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Portfolio Investment: Definition and Asset Classes

How To Tailor Your Strategies for Allocating Stocks, Bonds, and Other Investments

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DEFINITION:

A portfolio investment is own... asset with the expectation th... time.

Portfolio investment refers to a... assets, such as stocks, bonds, a... maximizing returns over time. Y... security and a stable retiremen... filled maze of investment choic... and unready to tackle their portfolio investments.

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Americans in the lower 90% of income earners feel adrift when managing their investment portfolios. More alarming is that two-thirds of non-retirees say they're not on track in saving for retirement. [1] These statistics aren't just numbers; they represent millions of individuals grappling with the stress and painful choices that come with an uncertain financial future.

KEY TAKEAWAYS

- Portfolio investment involves buying financial assets with the expectation of earning returns.
- Common asset classes for portfolio investment include stocks, bonds, cash equivalents, real estate, commodities, and alternative investments like cryptocurrencies, private equity, or hedge funds.
- Diversification across different asset classes and geographic regions is an important strategy to manage risk and potentially improve returns.
- The right mix of assets in a portfolio investment depends on your risk tolerance, financial goals, and timeline.
- Regular portfolio rebalancing is important to maintain your desired asset allocation since market moves can alter the portfolio's composition.

Portfolio Investment: A collection of financial assets such as stocks and bonds owned by a person or an entity.
Investopedia / Michela Buttignol

As such, at a time when investn
resources on learning about stc
click away, for too many, mana
notion rather than a practical tc

David Tenerelli, a certified finar
Plano, Texas, said that with ma
companies and given the profo

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diversified, low-cost portfolio for any risk profile and time horizon," he said. "Resources for investors of all experience levels abound. Knowledge is power, but you don't have to become a financial prodigy to set yourself up for long-term success."

Thus, learning the art of constructing and managing portfolio investments isn't just a skill for finance professionals; it's almost a necessity for anyone hoping to build long-term financial security, given the vast changeover since the early 1980s from defined pension plans to 401(k)s and the like for retirement planning.

As Tenerelli noted, you don't ne
help investors avoid pitfalls anc
investment planning with the r
planning, estate planning, insu
how portfolio investing works i
someone who feels better hanc

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The ability to effectively choose
defining factor between a futur

understanding portfolio investment is critical and rewarding. Below, we'll explore the core principles of portfolio investment, clarify the main asset classes you'll be choosing from, and provide actionable insights from Tenerelli and others that can help you build and manage a portfolio that aligns with your financial goals and risk tolerance—no matter your financial experience.

Understanding Portfolio Investments

Portfolio investment involves assembling a collection of financial assets with the goal of achieving specific financial goals while managing risk. This approach recognizes that different assets perform differently under various economic conditions, and some have greater risks with a greater potential for rewards than others.

FAST FACT

A portfolio investment can be anything from a stock or a mutual fund to real estate or art.

Portfolio investments come from a range of asset classes, including stocks, government bonds, corporate bonds, mutual funds, exchange-traded funds (ETFs), and certificates of deposit. Your portfolio might also include more esoteric choices, including derivatives like options and futures or physical assets like real estate, commodities, and art and collectibles.

Here's a closer look at the essential aspects of portfolio investment:

Asset Allocation

This is the process of determini
each type of investment. This d
risk tolerance, and investment t
saving for retirement might hav
potential, while a retiree might
stability. [2]

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Investment allocation styles for

- Conservative investors prefer preserving their savings or capital and income and typically have a higher proportion of bonds and cash equivalents.
- Some investors opt for income-focused allocations for regular cash flow from dividends and interest payments.
- Moderate allocations aim to balance risk and return with a more even mix of stocks and bonds.
- Growth-oriented allocations emphasize capital appreciation, with a larger share of stocks to potentially achieve higher long-term returns.
- Aggressive allocations maximize exposure to stocks and higher-risk assets, suitable for those with high-risk tolerance and longer investment horizons. [3]

Each style offers a different balance of potential risk and reward, allowing investors to align their portfolios with their individual financial circumstances and objectives.

