# Asset Allocation: The Cornerstone of Successful Investing

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Asset allocation refers to an investment strategy in which individuals divide their investment portfolios between diverse asset classes to minimise risk. Through asset allocation, you decide how much of your wealth should be in equity, debt, gold etc. Research time and again has shown that over the long term, the key determinant for successful wealth creation is having proper asset allocation in place. By doing so, the overall risk to the portfolio gets substantially minimized.

Asset allocation depends on several interlinked factors such as age, income, wealth, risk appetite, personal goals, liquidity preference and investment horizon. As each of these factors varies from person-to-person, there is no one size fits all asset allocation plan which can be implemented.

**Why Allocate Across Assets Classes?**

Each asset class has a unique risk and return profile. Equity, in your portfolio, plays the role of wealth creator but goes through phases of consolidation and growth during the process of wealth creation. On the other hand, debt aims to offer stability to your portfolio and provides opportunities for consistent returns over a longer time horizon. The other asset class, which is popular among the masses, is Gold. The yellow metal which comes with its own phases of consolidation and growth, acts as a good hedge and aids in protecting portfolio against inflation and global risks. Also, the co-relation between most of the asset classes is minimal or negative.

What this means is that no two assets class will react to a development whether economic or market related in the same manner. So, because a portfolio is made up of various asset classes, the negative development in one asset class will not have an adverse impact on the overall portfolio return. The perfect example to this was seen during March 2020 and thereabouts, a time when equity markets across the globe reacted sharply owing to the spread of the pandemic. While equity markets corrected in double digits, gold rallied at the same time. So, hypothetically, if a portfolio held equity, debt and gold, then the net impact of the equity market correction would have been dented by the resilience of gold. As Ray Dalio, Hedge Fund Investor & Founder of Bridgewater Associates says, "The most important thing you can have is a good strategic asset allocation mix. So, what the investor needs to do is have a balanced, structured portfolio – a portfolio that does well in different environments… we don't know that we're going to win. We have to have diversified bets."

**Practical Challenges**

While all of this reads fine and even when a plan is made executing it may prove to be challenging. This is because an asset allocation may call for change when there are some drastic changes in one's life such as having a child, losing a job etc. At other times, there may be a need to rebalance because a certain asset class may have rallied very much and would have distorted the allocation profile. All of this calls for active participation of the investors if he or she is to do it on their own. Also, one would have to be mindful of the developments across equity and debt markets.

While at it, one of the major challenges the investor will face is one's own behavioural biases. At a time when the stock market is steadily rallying it is close to impossible to book profits or trim allocation to equity because one fears on missing out the potential gains if the market rally continues. Conversely, if any of the investment decisions is doing badly and calls for booking losses, that again turns out to be challenging as one hopes that there will be a change in fortune in the near future. As a result, the decision we take at such times may prove to be counterproductive, hurting our portfolios in the long run.

**Asset Allocation Scheme with In-built Mechanism**

One of the easiest ways to address asset allocation need is to opt for dynamically managed asset allocation mutual fund schemes or a multi asset category of fund. In an asset allocation scheme, based on the prevailing opportunities across equity and debt asset classes, the fund manager will toggle one's investment corpus such that one can gain from these investment opportunities. The equity allocation in case of a fund like ICICI Prudential Balanced Advantage Fund can be anywhere from 30% to 80%. Because of this arrangement, an investor is free from the need to track markets closely. Hence, dynamically managed asset allocation schemes emerge as a one-stop solution for your asset allocation needs. In case you wish to add gold to the mix as well, then opt for a multi asset fund.

Furthermore, by investing in a dynamically managed asset allocation scheme, an investor can be rest assured they would not be facing the challenges related to the pitfall of greed and fear. Most often, when markets are trending higher, booking profits tend to be a challenging

proposition. Similarly, when there is a market correction and valuations have turned attractive, fear stops most of the investors from making aggressive investments. As a result, an investor loses on the opportunity to buy low and sell high, an approach which helps investors tap into disproportionate gains over the long term. Through this fund, an investor can address these anomalies very easily.

When investing into a dynamically managed fund, if the market valuations are attractive, then the allocation is incrementally made towards equities. Furthermore, when valuation turns expensive, profits are booked and the same is deployed in debt. For example: Prior to the onset of the pandemic in December 2019, the equity allocation in ICICI Prudential Balanced Advantage Fund was at 46%. From here, as the market started correcting, the equity allocation of the scheme increased over time and at the height of market correction, equity allocation rose to a high of 74% in March 2020. Given the market recovery post correction, once again the equity allocation has been reduced to 39% as of June 2021.

The beauty of such an allocation scheme when looked over longer period reveals a very positive investment experience. If one were to look at the performance of the fund over the past decade, it has delivered a CAGR of 12.4% with an average net equity level of 55%. At the same time, Nifty 50 TRI has delivered a CAGR of 12%. This shows that despite lower allocation to equities, dynamically managed asset allocation could deliver returns which are at par with equity schemes. So, through this fund an investor gets the opportunity to gain from a rally, while in case of a correction; the downside is minimized due to the debt component. (Data Source: Value Research, Data as of June 30, 2021)

This makes dynamic asset allocation fund an all-weather investment solution and can be considered by investors across the risk appetite spectrum. It can also be considered as a stepping stone into the world of equity investments for a novice investor. Also, if you are an investor looking to deploy lump sum investment but are apprehensive due to elevated market valuation, do consider investing into asset allocation schemes.

**Riskometer & Disclaimer**

Disclaimer: Mutual Fund investments are subject to market risks, read all scheme related documents carefully.

All figures and other data given in this document are dated. The portfolio of the scheme is subject to changes within the provisions of the Scheme Information document of the scheme. Please refer to the SID for investment pattern, strategy and risk factors.