How to Diversify Your Portfolio the Right Way

Diversification is a must, but there is a right way to diversify and a wrong way. Loading your portfolio with eight different stock ETFs may minimize stock-specific risk, but in a nasty bear market, all eight of your ETFs are likely to get bludgeoned. The right way to diversify is to include assets that tend to zig when others zag. Counterbalancing is key here and the all-time counterbalancing champion is Treasury bonds. As a measure of the powerful counterbalancing force of Treasury bonds, consider that in 22 of the 24 bear markets since the 1920s, intermediate Treasuries have risen in value.

I have long urged readers and clients to diversify across asset classes, and in 1999 I told them that asset allocation is your vital first step. I wrote:

> *Asset Allocation Your Vital Fist Step*
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> *I am 58 years old and have worked in the investment business for 35 years. I will not compromise 35 years of savings to speculate in the financial markets today, and I strongly hope that you adopt the same approach. I am well diversified to ride through any sort of financial turmoil, and this is the strategy I offer to you monthly. Your most important task is asset allocation. …*
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> *The older you are the larger the fixed income component of your portfolio should be. Each month I provide you with recommendations for this portion of your portfolio. Given the booming stock market of recent years, you may be hesitant to increase your commitment to fixed-income securities. But what if I told you that long-maturity Treasury STRIPS actually have outperformed the stock market since 1982? I'm making this up,*

> *right? No, indeed. You'd have been the winner with your U.S. Treasury STRIPS, even through the great stock market of the 1980s and 1990s. And, oh yes, your full-faith-and-credit Treasuries, along with being free of state and local taxes, guarantee your return of principal at maturity. Anything not to like here? See how easy it is to lose perspective? It's also easy to become lazy and carelessly greedy.*

Shortly after I suggested allocating assets to bonds, the market proved the value of fixed income once again. During the bear market that started in January 2000, intermediate-term Treasury bonds gained nearly 15%.

At my family run investment counsel firm, Richard C. Young & Co., Ltd., fixed income portfolios are crafted for clients with a focus on age, risk tolerance, and objectives. If you would like to learn more about Richard C. Young & Co., Ltd.'s approach, sign up for the firm's monthly client letter. My son Matt writes the letter each month to explain the investment philosophy used to create client portfolios, and any changes that may have been made during the month. The letter is free, even for non-clients.