

# Diversify by going for gold

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IF THERE is one lesson Irish investors can take from the current crisis, it is the importance of diversification. Top-heavy in Irish stocks and Irish property, many investors saw the value of their portfolios disintegrate as shares hit the floor and the property bubble collapsed. While only history will tell if Irish investors stick to a broader investment portfolio in the future, the case for diversification has never been stronger.

Maeve Corr, director of private clients, with PricewaterhouseCoopers, says diversification is all about trying to get clients to spread their assets and understand the risk they're getting into.

Investors, for their part, are taking heed. "Investors have learned from their recent experience and are now looking to a more balanced portfolio with risk spread across asset classes and more interest in areas such as absolute return funds, private equity, corporate bonds and commodities," says John Dolan, a director at NCB Wealth Management.

With surveys indicating that asset allocation is responsible for 90 per cent of a portfolio's performance, with stock selection and market timing accounting for just 5 per cent, Dolan says that investors need to spend more time and focus on choosing the right assets. "Ultimately, that's what drives the portfolio's return."

However, when it comes to picking the type of assets you should invest in, there is no "one size fits all approach", he adds.

"The appropriate asset allocation for an individual will depend on their personal risk profile and financial objectives (income needs or level of capital growth) within a set time horizon; a view on the likely future performance of respective asset classes; and the

global economic environment," says Dolan.

So, broadly speaking, he recommends that a low risk conservative investor targeting capital/wealth preservation should invest in a diversified portfolio broadly of fixed income and cash instruments with a relatively small equity allocation, while someone seeking a balanced strategy of income and growth would have a larger allocation to higher risk/return assets – equities, private equity, property

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and commodities, and someone targeting capital growth over a longer term horizon, with a willingness to accept greater volatility in the short term, should have a primary focus in equities and private equity.

To successfully diversify, you need to find investments that aren't closely correlated to each other. For example, while an emerging markets stocks fund might give you exposure to countries such as Brazil and Russia, and diversify your portfolio away from western markets, in times of trouble such funds are shown to act like US stocks.

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ties tend to be less correlated to equities, while one asset class long associated with effective diversification is gold. Seen as the ultimate hedge against inflation, gold can also protect your portfolio against a falling stock market as it is shown to perform strongly when stock markets are falling.

One of the simplest ways to buy gold is to purchase shares of an exchange-traded fund that owns gold, or alternatively buy the real thing, in either coins or small bars. The price of gold recently closed above the psychologically important \$1,000 level, although some analysts warn that the price might drop due to increasing fears of deflation, rather than inflation.

To get adequate equity diversification, it is generally recommended that you hold 40-50 stocks. Rather than investing in a few stocks, and bearing the risk that one event might have a catastrophic effect on your wealth, this means you are spreading this risk across a number of investments. As the nationalisation of Anglo Irish Bank clearly shows, allocating a lot of your portfolio to one stock is a high risk strategy.

An easier way of getting exposure to different stocks is by buying a fund – an effective way of spreading your risk. It can also be very cost-effective. One cheap,

effective way of diversifying is by putting your money into various exchange-traded funds (ETFs).

Cheaper than a managed fund, ETFs can give you access right across the asset class spectrum – equities, commodities, property and corporate bonds.

If you are looking to get exposure to different markets, it might make sense to go down the multi-country route, rather than investing in a particular country.

If you're looking at niche investments, the general recommendation is to invest no more than 10 per cent of your money, while Corr advises keeping investments in which you are interested – wine or art, for example – separate from your financial interests.

One downside to diversification is that one asset class may perform very strongly but you will only have a small allocation to it. However, Corr notes that in the current environment, investors are willing to give up return for stability.

For people with legacy investments who may be overweight in Irish assets, Dolan says it's important to strike a balance and, while it will be difficult to change your allocation, you can gradually reduce your exposure to one class.

But diversification doesn't always work – in 2008, it mattered little what you were invested in. The only asset that performed well was cash.