

Does Your Portfolio Pass My Three Step Test for Balance?

Back in 1993 I explained my three-step test for balancing your investment portfolio between bonds and stocks. At the time I was recommending Treasuries, but you can use this advice no matter what kind of bonds you're buying. Use your age and my three-step test as a starting point for how you plan to allocate your portfolio. I wrote:

I want you to keep your investment portfolio well balanced. But just how much of your portfolio should be invested in equities and how much should be in Treasuries? Here's a basic strategy that is based on your age. The percentage of your portfolio that is in Treasuries should not exceed your age. For example, if you are 60, you will want a maximum 60% Treasuries component. That's your starting point. Now take these tests to see if you need to reduce that percentage. If any of these statements fits you, knock 10 percentage points off your age number. But you will only knock off a maximum of 20 percentage points in total.

Test #1: You do not require current income from your portfolio to live on. If that sounds like you, knock off 10 points. Test #2: You consider yourself to be a sophisticated, patient, seasoned investor. Answer yes to all three descriptions without a wince or snicker, and knock off 10 points from your age percentage number. Test #3: You are financially secure, if not wealthy. If you have what you believe is a solid store of financial wealth, knock off 10 points from your age percentage figure. If you qualify with two or three tests, you can knock off the maximum allowed, 20 percentage points, but no more.

A fixed income component to balance out your equity portfolio is

a vital necessity for any serious investor focused on income generation and capital preservation.