

Understanding diversification

INVESTOR GUIDE

WHAT IS DIVERSIFICATION?

Diversification means spreading your money across different investments to reduce risk – that is a lot of small investments can be better than a few big investments. It is perhaps one of the most important of all investment disciplines. That’s why it has become the world’s most used and most valuable piece of investment advice – “don’t put all your eggs in one basket.”

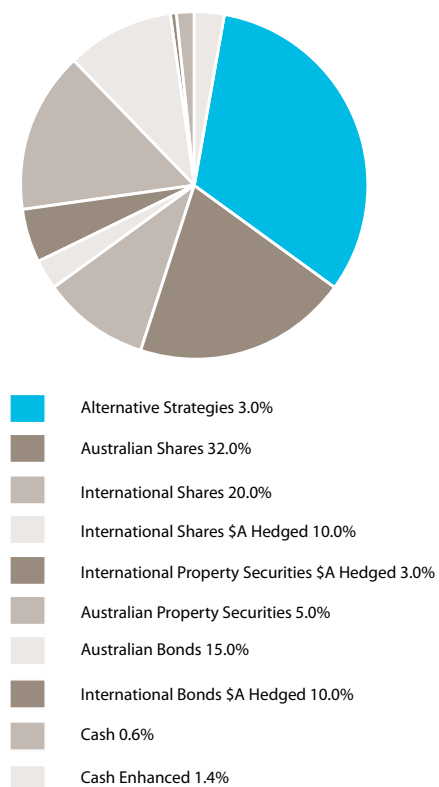
The more you diversify your investments, the less likely you are to suffer from the poor performance of one investment. Unfortunately, a large number of investment portfolios appear poorly-diversified – and that can be expensive.

A study by W.N. Goetzmann and A. Kumar¹ followed the results of 60,000 individual share investors. Their report showed that a vast majority of individual investors were under-diversified, taking too much risk and losing out on returns as a result. On a risk-adjusted basis, the least-diversified investors earned 2.4% less each year than well-diversified investors.

What’s more, the benefits of diversification can be obtained with relatively little cost.

According to their report, over 25% of portfolios contained just one stock. Fifty per cent contained fewer than three stocks and only 5-10% of portfolios contained more than ten stocks. As a result, the investor portfolios were extremely volatile (ie the value of their portfolios went up and down a lot). The pie chart on the right gives an example of the level of diversification achieved by investing in a diversified portfolio – such as a balanced fund.

Asset allocation of a typical Balanced Fund



Graph prepared by Russell Investment Management Ltd. The pie chart indicates asset allocations of a 'typical' Balanced Fund. The composition of this chart may change. Please note that asset allocation would vary depending on individual circumstances.

¹Goetzmann, William. N and Kumar, Alok. "Diversification Decisions of Individual Investors and Asset Prices" (January 14, 2004), Yale ICF Working Paper No. 03-31. Source: The Trade Off Financial Planning Association of Australia 2008.

Spreading your investments reduces your overall risk.

More than one kind of diversification

Professional investment managers normally produce better returns than individual investors, yet it is equally important to diversify across managers as well as asset classes. Different managers have different skills and perform well under different conditions. One efficient and effective way of diversifying your investment portfolio is by using a multi-manager investing approach.

Multi-manager investing is based on the idea that no single investment manager is likely to perform well in all market conditions, so using a number of different but complementary managers across a range of asset classes reduces the risk of say one investment manager performing poorly.

TOWER's multi-manager, diversified investment options are managed by Russell Investment Management Ltd (Russell), one of the world's leading investment managers. Russell pioneered the multimanager investing approach in Australia. Russell's disciplined approach uses three levels of diversification so investors can benefit regardless of which manager or asset class is in favour with the market.

No two diversification strategies are the same

Diversifying across shares, cash, bonds and property potentially reduces your risk. It also plays a crucial role in tailoring your investment portfolio to your needs. Just as no two investors are the same, no two diversification strategies need to be the same. This asset allocation process is one of the crucial parts of investment strategy.

Talk to your Financial Adviser about the best diversification strategy for you.

Russell Investments – three levels of diversification



TOWER Australia Limited

ABN 70 050 109 450 AFSL Number 237848
80 Alfred Street Milsons Point NSW 2061
Call 02 9448 9000 Fax 02 9448 9100

TOWER Australian Superannuation Limited
ABN 69 003 059 407 AFSL 237851

www.toweraustralia.com.au

Information in this brochure is for general information only and does not constitute financial or investment advice, taxation advice or recommendation, nor can it be relied on as such. You should seek professional advice from your own Financial Adviser tailored to your individual objectives, financial situation and particular needs.