach does not require any trading between the investment inception and the end of the investment horizon.

Asset allocations should differ depending on an investor's risk preference, age, income, existing wealth, list of tradable securities, market conditions and anticipated cash needs.

IF YOU WANT TO USE THE TERM, JUST SAY:

Investors who are more risk-tolerant may follow a more aggressive asset allocation that has a higher exposure to equities, compared to government bonds.

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