A Recipe for Investing

Are you limiting your investment success potential by investing without a plan or process? Just as you need a chocolate cake recipe in order to bake a chocolate cake, you need an appropriate investment plan to achieve your vision of success. Choosing the right recipe involves understanding your vision of success, the amount of risk you are willing and able to accept, which ingredients are right for you and how much of each ingredient you will need.

TYPES OF INGREDIENTS

There are two ways to invest: you can either own or loan. "Owning" investments are known as equity because you essentially own a piece of the underlying companies represented. While this type of investing has a potential for greater returns, it also carries a greater amount of risk. Types of equities include stocks, stock mutual funds, stock ETFs (exchange traded funds), privately owned real estate and private business ownership. "Loaning" investments are also known as fixed income and cash equivalents because you are loaning your money to be used by another entity. While this type of investment typically has conservative (smaller) returns, it is also less risky. Types of fixed income and cash equivalents include bonds, bond mutual funds, bond ETFs, mortgages, Certificates of Deposit and money market accounts. There are also hybrid products that combine the elements of both equity and fixed income, such as a balanced mutual fund. Knowing which type of investing is right for you will help you determine which ingredients to use in your recipe.

THE RECIPE

Your recipe, or "asset allocation," is the investment plan that divides your portfolio (or your investment assets) among equities, fixed income and cash equivalents. Just as a recipe tells you how much of each ingredient you should put into the bowl, the asset allocation tells you where to invest your money. Diversification is a key component of your asset allocation because it typically reduces your overall risk. It is a fancy way of saying, "Don't put all your eggs in one basket;" to do so could be disastrous for achieving your vision. There are many different ways to allocate between "owning" and "loaning." A few examples of asset allocations that are identified by their risk measurement might include aggressive, moderately aggressive, moderate and conservative. By knowing which type of investor you are by risk level, you (or the advisor to whom you have delegated) can determine the percentage of equities and fixed income or cash equivalents that make sense for your investment portfolio.

STICK TO THE RECIPE

Let your vision (the kind of cake you want) help you select the right asset allocation plan (the right recipe). Your plan will help you make decisions in the face of multiple options. When you see everyone jumping on a bandwagon or someone pitches the next great "can't lose" investment idea, you can see if it is right for you by comparing it to your plan. It is very tempting to invest in something because a relative, co-workers or even news media are talking about it; it is in our very nature to follow the crowd! We rely on and respect the opinions of those in our lives, so why not join in? Remember, their vision and goals are probably quite different from yours; so, you must make decisions based on what will help you reach your vision. Resist the temptation to add some of their ingredients to your recipe, which could lead to a disastrous mess. Instead, wait to enjoy what you've been preparing!

Jessica A. Maldonado, AIFA™, PPC™, is Chief Compliance Officer for Allos Investment Advisors, a registered investment advisory firm located in Overland Park, offering fee-only investment management services with no account minimums. For additional information, follow them on Facebook, Twitter (@allosadvisors), or visit AllosAdvisors.com.