WHAT EVERY INVESTOR SHOULD KNOW

Defining Your Investment objectives

Investing wisely is a function of your specific needs and goals. Each investor has different objectives that need to be met depending on age, income, planned activities, and attitudes about risk. How can you work with your investment advisor to best determine which investments are right for you? Among the important factors to consider are personal status, plans, and constraints. Some of the issues that you and your advisor should consider in defining the objectives that are right for you are listed below.

Goals and Needs

You may have specific goals and requirements that you want your investment portfolio to fulfill. For example, you may be funding college for children, business expansion, travel plans, or retirement needs. You should identify these goals and needs clearly with your investment advisor so that his or her recommendations for your portfolio can assist you in meeting them.

Age

Your age is an important consideration when deciding how much risk to assume. Portfolio assets that are riskier and that will fluctuate more over time may be appropriate for younger investors but not for others. An individual who does not expect to liquidate the assets in his or her portfolio for a number of years has more time to recover from a market downturn, while an investor close to retirement may be more likely to prefer stable assets and capital preservation.

Age also affects the choice between income-earning securities and those oriented toward capital gains. An investor who is employed and near peak earning power will probably want to minimize paying taxes, and will therefore lean toward investments that do not provide current income.

Income

Both your absolute income level and your income requirements influence your investment objectives in several ways. First, income, like age, influences the choice between dividend-paying or interest-paying investments, and those whose primary return is in the form of capital gains. You may prefer income-producing investments if you need to supplement or replace earned income. Your income level also affects your investment choices because it determines your tax rate. Low-tax-bracket investors — generally those whose income is lower — will be more likely to prefer income-producing investments. High-tax-rate investors are more likely to choose tax-deferred or tax-sheltered assets.

Income also may influence risk preferences. High income investors may be more willing to choose higher risk investments since they can more easily contribute additional investment capital should they sustain losses.

Taxes

Your after-tax return is the return that matters. Interest income from banks, financial institutions, and/or from corporate debt securities (debentures) are subject to a 10% WHT, while dividend income is also liable to a 10% WHT. However, profits on sale of shares or capital gains on sale of debentures are not taxed provided it is not being done as a trading business. A 0.3% share transaction levy (STL) is applicable on all purchases and sales of publicly listed shares.

Occupation

Your occupation also can affect portfolio objectives. Some professions produce more stable incomes than others, enabling the investor to tolerate more investment fluctuations. Your profession also may determine other assets. For example, does your job provide an adequate retirement plan, or must you fund your retirement from your investment portfolio? If your employer provides a stock-purchase plan, this may be a substantial part of your personal wealth, and you should consider it as a diversification issue when you make other portfolio choices. If you receive tax-qualified or tax-deferred assets from your job, these also will influence your investment decisions.

Wealth

Investment objectives should take into consideration the assets you hold outside the portfolio. For example, if you have substantial equity in your home, you may want to minimize real estate holdings in your financial assets, or you may need to consider a different type of real estate asset. If you hold illiquid assets, then new investments may emphasize liquidity. The value of your existing assets will probably affect your tolerance for risk. In addition, your level of wealth has probably influenced your lifestyle. Maintaining a desired lifestyle into retirement and throughout will need to be factored into your investment objectives.

Time Horizon

An important consideration in setting investment objectives is your time horizon. *When do you expect to liquidate a portfolio? Should you choose assets of short or long maturity? Do you have time to recover from a declining market, or is capital preservation important to meet an immediate financial need?*

Liquidity

Liquidity is the ease with which you can convert your assets to cash at fair market value. It is essential that you recognize the need to convert your assets into cash at the appropriate times. *Do you require a portfolio that can be liquidated easily, or can you afford to wait?* Since greater liquidity generally results in lower return, it is necessary to give serious consideration to the inherent tradeoffs.

Tolerance for Risk

Your tolerance for risk is a very personal decision, and a question that is difficult for many investors to answer. In general, markets tend to provide higher returns in exchange for bearing higher risks. Often you will find that the investments with the highest long-term returns are very volatile in the short run. It is important to be honest with yourself in assessing whether you are comfortable with market volatility, and the level you can tolerate. While it is easy in hindsight to wish you had invested in a risky segment of the market that has performed well recently, a more realistic view is to look forward at the risk that might occur in the future.

Other Special Circumstances

Are there other considerations of which your advisor should be aware? Consider here any special needs, goals, or problems you have not already addressed.

Putting It All Together

A professional investment advisor can work with you to answer all of these questions and prepare a written statement of investment objectives. Together you should then be able to determine a target rate of return, and an appropriate mix of assets to place in the portfolio. Regular feedback will enable your advisor to incorporate any changes in your needs or circumstances. (Source CFA Sri Lanka)