

# PERSPECTIVES

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## Asset allocation

### Asset allocation: Your most important investment decision

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**Your first, and probably most important, decision about investing is how to divide your money into different types of assets. This is called asset allocation. Here, and in the next several articles, we will discuss asset allocation: What it is, the various types, and how they differ. And finally, how do you decide what the best asset allocation is for you?**

There are many ways of classifying assets, so it can be confusing. For example, mutual funds can be broken down into hundreds of different groupings. So, it's easy to lose sight of what's important. Some typical mutual fund groupings might be "Canadian-balanced," or "U.S. small-cap growth."

But the most basic division is by asset class. Almost everything can be broken down into one of two types: equities or fixed income. And if it's not one of these, it is usually a blend of the two. These two asset classes are often called stocks and bonds, which are the most common types of each.

Equities and fixed income are so different from each other that the balance between them dramatically affects the risk and return of your portfolio. Because the balance is so important, you need to focus on it first. But to do that, it helps to know what they are and how they are different.

Equities represent ownership in a business. When people think about equity, the first thing that usually comes to mind is the equity they have in their home. Equity in your home is the value of your home, less whatever mortgage you might owe on it. When you own shares in a company, the concept is the same. The value of a stock is the value of a business, less any debt the business might have. Owners of shares also own the profits of the business.

With fixed income, rather than being an owner, you are a lender. Usually with fixed income, the investor is paid a fixed rate of interest. The income and principal can be guaranteed by government, or an obligation of a company. Fixed income can also vary by the term – meaning how long it is before they have to return your money. Fixed-income investments include things such as T-bills, bonds and term deposits.

In the next article, we'll talk more about asset allocation. We'll look at how these two basic types of assets differ in risk and return and why it's so important to get the mix right.



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