

Last week the Dow Jones Industrial Average fell almost 400 points, or almost three percent, in one day. The media reported it like the sky was falling. What they didn't say is for the past several months, the Dow Jones Industrial average performance was spectacular. Now, the point of this is two things, ensure an investment portfolio is properly diversified and maintain a long term view of investments.

Diversification in investment terms is the commitment of investment funds into varied types of businesses or geographic regions. Diversification of a portfolio reduces the volatility, or ups and downs of its value. Proper diversification does not mean blindly purchasing a bunch of stocks or mutual funds. Instead, it means to have things in your portfolio that are not related. A well diversified portfolio has a substantially lower chance of ever having a negative annual return. This is important because it creates more wealth over time. It is similar to a student who has received 5 As and all of a sudden gets an F. To get his average back to A will be hard; while had he received a C it would be much easier. For example, if you had a portfolio of GM, Wal Mart, and Walt Disney stock, you would have been one of the many people who lost 3 percent of their portfolio last Tuesday. These are companies you probably recognize that are part of the Dow Jones Industrial Average. If you had a piece of your portfolio invested in bonds, you would have reduced your loss significantly.

Bonds, or fixed income, are often the most overlooked, yet one of the most important tools of diversification. These should be in everyone's investment portfolio, yet many people do not understand what they are. Simply, bonds are loans to corporations or governments that pay you interest for a certain amount of time, and then your money is given back to you. The interest rate is determined by the length of the loan and the ability of the company or government to pay the bills. Think about purchasing a car--the longer the car is financed, the more interest is charged. The lower a credit score, the higher the interest rate.

Proper diversification leads to successful investing. Studies have shown it is not picking the right time to invest or picking the right stock that determines most of the return of your portfolio. Instead, most of the performance is determined by how the portfolio is diversified. This means that instead of trying to find the next Microsoft, you should focus on purchasing unlike assets in different industries and countries.

Investing for the long term is very hard for people to do, especially when the media talks about doom and gloom when there is a short term down market. Looking at all the books and seminars out there, they talk about how to get rich overnight. Think about it, why are they telling you their secret? If it was so good, then wouldn't they want to keep it for themselves? There is only one person getting rich overnight and that is the author taking your money. Success in investing is achieving your realistic financial goals.

The key to goal-based investing is to understand there are going to be fluctuations in short term time periods, but over time should grow steadily. If you begin an exercise program today, do you think you are going to be 10 lbs lighter tomorrow? A more realistic goal would be to lose 10 lbs in a couple of months. The same thing with investing, you should not expect to make your retirement goal overnight, and do not step on the scale every day.

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