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Six Keys to Successful Investing

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Wealth Management is more than just investments. It encompasses a disciplined professional approach, using a broad range of services and an experienced team of advisers.

I can help you put together your specialized team of investment, tax, legal and insurance advisers and then lead the development and implementation of your integrated wealth management plan.

If you are within 10 years of retirement, let me help you understand how the retirement landscape has changed and how these changes can impact your current and future financial decisions.

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Six Keys to Successful Investing

A successful investor maximizes gain and minimizes loss. Here are six basic principles that may help you invest successfully.

Long-term compounding: your nest egg may get bigger, and bigger, and bigger . . .

It's the "rolling snowball" effect. Put simply, compounding pays you earnings on your reinvested earnings. The longer you leave your money at work for you, the more exciting the numbers get. For example, imagine an investment of $10,000 at an annual rate of return of 8 percent. In 20 years, assuming no withdrawals, your $10,000 investment would grow to $46,610. In 25 years, it would grow to $68,485, a 47 percent gain over the 20-year figure. After 30 years, your account would total $100,627. (Of course, this is a hypothetical example that does not reflect the performance of any specific investment.)

This simple example also assumes that no taxes are paid along the way, so all money stays invested. That would be the case in a tax-deferred individual retirement account or qualified retirement plan, or even if you just bought and held shares of a stock that paid no dividends. The compounded earnings of deferred tax dollars are the main reason experts recommend fully funding all tax-advantaged retirement accounts and plans available to you.

While you should review your portfolio on a regular basis, the point is that money left alone in an investment offers the potential of a significant return over time. With time on your side, you don't have to go for investment "home runs" in order to be successful.

Endure short-term pain for long-term gain: ride out market volatility

It sounds simple, doesn't it? But what if you've invested $10,000 in the stock market and the price of the stock drops like a stone one day? On paper, you've lost a bundle, offsetting the value of compounding you're trying to achieve. It's tough to stand pat.

There's no denying it--the financial marketplace can be volatile. Still, it's important to remember two things. First, the longer you stay with a diversified portfolio of investments, the more likely you are to reduce your risk and improve your opportunities for gain.

Second, during any given period of market or economic turmoil, some asset categories and some individual investments historically have been less volatile than others. Bond price swings, for example, have generally been less volatile than stock prices. Although past performance cannot predict future results, you can minimize your risk somewhat by diversifying your holdings among different classes of assets, as well as different individual assets within each class.

Asset allocation: spreading the wealth

Asset allocation is the process by which you spread your investment dollars over several categories of assets, usually referred to as asset classes. These classes include stocks, bonds, cash (and equivalents), real estate, precious metals, collectibles, and insurance products.

For many average investors, the focus is almost entirely on stocks, bonds (or mutual funds of stocks and bonds), and cash. You'll therefore also see the term asset classes used to refer to subcategories of these investments, such as aggressive growth stocks, long-term growth stocks, international stocks, government bonds (U.S., state, and local), high-quality corporate bonds, low-quality corporate bonds, and tax-free municipal bonds.

There are two main reasons why asset allocation is important. First, the mix of asset classes you own is a large factor--some say the biggest by far--in determining your overall investment portfolio performance. In other words, the basic decision to divide your money 80 percent in stocks and 20 percent in bonds is probably more important than your subsequent decisions over exactly which companies to invest in, for example.

Second, by dividing your investment dollars among asset classes that do not respond to the same market forces in the same way at the same time, you can minimize the effects of market volatility while maximizing your chances of return in the long term. Ideally, if your investments in one class are performing poorly, you will have assets in another class doing well. The gains in the latter will offset the losses in the former, minimizing the overall effect on your portfolio.

Consider liquidity in your investment choices

Liquidity refers to how quickly you can convert an investment into cash without loss of principal. Generally speaking, the sooner you'll need your money, the wiser it is to keep it in investments with comparatively less volatile price movements. You want to avoid a situation, for example, where you need to write a tuition check next Tuesday, but the money is tied up in a long-term mutual fund whose price is currently experiencing a loss.

Therefore, your liquidity needs should affect your investment choices. If you'll need the money within the next one to three years, you may want to invest in short-term bonds, certificates of deposit, a money market account, or a savings account. Your rate of return will likely be lower than that possible with more volatile investments such as stocks, but you'll breathe easier knowing that the principal you invested is relatively safe and quickly available, without concern over market conditions on a given day.

Dollar cost averaging: doing it consistently and often

Dollar cost averaging is a method of accumulating shares of stock or a mutual fund by purchasing a fixed dollar amount of these securities at regularly scheduled intervals over an extended time. When the price is high, your fixed-dollar investment buys less, but when the prices are low, the same dollar investment will buy more shares. A regular, fixed-dollar investment should result in a lower average price per share than you would get buying a fixed number of shares at each investment interval.

Remember that, just as with any investment strategy, dollar cost averaging can't guarantee you a profit or protect you against a loss if the market is declining. To maximize the potential effects of dollar cost averaging, you should also assess your ability to keep investing even when the market is down.

An alternative to dollar cost averaging would be trying to "time the market," in an effort to predict how the price of the shares will fluctuate in the months ahead so you can make your full investment at the absolute lowest point. However, market timing is generally unprofitable guesswork. The discipline of regular saving is a much more beneficial strategy, and it takes no mental effort or study.

Review your portfolio and game plan: buy and hold, don't buy and forget

Unless you plan to rely on luck, your portfolio's long-term success will depend on periodically reviewing it. Maybe your uncle's hot stock tip has frozen over. Maybe economic conditions have changed the prospects for a particular--or a whole class of--investment.

Even if nothing bad at all happens, your investments will appreciate at differing rates, so after a while, your asset allocation mix will change. For example, if you initially decided on an 80 percent to 20 percent mix of stocks to bonds, you might find that the total value of your portfolio has become divided 88 percent to 12 percent. When that's the case, you'll need to rebalance your portfolio.

Rebalancing involves restoring your original asset allocation decisions by shifting your funds among investment classes to restore the ratios you decided on in first designing your portfolio. Many investment advisors recommend using shifts of 5 percent or more as a trigger for rebalancing. Others recommend doing it every year.

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