

Asset allocation tends to reduce overall risk

INVESTMENT MAILBAG

Q. Around February 1999, on the recommendation of my broker, I diversified my portfolio into stocks and bonds. The stocks are doing well, but the bonds and bond mutual funds never seem to gain.

It appears I will never get even with the original investment. I feel as if I am in quicksand, sinking slowly.

Should I sell the bonds and bond funds, take the loss, and move on? Or should I hold on in hopes they will return to at least my original investment? — K.S., Lodi

A. The theory behind asset allocation is that various asset classes perform well in different markets, and that over time, the diversification serves to minimize the overall risk, without reducing the total expected return of the portfolio.

The percentage of stocks, bonds, and cash you should carry differs greatly, depending on your goals. Bonds are used for current income; stocks historically have provided long-term capital appreciation. Cash — in checking accounts, money markets, or certificates of deposit — is used for short-term needs.

If you are a long-term, buy-and-hold investor, one year's performance will not be meaningful, despite the urge to check it periodically.

The value of your bonds and bond mutual funds has dropped because interest rates have been rising for about a year. The bond yield, or dividend, however, will tend to increase as interest rates rise. So you will want to add both components — principal value and yield — of the bond's total return to ascertain any bond's actual return.

Since you have not indicated your age, your investment objectives, or your risk tolerance, I am not equipped to make specific recommendations about how to divide your money among stocks, bonds, and cash. Generally, however, if your investments are generating adequate income to support your lifestyle (without costing you too much in taxes) and are positioned for medium- and long-term growth, I would find little reason to sell in the short term. — Debra L. Morrison is a fee-and-commission certified financial planner in Fairfield.

Questions are answered by The Record's Investment Mailbag Committee, a group of local professionals who are volunteering their time. If you have a query, drop a note to: Investment Mailbag, The Record, 150 River St., Hackensack, N.J. 07601. Or e-mail newsroom@bergen.com or fax (201) 646-4164. This column is intended to provide general responses to questions. For more specific information about your situation, consult a financial adviser.