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Diversification

Diversification is the cornerstor

portfolio. This strategy helps to mitigate risk and can lead to more stable returns. [4]

"At a basic level, a diversified portfolio will probably include at least some stocks and some bonds," Tenerelli said. He advised those beginning with portfolio investments to look at ETFs and index or passive mutual funds, which are "the easiest, lowest-cost way" to assemble a portfolio that meets most people's needs. However, "if investors wish to 'slice and dice' or 'tilt' their portfolio toward certain asset subclasses (such as small-cap value, emerging markets, etc.), or if they wish to invest in more esoteric asset classes such as derivatives or private equity, then more research is warranted."

There are several approaches for diversifying a portfolio:

1. Distributing your investments across a wide range of vehicles, including cash, stocks, bonds, mutual funds, ETFs, and other financial instruments. You should seek out assets whose historical returns have shown little correlation, that is, they move independently of each other. This helps ensure that while one part of your portfolio may shrink, others could grow. [5]
2. Maintaining diversity within each asset category. For stocks, this means including securities that vary by sector, industry, geographic region, and market capitalization. Some mix investment styles such as growth, income, and value. [6] You can also apply a similar approach to bonds by varying maturities and credit qualities. [7]
3. Investing in securities with different risk profiles. Including investments with varying levels of risk ar
portfolio. This allows for the
areas may offset losses in m

FAST FACT

Portfolio investing can be
Strategic investing involve
grow significantly over tin
Investors that adopt this s...

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term market movements. Tactical investors often adjust their portfolios to exploit perceived opportunities or mitigate risks based on market conditions. [9]

Managing Risk

Portfolio investment involves continuously managing your risks to align with your risk tolerance and financial goals. The primary tool for managing risk is diversification. This approach helps insulate the portfolio from the poor performance of any single investment or market sector.

Investors can further manage risk by regularly rebalancing their portfolios, ensuring that asset allocations remain aligned with their risk tolerance and goals despite market volatility.

Tip: While it's easy to let concerns about the best way to invest for your portfolio keep you from getting started, procrastination could mean losing out in the long term. "If someone needs to invest for the future but has not yet gotten started, the best time to get started is yesterday, and the second best time is today," Tenerelli, the Plano, Texas-based certified financial planner, told Investopedia.

Another key aspect of risk management is understanding and adjusting for your risk tolerance, which can chang
need for liquidity, and market c
to more conservative financial
strategies during periods of hig
like stop-loss orders to automa
or employ options strategies to

Managing risk includes account
financial product. Generally, lo
returns, while higher risk levels are associated with higher potential returns.

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Risk / Reward (lower risk/low potential reward vs. higher risk/higher potential returns)

Portfolio Investment Horizons

Investment horizons range from the short term—hours, days, weeks, etc.—to much longer spans, years and decades. For example, post-college professionals with a 401(k) plan would have an investment horizon of decades. Meanwhile, a day trader's horizon doesn't last beyond the trading today. [12]

In general, portfolios that have a shorter time horizon should be those where investors are willing to take on less risk—such as when retirement is imminent. The longer the horizon, the greater the risks you can take since there's time for you to make up for shortfalls. Obviously, it isn't carte blanche to make the riskiest trades just because you have decades until retirement. Rather, a longer-term investor may hold what are considered riskier types of equities, such as mid-cap, small-cap, or high-growth stocks. [12]

> ### Risk Tolerance
> *Those with a greater risk tolerance may favor investments in growth stocks, real estate, international securities, and options, while more conservative investors generally opt for government bonds and blue chip stocks.*

Active vs. Passive Manag

You'll need to decide whether y
your portfolio investments. Act
assets to outperform the marke
analysis. Meanwhile, passive m
a specific index or benchmark,
investment option. This can be
ETF that tracks an index of secu
These are among the most pop

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long-term investors that tracks the performance of the S&P 500 Index. The fund manager simply replicates the holdings by weight of the S&P 500's large-cap stocks.

Tax Considerations

These shouldn't be left for last. Often, the type and amount of assets you'll choose for your portfolio investments will depend in part on their tax efficiency, an essential aspect of portfolio investing. Different assets and accounts are subject to varying tax treatments, which can greatly impact your returns in the long run. Using tax-advantaged accounts can help minimize tax liabilities and increase your after-tax returns. [13]

Asset Classes

Asset classes are sets of investm
behave similarly in the marketp

Equities (Stocks)

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Equities represent ownership ir
exchanges or over-the-counter (OTC) markets. Investors can earn returns from

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There are two main types of equities:

1. **Common stock**: The most common, offering ownership and voting rights. When you hear about the price of a major company going up or down, this is what's usually being discussed.
2. **Preferred stock**: A hybrid security with characteristics of both debt and equity, usually paying fixed dividends and having priority over common stockholders in case of liquidation. [14]

While generally considered riskier than other asset classes, stocks can deliver higher returns over the long term. Their performance is influenced by company performance, market conditions, and broader economic trends.

