Things to Consider Before You Make Investing Decisions

When it comes to investing, while it may seem there are dozens of options, there are really only two. You can either be a loaner or an owner. A loaner is someone who allows others to borrow their money in exchange for interest. An owner, on the other hand, invests in somebody else's business with the hope that their ownership interest grows in value.

If you put money in the bank, or in any kind of bonds, you're a loaner. You're investing in debt. If you invest in the stock market or real estate you're an owner. You're investing in equity. Over decades, loaner investments like government bonds have paid a little less than the inflation rate. Owner investments, like stocks, have paid a lot more, beating inflation. This is as it should be: after all, ownership investing carries additional risk. If it didn't pay more, nobody would do it.

But that doesn't mean owner investments are better than loaner. Both are necessary. Loans offer relative safety, depending, of course, upon who you lend your money to. And ownership investments offer the opportunity for growth, depending on whose business or what real estate you invest in. If you try to play it too safe and put all your money into super-safe loan investments, you're practically guaranteed to lose to inflation over time. But if you put all your eggs in a risky ownership basket, you're likely to lose both sleep and your savings. So you need both. The trick is how to determine how much of each, then to learn about both.

Given recent market events, you may be wondering whether you should make changes to your investment portfolio. It is noteworthy to mention here that some investors are making rapid investment decisions without considering their long-term financial goals. While we can't tell you how to manage your investment portfolio during a volatile market, we will give you the tools to make an informed decision. Before you make any decision, consider these areas of importance:

Evaluate your current financial roadmap.

Before you make any investing decision, sit down and take a fresh look at your entire financial situation. An important step to successful investing is knowing your current goals and risk tolerance. These factors may have changed with the current economy.

Evaluate your comfort zone in taking on risk.

Traditionally, if you have a financial goal with a long time horizon, you are likely to make more money by carefully investing in asset categories with greater risk, like stocks or bonds, rather than restricting your investments to assets with less risk, like cash equivalents. On the other hand, investing solely in cash investments may be appropriate for short-term financial goals. The principal concern for individuals investing in cash equivalents is inflation risk, which is the

risk that inflation will outpace and erode returns over time. With today’s market volatility, investors must evaluate their acceptance and comfort zone for risk. Can you stomach the current up-and-down market for longer term goals?

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.

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.

Consider rebalancing portfolio occasionally.

Rebalancing is bringing your portfolio back to your original asset allocation mix. By rebalancing, you'll ensure that your portfolio does not overemphasize one or more asset categories, and you'll return your portfolio to a comfortable level of risk.

You can rebalance your portfolio based either on the calendar or on your investments. Many financial experts recommend that investors rebalance their portfolios on a regular time interval, such as every six or twelve months. The advantage of this method is that the calendar is a reminder of when you should consider rebalancing. Others recommend rebalancing only when the relative weight of an asset class increases or decreases more than a certain percentage that you've identified in advance. The advantage of this method is that your investments tell you when to rebalance. In either case, rebalancing tends to work best when done on a relatively infrequent basis.

Avoid circumstances that can lead to fraud.

Scam artists read the headlines, too. Often, they'll use a highly publicized news item to lure potential investors and make their "opportunity" sound more legitimate. This can be particularly true during troubled economic times when investors are frustrated. We recommend that you ask questions and check out the answers with an unbiased source before you invest. Always take your time and talk to trusted friends and family members before investing.

What you need to remember:

- Don't ever put any money into stocks that you could possibly need within five years. The longer your time horizon, the lower your risk. This is also true of real estate investments.
- Don't put all your eggs in one basket. If you can't afford to buy more than one stock, use a mutual fund or Exchange Traded Fund. That way you own a sliver of lots of different companies rather than just one or two.
- Don't invest in stocks all at once: invest small amounts monthly. That way, should the market fall, you'll have money on the sidelines to buy at lower prices.
- To decide how much to put in loaner investments (the bank) and how much to put in owner investments (stocks or real estate) here's your rule of thumb: Subtract your age from 100 and that's the percentage you might want to put in stocks. So if you're 25 years old, you'd take 25 from 100 and put that amount, 75%, of your long-term savings into stocks. If you're 75 years old, you'd only take that kind of risk with 25% of your savings.