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Speaker 1

Welcome. My name is Andrew Baron, and this is, Well... It Depends! The podcast where I present the pros and cons of financial decisions so that you, the audience, feel better informed when you are confronted with these decisions in your own life. In this episode, I ask the question, should I change how I'm invested?

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Speaker 1

Getting into it, should change how I'm invested? Well... It Depends! With the stock market continuing to do poorly this year, perhaps you're wondering if you should change your investments around. You might think to yourself, the stuff I'm in isn't doing very well, and therefore I should be in other “better stuff”. Instead, try to evaluate your investments by considering a few questions.

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What is your time horizon? Or said another way, how long until you need to use the money? A short time horizon, which for investing is less than five years, you need to be secure. Five years isn't very long and if you experience a downturn, you don't have very much room to make up for it. If you're investing for the short term, you need to be confident your money is going to be there when you need it.

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An example of this is saving for college if the student is already in high school. While you may not need the money today, you need to be there in a relatively short timeframe. You likely want this money to grow, but you can't afford to risk a dramatic downturn in value either. Compare that with a long time horizon, such as a retirement, where you stock away money for decades to provide for yourself later in life.

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The longer your time horizon, the more time you have to bounce back. What are your goals? When you invest, there's a purpose behind it and it falls into one of three broad categories: growth, income and preservation. Growth is obviously the increase in value of your investments. Growth takes risk, and if you want to grow really fast, you need to take a lot of risk.

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The problem is that growth doesn't go straight up. Instead, it goes back and forth, up and down, side to side. And if you don't have time to wait, you could end up with less money than when you started out with. The next category is income. Once you have grown your assets to a sufficient size, you may decide to draw income from them.

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Retirement is an example of needing income from your investments. If you want income from your assets but they're geared towards high risk growth, you might have a really difficult time making ends meet. So if you're investing for income, you can't take as much risk as you can for growth, since you need to have confidence your cash flow remains steady.

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This brings us to preservation. Preservation forgoes all volatility, and oftentimes yield, in exchange for safety. Your savings account is an example of this. You need to have a certain amount of money in your savings account no matter what, even if it's not growing very fast. Is your portfolio diversified? Having all of your money in one investment is kind of like putting all your money on black in roulette.

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You could win, but if you don't, you could end up with nothing. This is why financial planners often talk about having a diverse portfolio with multiple investments. A diverse portfolio is theoretically safer than a concentrated portfolio because it can spread risk out among many different investments, sectors, companies, etc.. Okay, if your portfolio is out of whack, what can you do?

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There's really two strategies. One is a little bit more dramatic and one is a little gradual. The first is you can sell your investments and buy new ones. This has the immediate effect of having new investments, but it's also dramatic and can have tax consequences depending on which accounts you're trading in. The alternative is to gradually change your allocation by purchasing additional investments with new money.

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This way you keep what you already have, but by adding, you change the overall composition and risk profile. To recap, what's your time horizon? The more time you have, the more risk you can take on because you can make up for the downturn over time. Conversely, a short time horizon means you need to be careful with your money.

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What are your goals? Growth, income or preservation? Different accounts may have different purposes, like retirement accounts may be for growth, while your savings account is for preservation. Are you diversified? It's important to spread out your risk so that you don't have to end up in the roulette situation losing everything.

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So to answer the question, should I change how I'm invested? Well... It Depends!

Speaker 1 – Andrew Baron, CFP®, Enrolled Agent