What's Really Driving Your Portfolio Performance?

by NewsUSA

(NewsUSA) - Many investors tend to focus on selecting the right stock to buy and choosing the perfect time to buy and sell. But some experts say these factors are a sure-fire way to damage portfolio performance.

According to Roger Ibbotson, chairman and founder of Ibbotson Associates and a professor in the practice of finance at the Yale School of Management, what really drives performance over the long term is asset allocation - the assignment of money to different categories of assets, such as large- and small-cap funds, international funds, bonds and cash.

"Over the long run, what drives performance is not whether you've picked the hot mutual fund, but which asset classes you hold in your portfolio and in what proportion," said Ibbotson.

To develop a long-term investment strategy, investors should evaluate their goals, time horizon and risk tolerance to determine an appropriate asset allocation and then select mutual funds to fill it.

An individual's investment goals, such as funding retirement, college or a vacation home, tend to guide the time horizon of the investment. If the investment horizon is fairly short, it is recommended that the investor maintain a conservative portfolio - one that has returns that don't fluctuate too much. If the investment time horizon is longer, an investor can be more aggressive in the early stages and move to a more conservative asset allocation as the goal nears.

Since everyone has a different emotional reaction to sudden changes in their portfolio value, it's important for investors to know their risk tolerance. This will determine an investor's ability to handle declines in the value of investments.

"Investors have a tendency to let emotions drive their investment decisions," Ibbotson said. "Chasing highflying funds that may have already peaked and selling on downturns can greatly depreciate the value of your portfolio."

Experts also suggest that investors evaluate their portfolio performance as a whole rather than look at how each individual investment is doing. Investors reduce their risk by investing in a variety of asset classes with the hope that when one is doing poorly, others will do well.