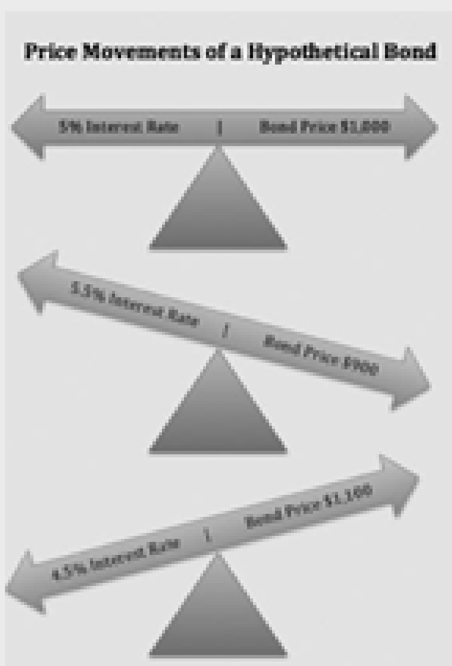
Is Your Portfolio Diversified? The Ugly Truth About Stocks and Bonds

Throughout your search and preparation for retirement, you might have heard of the Rule of 100, which suggests that if you subtract your age from 100, the result is how much of your portfolio should be invested in stocks, with the remainder in bonds. Presumably, that would keep your investments diversified.

However, that's not true diversification. If you have everything in stocks and bonds, you still have all of your assets exposed to some levels of risk. In my opinion, rules of thumb such as that will generally hurt you more than they will help you because they are an attempt to apply a general principle to highly individual needs and wants. Should everyone age 76 have the same portfolio? No, that's quite the opposite of diverse, not mention no longer realistic as the market and interest rates shift.

To provide some background information, the bond market is not a world of safety. Here's what people don't realize: We have just gone through a 30-year bull run in the bond markets [1]. In 1981 you could get CDs for 16 percent; now, the rates are 1 percent or less. These are the lowest interest rates people have seen in their lifetime. Why were the bond markets so attractive in the last 30 years? Because as interest rates go down, the price of the bonds appreciate. It was a great place to obtain some safety and catch a wave for three decades.

Today, with money market rates near zero, one could assume that rates cannot go down much further and that they likely will rise as some point in the future. As those rates rise, what will happen to bond values? They will fall. Rising rates equal falling bond value, just as falling rates equal rising bond value. This is no longer a conservative and lucrative approach to diversification.



So what is a diverse portfolio for today's retirees? Professor Moshe Milevsky (The IFID Centre, York University Toronto), a researcher, author, and speaker on personal financial planning, talks about not just asset allocation, but product allocation for retirement. A truly diversified portfolio isn't a mix of stocks and bonds, but rather it includes some genuinely conservative investments across several specific asset and insurance areas.

1 "PIMCO's Gross Says Bull Run in Bonds over." Reuters. Thomson Reuters, 10 May 2013.