Fixed-Income Securities (Bo

Fixed-income securities are inv
interest payments and the retu
several features:

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- **Principal repayment**: The initial investment is typically returned at maturity.
- **Inflation risk:** Returns may not always keep pace with inflation, potentially reducing purchasing power over time.
- **Liquidity**: While less liquid than equities, many fixed-income securities can be traded on secondary markets.
- **Less risk**: Bonds are typically viewed as less risky than equities, offering more stable but potentially lower returns.
- **Price fluctuations**: Bond values can change based on shifts in interest rates and the issuer's credit risk.

Bonds play a crucial role in many portfolio investments, providing income stability and often serving as a counterbalance to the higher volatility of stocks. However, investors should consider interest rate and credit risks, as well as the potential impact of inflation when incorporating bonds into portfolio investments.

Cash and Cash Equivalents

Cash and cash equivalents form a crucial component of many portfolios, offering stability and liquidity. This asset class includes cash, bank deposits, money market funds, short-term government securities (e.g., Treasury bills), and highly liquid, short-term debt instruments.

> **Tip:** In 2024, the Financial Industry Regulatory Authority found that 70% of crypto advertisements among its members were afoul of its rules, compared with 8% for all others. Many ads claimed the marketed crypto assets w
> To be clear, cryptocurrenc
> equivalents for portfolio i
> trade in a pinch—that is, t

These assets are characterized
quickly converted to cash with
lower returns than stocks or bo
immediate needs or investment prospects.

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necessarily keep pace with inflation over the long term. Holding onto these assets often results in a gradual erosion of purchasing power. Therefore, investors usually need to balance liquidity and safety with higher-yielding investments to achieve their long-term financial goals. [16]

Alternative Portfolio Investment: Real Estate

Alternative portfolio investments are a broad category for assets that fall outside the traditional list of stocks, bonds, and cash. Many alternative investments have low liquidity, meaning they can be difficult to buy or sell quickly. They are also often associated with higher potential returns but also higher risk and can require far greater kinds of knowledge or expertise.

Real estate investing involves buying, owning, managing, selling, or financing real estate properties to generate profit. Real estate investments fall into two main categories:

- **Real estate**: This includes residential properties (single-family homes, apartments, and condos), commercial properties (such as office buildings, retail spaces, and industrial facilities), and land.
- **REITs**: These are companies that own, operate, or finance income-producing real estate. REITs allow investors to gain exposure to real estate without directly owning and managing physical properties. [17]

Real estate can generate income through rent and can appreciate in the long term. However, it also comes with risks such as market fluctuations. Property values and income are often gr
interest rates, and local market
liquidity risks are all risks that c

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Alternative Portfolio Investment: Commodities

Commodities are the oldest traded goods, typically raw materials or agricultural products traded either OTC or on exchanges like the Chicago Board of Trade. Common examples include precious metals (gold, silver, copper), energy resources (oil, natural gas), agricultural products (wheat, corn, livestock), and industrial metals (copper, aluminum).

These investments offer several features:

1. **Diversification**: Commodities often have a low correlation with stocks and bonds, potentially reducing the overall risk of your portfolio.
2. **Inflation hedge**: Many commodities increase in value during inflationary periods, helping to preserve purchasing power.
3. **Market-specific drivers of demand**: Commodity prices are primarily driven by global supply and demand specific to the seasonality and fluctuations of each good. They can also be influenced by weather, geopolitical events, and economic cycles.
4. **Volatility**: Commodity price
high returns and significant

Investors can gain exposure to
the physical goods), futures co
value), commodity-linked ETFs
producing companies.

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14.9%

investments, down to about 14.9% at the end of 2023. [18]

Additional Alternative Investments

While commodities can offer portfolio diversification and potential inflation protection, they also come with unique risks, including storage costs for physical commodities, complex pricing, and high sensitivity to global economic and political events.

