MAINESAVES

About Diversification and Asset Allocation

Managing risk with diversification and asset allocation

When you're deciding how to invest your savings, you may want to make investment choices based on the investments that offer the greatest potential return for the amount of risk that you can afford to take. That said, there are some strategies you can use to help minimize the effects of risk, such as diversification and asset allocation.

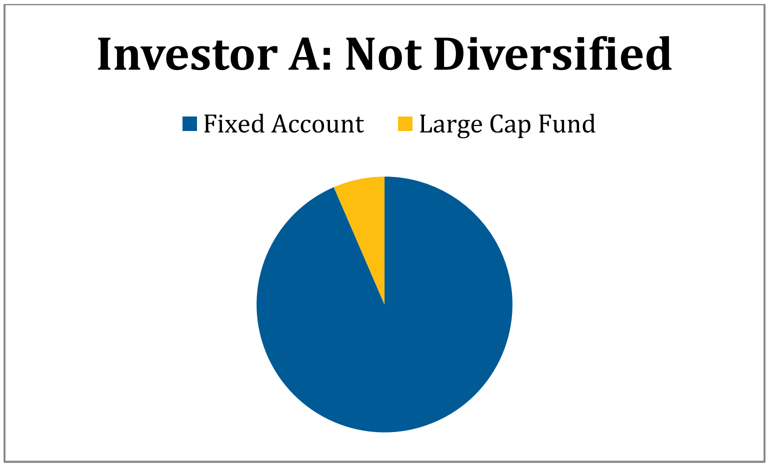
What is diversification?

When you diversify your investments you spread your money around so that it's not all invested in the same fund. In other words, you don't put all of your eggs in one basket. Why is this important? Take a look at this example.

Example: Investor A

Risk tolerance: Low
Investments: Mostly in one fund, the Fixed Account

With a guaranteed return, the Fixed Account may seem like a completely safe investment. However, Investor A's portfolio is facing extreme exposure to inflation risk. In the future, food, gas, utilities and other products she needs will all cost more than they do today. At the rate her savings is growing it may not keep up with the rise in the cost of living. If her Fixed Account grows at 3% but inflation grows at 4%, her account will actually be losing value over time. Because she hasn't diversified her account, almost all of her savings is exposed to this risk.



You can reduce the risk and volatility in your portfolio by investing in several different funds. The practice of spreading money among different investments to reduce risk is known as diversification.

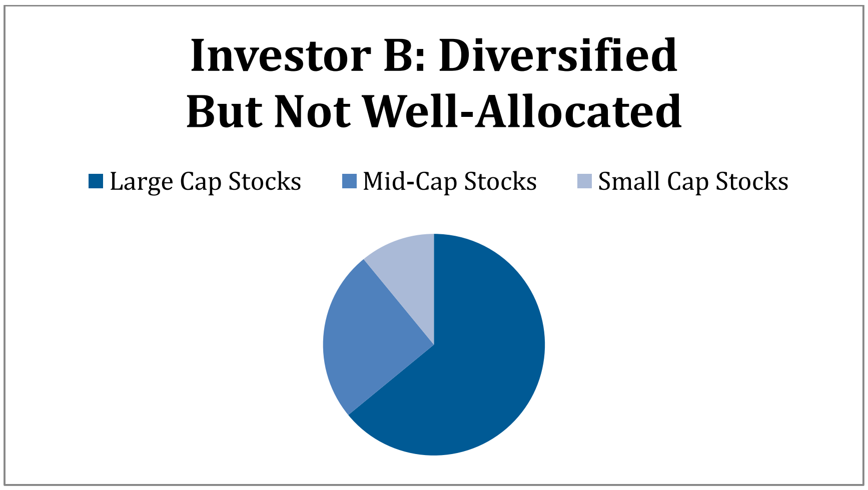
Why Asset Allocation Is Important

On its own, diversification doesn't go far enough to promote growth and protect against risk in your investment portfolio. With asset allocation, you go a step further, ensuring that your money is spread among different ***types*** of investments. Stocks, bonds and cash have varying degrees of risk and return over time. When you allocate your assets to different types of investments, you also decide how much money you will put into each type of investment, basing your decisions on factors such as your goals, the amount of time you have to achieve those goals (your time horizon) and how comfortable you are with taking risk in order to earn a potentially greater rate of return (your risk tolerance). Let's look at another example.

Example: Investor B

Risk tolerance: High
Investments: Invested in three funds, all stocks

Investor B is diversified—he has spread his money across different funds. However, all of his investments are in stocks. If the stock market falls, he stands to lose a good deal.



Investor B may be diversified, but he needs to learn about asset allocation. He should consider dividing his investments among different kinds of asset categories, such as stocks, bonds and cash, to optimize the potential for reward while balancing out the risks involved with investing.

In general, stocks, bonds and cash all react differently to different economic circumstances. When interest rates go up, bond prices tend to go down. But if interest rates are up, then the economy may be doing well so stock prices may rise. If you spread your money across different asset classes, you are increasing the chance of making some money while lowering the chance that any one bad event will derail your entire portfolio.

Note: Diversification and asset allocation are strategies to help boost the potential for gain and minimize the potential for loss. They cannot ensure a profit or guarantee against loss.

Questions?

If you have additional questions about diversification and asset allocation, please call one of the local representatives. Phone numbers for the local representatives are shown under Local Providers on the *Home Page* at **www.MaineSaves.com** or from Employee Health & Benefits by calling (207) 624-7380 or 1-800-422-4503.