

THE ADVANTAGES OF THE INVESTMENT PORTFOLIO DIVERSIFICATION

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Unlike the investment approach of classic security analysis that focuses on individual security selection, portfolio investment is a modern investment method that involves asset allocation and diversification to construct a collection of investments. The biggest challenge in investing is the uncertainty of an investment's future performance and thus the risk of potential investment losses. Not counting on investment results of single investments, portfolio investment can hedge investment risks by canceling out different investment returns among component investments.

Before you make even one investment, you must decide on your optimal investment strategy. Two very different strategies are active portfolio management and long term investing. The strategies that you choose for an optimal trading strategy will depend largely on your investment goals. Long term investing offers more benefits and rewards, while active portfolio management is very hands on and may mean checking you investments frequently. The optimal investment strategy is to use long term investing and passive portfolio management instead active portfolio management.

Since portfolio investments tend to vary a lot, they include most kinds of investment instruments. Stocks are the most common, but they are closely followed by bonds, which are investments in business debt instead of business equity. This is another reason economists prefer direct investment, which must be equity investment in order to control a company.

The underlying reason for a diversified portfolio is that it is typically less risky than a concentrated portfolio. The old caution against "all one's eggs in one basket" applies.

To diversify your portfolio, you'll want to utilize various investment instruments such as stocks, bonds, and cash and cash assets. This diversification will ensure that you enjoy different rates of return as market conditions fluctuate, with each investment responding differently. This is a benefit to investors because markets are unpredictable. For instance, when interest rates fall, the rate of return on more secure investments like money market funds and bonds, increases with the opposite occurring for high-risk equity investments like stocks. Such an approach minimizes risk --- a situation that would be nearly impossible without a well-considered portfolio.

Besides diversifying your investment assets, you should diversify across categories or market segments, which provides an additional benefit in terms of risk aversion. Political, economic and social factors all affect markets, but a diversified portfolio can help protect against such vagaries.