Besides real estate and commodities, lists of alternative portfolio investments typically include the following:

- **Art and collectibles**: Tangible assets like art, antiques, and rare coins that can rise in value over time.
- Cryptocurrencies: Digital currencies that run on blockchain technology, offering a new asset class for investors.
- **Hedge funds**: Pooled investment funds that use leverage, derivatives, and other highly sophisticated trading techniques for well-heeled and institutional investors.
- Private equity: Investments in private companies or buyouts of public companies that result in their delisting from public stock exchanges.

Portfolio Investments Examples

Suppose you have $100,000 to invest. You decide to build a diversified portfolio with the following asset allocation:

60% Stocks

- 40% U.S. large-cap stocks
- 10% U.S. small-cap stocks
- 10% international stocks

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35% Bonds

5% REIT shares

The portfolio is designed to provide exposure to various asset classes with different risk and return characteristics. The bulk goes to stocks for growth potential, with a significant portion in U.S. large-cap firms for stability. Bonds provide income and help mitigate overall portfolio risk, while REITs offer exposure to the real estate market.

The initial investment of $100,000 meets its target percentages. As the markets move, however, the portfolio investment allocations will shift. For example, if stocks have a strong year, the equity portion may grow to 65% of the portfolio.

To maintain the intended risk p
portfolio by selling portions of t
to buy underperforming assets.
original 60% stock / 35% bond /

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In the long term, you'll generat
individual asset classes. This diversification helps smooth out volatility

How Do I Build A Portfolio?

You'll want to start with having an understanding of the different asset classes such as stocks, bonds, and real estate, and assessing your investment goals and risk tolerance. Aim for diversification by including a mix of these asset classes to mitigate risk, and select specific investments within each category. Regularly review and rebalance your portfolio to maintain your desired asset allocation, and consider seeking professional advice if needed to tailor your strategy to your finances, risk tolerance, and goals.

For more information, see Inve... Process."

What's the Right Portfoli

Investors saving for retirement
low-cost investments for their p
individual retirement accounts
exposure to certain asset classe
funds make a solid core for a re

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equity, and individual stocks and bonds to the portfolio investment mix.

How Should Investors Approach Their Existing Portfolio Investments?

When reviewing an existing portfolio, Tenerelli told Investopedia, "The first step is to determine whether that portfolio is right for your goals, objectives, risk profile, and time horizon." He advised that the process should include a comprehensive analysis of your finances and a detailed review of your portfolio's composition.

Tenerelli said that by being systematic in addressing your portfolio's composition, you can better ensure that it remains optimized for your financial circumstances and long-term goals.

What Is a Balanced Portfolio?

A balanced portfolio typically combines a mix of asset classes, including equities, bonds, and perhaps a low percentage of alternative investments, to achieve your desired level of risk and return.

For instance, a traditional strategy is the 60/40 portfolio, which allocates 60% to stocks for growth potential and 40% to bonds for stability and income. This approach aims to provide capital appreciation and income generation while managing risk through diversification, as different asset classes often react differently to market conditions.

Bottom Line

Portfolio investments involve a
returns over time, including sto
diversifying across different ass
potentially improve their returr
changing market conditions.

A key part of successful portfoli
including their risk profiles, liqu
allows you to build a balanced portfolio better tailored to your financial goals

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changes in your finances and the broader economic world. By following these principles, you can better position yourself for long-term portfolio investment success while addressing the inherent uncertainties of financial markets.

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Related Terms

How to Use the Time-Weighted Rate of Return (TWR) Formula

The time-weighted rate of return (TWR) measures the rate of return of a portfolio by eliminating the distorting effects of changes in cash flows. more

Portfolio Management: Definition, Types, and Strategies

Portfolio management involves selecting and overseeing a group of investments that meet a client's long-term financial objectives and risk tolerance. more

Investment Income: Definition, Example, and Tax Treatment

Investment income is money derived from interest payments, dividends, or capital gains realized on the sale of stock or other assets. more

Nominal Rate of Return Calculation & What It Can/Can't Tell You

The nominal rate of return is the amount of money generated by an investment before factoring in expenses such as taxes and inflation. Tracking the nominal rate of return for a portfolio or its components helps investors to see how they're managing their investments over time. more

Unrealized Gain Definiti

An unrealized gain is a potential pr
that has yet to be sold for cash. mc

Direct Stock Purchase P Works

A direct stock purchasc plan (DSPP
directly from the issuing company \

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walking upstairs.

4 Steps to Building a Profitable Portfolio

man looking at computer screens with line graphs

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Time-Weighted Rate of Return

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