Diversifying your investment portfolio-the how to’s!

Diversifying your investment portfolio in order to protect yourself in the case of a market crash is a necessity. Luckily, it isn’t as complicated as it sounds.

[This article is not meant for the reader to use as investment advice. You should seek your own investment advice from a trusted professional.]

Most people when savings for retirement; would rather save their money in a bank somewhere or open up an IRA or 401k; than invest in a self-directed IRA. I believe this is mainly because of the false risks associated with investing in a self-directed IRA’s. I used to dread the thought of risking my hard-earned money until I understood one of the most basic and effective risk management techniques—diversification.

You’ve probably heard of the term diversification. In finance, diversification refers to the process of assigning capital in a manner that decreases exposure to risk.

The rationale behind diversification is simple—on average, investment portfolios composed of different kinds of investments in different types of asset classes, yield higher returns and pose a lower risk, compared to any individual investment within the portfolio. This is due to the fact that asset classes are cyclical and assets go up and down according to demand. With time and when invested in different kinds of investments; in different types of asset classes the risk to exposer is lowered.

The problem with only saving your money in a bank, or in a traditional IRA, is that they are not tax-inefficient instruments, or are not suitable for long-term wealth creation.

In this article, I'll cover how to, and why you should be diversifying your investment portfolio in different asset classes not just in different sectors.

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Here are steps you can take to start bringing more diversity to your portfolio:

Step 1: Ensure your portfolio has many different investments

ETFs & mutual funds

An effortless way to do this is by purchasing ETFs, index funds, or mutual funds. ETFs and mutual funds act as a basket of different stocks—giving you instant diversification. They trade differently, so you'll want to read about each in detail before buying them, but they're an excellent method to diversify without getting overly complicated.

Index funds

Index funds are another excellent option—as they include stocks that mirror a specific index—such as the S&P 500. Your diversification may be a little more limited here, but it's still a sound option to consider.

One thing to remember when investing in ETFs, mutual funds, or Index funds is that diversification occurs in sectors not different asset classes. So true diversification is not achieved if this is the only retirement investment you have.

A properly diversified investment portfolio should include:

- Stocks or equities.
- Bonds or fixed-income instruments.
- Money market or cash equivalents.
- Real estate or other tangible assets.

Step 2: Diversify within individual types of investments

Pick investments with different rates of returns

This becomes more challenging when you're buying individual stocks since you'll want to invest a decent amount to make the cost of trading worth it. For example, you don't want to spend $10 to buy one share of stock for $200. You should invest a more substantial chunk, so you save money on fees. Because of this, many people end up with a handful of stocks in their portfolio, putting them at risk.

So, when investing in stocks, for instance, don't concentrate on a single stock or a few stocks but rather, different stocks in different sectors. It's also essential to have stocks with mixed-income, growth, market capitalization among other metrics. When investing in things like bonds, consider bonds with different credit qualities, duration, and maturities.

Step 3: Consider investments with varying risk

Choose investments with various rates of return

When diversifying your portfolio, pick different investments whose rate of return is different. This will ensure substantial gains for certain investments, and offset losses in other investments.

Remember, although the intention is to minimize risk,

Step 4: Rebalance your portfolio regularly

Contrary to popular belief, diversification isn't a one-time task. You should check your portfolio often and make changes according to your life changes within your wants, needs, and goals.

It's recommended to rebalance your portfolio at least two times per year.

Here are some asset classes to consider investing in.

Domestic stocks

Buying stocks gives you an opportunity to own a percentage of a company which comes with benefits such as dividend payouts and capital gains when the stock increases in price over time. Domestic stocks should be a significant part of your investment portfolio provided they offer great opportunities for growth in the long-term.

The world's greatest investor, Warren Buffet shows us exactly how to diversify when investing in domestic stocks with his top five stock picks being Apple, Wells Fargo, Kraft Heinz Company, BoA (Bank of America) and Coca-Cola. The stocks represent different companies in different sectors.

Bonds

Bonds offer regular interest income. They are less volatile than stocks making them a good investment for a risk adverse portfolio.

Stocks should be a significant portion of a portfolio for an investor focused more on the growth of their investment than the safety. It is worth noting that bonds offer fix rate of return with preferential treatment when bond matures.

Short-term investments

Your portfolio should also include short-term certificates of deposits as well as money market funds which offer stability as well as easy access to investments. Investments such as certificates of deposits are insured/guaranteed by the FDIC making them safer; however, they aren't as liquid as money market funds.

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Real estate fund

Investment portfolios with real estate funds which include real estate investment trusts offer protection against inflation. The funds also provide unique opportunities in real estate you wouldn't otherwise be able to take advantage of on your own.

Central Ohio Real Estate Investment LLC uses self-directed IRA saving accounts and a 506b fund to provide a bond secured by real estate, that produces a fixed rate, set amount cash return through Central Ohio Real Estate. Our clients receive a

- preferred return

This enables our client's diversification with a set, monthly, fixed rate, cash return.

Diversifying reduces the uncertainty of investing

There is a level of uncertainty in every financial market. If you put all your money in stocks, you risk losing everything if the stock market crashes. The same applies to the real estate market, commodities markets, currencies, and any other investment. However, it is every unlikely that all markets will crash at the same time, in the same manner.

So, investing into different asset classes; not just different sectors of one asset class will provide true protection to your retirement savings. This can be accomplished by taking the gains from a 401k or a traditional IRA and reinvesting into a SDIRA. This strategy provides you with control and freedom in diversifying your investment portfolio.

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