INTEGER WEALTH GLOBAL

Literature – Types of Asset Classes

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What is an Asset Class?

An asset class is a group of similar investment vehicles. Different classes, or types, of investment assets – such as fixed-income investments – are grouped together based on having a similar financial structure. They are typically traded in the same financial markets and subject to the same rules and regulations.

Understanding Different Asset Classes

There's some argument about exactly how many different classes of assets there are. However, many market analysts and financial advisors divide assets into the following five categories:

- **Stocks or equities** – Equities are shares of ownership issued by publicly-traded companies. They are traded on stock exchanges such as the NYSE or NASDAQ. You can potentially profit from equities either through a rise in the share price or by receiving dividends. The asset class of equities is often subdivided by market capitalization into small-cap, mid-cap, and large-cap stocks.
- **Bonds or other fixed-income investments** – Fixed-income investments are investments in debt securities that pay a rate of return in the form of interest. Such investments are generally considered less risky than investing in equities or other asset classes.
- **Cash or cash equivalents, such as money market funds** – The primary advantage of cash or cash equivalent investments is their liquidity. Money held in the form of cash or cash equivalents can be easily accessed at any time.
- **Real estate or other tangible assets** – Real estate and other physical assets are considered an asset class that offers protection against inflation. The tangible nature of such assets also leads to them being considered as more of a "real" asset. In that respect, they differ from assets that exist only in the form of financial instruments, such as derivatives.
- **Futures and other financial derivatives** – This category includes futures contracts, the forex market, options, and an expanding array of financial derivatives. Derivatives are financial instruments that are based on, or derived from, an underlying asset. For example, stock options are a derivative of stocks.

Additional Factors in Classifying Assets

It is difficult to classify some assets. For example, suppose you are investing in stock market futures. Should those be classified with equities, since they are essentially an investment in the stock market.? Or should they be classified with futures since they're futures.? Gold and silver are tangible assets, but are frequently traded in the form of futures or options, which are financial derivatives. If you invest in a real estate investment trust (REIT), should that be considered an investment in tangible assets, or as an equity investment since REITs are exchange-traded securities.?

The diversity of available investments also creates complications. Exchange-traded funds (ETFs), for example, trade on exchanges, just like stocks. However, ETFs may be composed of investments from one or more of the five basic asset classes. An ETF that offers exposure to the energy market may be composed of investments in oil futures and in stocks of oil companies.

Assets may also be categorized by location. Market analysts often view investments in domestic securities, foreign investments, and investments in emerging markets as different categories of assets.

Other asset classes include collectibles, hedge funds or private equity investments, and cryptocurrencies such as Bitcoin. These asset classes are a bit more off the beaten path. For that reason, they are sometimes classified together under the heading of "alternative investments". Generally speaking, the more "alternative" an investment is, the more illiquid and the riskier it tends to be.

Asset Classes and Diversification

Good news.! You don't really have to know for certain which asset class a specific investment fall into. You just need to understand the basic concept that there are broad, general categories of investments. That fact is important because of the concept of diversification. Diversification is the practice of reducing your overall risk by spreading your investments across different asset classes.

There is typically little correlation, or an inverse or negative correlation, between different asset classes. During periods of time when equities are performing well, bonds, real estate, and commodities may not be performing well. However, during a bear market in stocks, other assets, such as real estate or bonds, may be showing investors above-average returns.

You can hedge your investments in one asset class, reducing your risk exposure, by simultaneously holding investments in other asset classes. The practice of reducing investment portfolio risk by diversifying your investments across different asset classes is referred to as asset allocation.

Asset Allocation and Risk Tolerance

The other reason to have a basic understanding of asset classes is just to help you recognize the nature of various investments that you may choose to trade. For example, you might choose to devote all, or nearly all, of your investment capital to trading futures or other financial derivatives such as foreign currency exchange. But if you do, you must at least be aware that you have chosen to trade a class of assets that is usually considered to carry significantly more risk than bonds or equities.

The extent to which you choose to employ asset allocation as a means of diversification is going to be an individual decision that is guided by your personal investment goals and your risk tolerance. If you are very risk-averse, then you may want to invest only in relatively safe asset classes. You may aim to diversify within an asset class. Stock investors commonly diversify by holding a selection of large-cap, mid-cap, and small-cap stocks. Alternately, they may seek diversification through investing in unrelated market sectors.

Alternatively if you possess a high risk tolerance and/or with having money to place at a higher risk, you may care very little about diversification, and just be focused on trying to identify the asset class that currently offers the highest potential profits.