# What is a diversified portfolio?

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A term often used in financial advice is “a diversified portfolio”. In this, the first of 2 articles, we introduce this concept and explore what it actually means to you, the investor.

**In general terms**

Having a “diversified portfolio” is ensuring your investments are split up covering as many areas as possible to ensure your money is not totally reliant on the success of one country, one company or one asset. In this article I will be concentrating on asset diversification with global diversification being explored in the next. There are other ways of diversifying which will be covered in future

If you have received financial advice, or invested any money, you will likely have heard the term “a diversified portfolio”. What may not have been explained to you is how you achieve this and, more importantly, why you would want to.

**A model portfolio**

The majority of investors, excluding cash investors, will hold their money in a “model portfolio”. This is a portfolio looked after by the provider they are invested with and, typically, the client will only really hear the name of the portfolio they are in. There is nothing wrong with this strategy a lot of the time but it is worth asking some additional questions of your adviser or provider.

If your money has been placed in a model portfolio to make the life of your adviser easier, then this does not necessarily mean it is right for you. If you have different pots of money, each with their own timescales and objectives, all in the same investment or same type of investment, this should be reviewed. If, however, the portfolio is well-diversified and has your own thoughts and goals in hand, it gives you the best chance of achieving your objectives.

**Asset diversification**

What happens with a diversified portfolio is money is moved from one specific area, such as deposit type accounts which provide safety but poor growth, into a mixture of different assets which aim to provide greater growth whilst trying to keep risks at acceptable levels. The level of risk is an important consideration by clients as it will go some way to determine which asset class is the best fit for their requirements.

According to the Investment Association, there are currently upwards of 30 asset classes but what are they? They’re actually  a group of investments vehicles that  are bought and sold in the same way. In the most basic form, they can be split into 4 groups :- cash, fixed interest securities, property and equities.

**Cash**

Also known as the money market, cash is the lowest risk area of investing. This can include any deposit accounts you hold but can also include very short term loan agreements between large financial institutions.

Typically, any money market investments will offer the most stability in all financial markets but also offer very low returns over the long term. Cash investments often give a return below the level of inflation, but will be a safe haven in poor market conditions. The balance between risk and potential return is an important consideration between all the asset classes.

**Fixed Interest Securities**

Loans to private companies or governments are known as fixed interest securities. The value of these securities, put simply, is that your money is invested and given to companies and governments for an agreed interest rate. At the end of the term the loan is repaid. As per individuals with different credit ratings, the more secure the provider, the lower the interest rate they pay as they are much less likely to default on the debt.

The size, strength and financial soundness of the company or government being lent to will dictate the interest rate. If the company is large, well established with a long proven track record of profit, then the interest rate will be low whereas if the company is a startup with no real track record, then the interest rate will be higher.

If the interest received by the security is higher than the economy's interest rate, the security is more valuable. This generally means that riskier loans will be more valuable when sold or repaid than loans to a large institutions or governments due to the potential for higher interest rates. If interest rates reduce, this class tends to look very favourable.

**Property**

In general, property funds will buy and sell properties, benefitting from rental income of those properties as well as the value of them rising. Property prices have tended to rise steadily year on year regardless of the rest of the economic picture. In recent years, there have been other strategies within this area that have been introduced, for example real estate investment trusts. With one of these trusts, rather than owning a physical property the investor is in effect buying a promise. For example, a percentage in some land purchased by a developer or a share in a property portfolio.

**Equities**

The most tracked and widely known asset class is equities. This is where an investor would own the shares of a company, ie owning part of the company. The value of the investment would be based on the full value of their shares when it sold. Equities are the riskiest of asset classes having the potential for the largest long term gains and of course losses. As we're so often advised, the value of shares can go up as well as down!

**Mixing it Up**

In general, your investment should be made up of a mixture of all four asset classes, although there are merits to not investing in cash. How much of your money is invested into each should depend on your attitude to investment risk and your objectives for the money you are investing.

If you are investing over a longer period of time or are solely focused on making as much money as possible, a higher weighting towards equities would make sense. If you are looking to draw from an investment over the shorter term, then a higher proportion invested in fixed interested securities may be more logical.

In the next article I'll be introducing global diversification.

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It is best to seek independent financial advice before embarking on any investment strategies and the content of this article can not be construed as financial advice.

If you would like to discuss your financial needs with a member of the Hampshire Hill Group Ltd team please call 01623 750000.