Are you a smart investor?

You may be wondering what to do with the extra money that is not spent during the month. Some people make impulsive investment decisions without giving proper consideration to their long-term financial goals. It is important that you make informed investment decisions and this article outlines some factors you need to consider prior to making an investment decision.

Your final plan may be to have extra money that is not spent during the month. You may be accumulating this extra money to spend on something important within the year. For this purpose, you need to accumulate your money in a savings account. The savings account may not be earning high interest, but it will keep your money safe. A savings account is a good place to keep your money if you have a short-term goal for saving.

For accumulating money to reach a long-term goal, say, for two or more years, you need to put your money in a place where your money should potentially earn more. For getting your child into college, setting up a business, or a retirement, you need to invest.

Investing is making your money grow at a rate that is faster than putting it in a savings account. It is a way of saving your money for something further ahead in the future. Although investing carries risks for your money, it will potentially give you a much higher return.

Also, the money that you save for the long term is going to be affected by inflation. Inflation, which is the rise of price of things, makes your money worth less and less over time. The interest you earn on savings account usually cannot cope with inflation. You need to put it in an investment where your money grows to retain its value or even increase in value. Before investing, you should first consider these factors that will determine when, where and how to invest:

Your objective for investing

A factor that determines where to invest your money is your objective for investing.
You may want to hopefully grow your money fast and you do not care if you risk it because you have more time to pick yourself up and recover from a downturn. Or your goal is just to preserve your capital in the safest way because you will need your money soon and it is important that it does not lose its value.

These different goals are compatible with different kinds of investments or a mix of investments as follows:

Keeping your money relatively safe because you need it soon – if you are close to retirement, you would not want your money to decrease in value just when you are about to retire. Therefore, if you have a financial goal that is near, investing in less risky instruments makes sense. Investments in mostly bonds are suitable here. Bonds are safe instruments.

Taking moderate risk with your money for better appreciation – if you can afford to take a little risk with your money because you will not need it soon, then buying an investment like a mix of stocks of very stable companies that pay out dividend (income) and stocks of companies that do not pay out dividend but reinvest their earnings in their future is a good choice for you.

Taking aggressive risks for higher gains – if you can afford to take a risk with your money for higher gains, then growth should be your goal. You should invest in stocks of companies that plow their earnings back into their future. This is appropriate if you can keep your investment for a long period of time because it takes time for some companies to make their value increase sizably.
It is also possible that you can invest for two different goals, such as investing for a house down payment (short term) and investing to retire (long term).

Your age

A factor you should consider to determine where to put your investment and how much to invest is your age.

In investing, being young has an advantage. You are able to wait a longer time for your investment to bear fruit. While young, you are also more secure, you do not have a lot of responsibilities, you have more disposable income and you can pick yourself up easier when you make mistakes. Therefore, when you are young, you can get into investments that are riskier but can potentially earn above average earnings.
Another advantage of being young is that you have more time for compound interest to work for you. Compound interest is earning interest on your interests as well as principal and this makes your money grow at a faster rate over time.

On the other extreme, if you are middle aged and thinking about retirement, but you are just starting to save for retirement, you should invest the maximum amount you can afford so you can live comfortably when you retire. You should also put your money in a relatively safe investment, so there is very little risk of losing much of it by the time you retire.

Time before you need the money

Not everyone invests to retire, some investments have shorter goals. Therefore, another factor you should consider to determine where to invest is the time you have before turning your investment into cash.
The longer you can stay invested, the more you can take risk (and hopefully get more gain) since you can still recover from any potential loss. If you do not have a lot of time and taking a loss would be disastrous to your plan, then it is best to stick to less risky investments like bonds.
Also, consider that some investments will cost you charges or penalties if surrendered or redeemed before a holding period. If this is a requirement, make sure that you do not need the money before the prescribed redemption period.

Consider an appropriate mix of investments

Historically, the returns of the three major asset categories – stocks, bonds and cash – have not moved up and down at the same time. Market conditions that cause one asset category to do well often cause another asset category to have average or poor returns. By investing in more than one asset category, you'll reduce the risk that you'll lose money and your portfolio's overall investment returns will have a smoother ride.
If one asset category's investment return falls, you'll be in a position to counteract your losses in that asset category with better investment returns in another asset category.
One of the most important ways to lessen the risks of investing is to diversify your investments – both among asset categories and within asset categories. It's common sense: Don't put all your eggs in one basket. By picking the right group of investments, you may be able to limit your losses and reduce the fluctuations of investment returns without sacrificing too much potential gain.

Risk tolerance

As a general rule, the higher the risk of an investment, the more potential for higher return.
However, not everyone can take risks with their money over a certain level. Not everyone is comfortable with the ups and downs of the stock market, for example. You may be so averse to risking your money that a potential higher rate of return may not be worth the stress and your losing sleep.
If your personality is one who can accept losing money for the possibility of getting much more profit on your investment, choose aggressive investments such as growth stocks. If you are the more conservative type, choose the relative safety of bonds.

Create and maintain an emergency fund

Most smart investors put enough money in a savings product to cover an emergency, like sudden unemployment. Some make sure they have up to six months of their income in savings so that they know it will absolutely be there for them when they need it. During a downturn of the economy, this is particularly important.
Investors need a balanced portfolio – including exposure to shares – to achieve improved returns over the long term