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Riding The Market

Some of the lessons we learned as children have important applications for us as adults. Remember learning to ride a bike? You'd be sailing along – then suddenly hit a bump – and down you'd go without warning. Most of us had similar experiences, and taken over the course of our childhood, they were relatively few and far between. Despite our bruises, we'd get back on that bike. We didn't let one crash – or even several – keep us from the joy we found on the open road. In other words, the benefits outweighed the risks.

What Goes Up Must Come Down

Investing in the market can be a lot like riding a bike. The ups and downs of the market can be as varied as the terrain we traveled as kids. We learned then "what goes up must come down" – and if as investors we look at the big picture we better be prepared to handle the bumps we're bound to encounter in the market.

Getting a Handle on Market Terminology

To help keep a proper perspective about the market, every investor should be familiar with some widely used market terminology. For instance, what is the difference between a correction and a crash? What is a bear market? What are some strategies you can use to help protect your investments from changes in market activity?

A *correction* refers to a drop in the price of a stock, bond, commodity or market, following a rise.

A *bear market* is more drastic, characterized by at least a 20% drop in the market, which lasts for a prolonged period.

Crashes are much less common – though much more severe – and are characterized by an instantaneous plummeting of the value of the market. Two notorious market crashes are the Crash of 1929 and the 1987 crash.

Help Guard Against a Fall

Though experts and amateurs alike can watch market trends and speculate, it is impossible to predict what the market will do next. But many experts agree certain strategies, when implemented as part of a long-term investment strategy, can help work for the overall benefit of the investor.

Considerations

When determining your long-term investment strategy, it is important to take into account some considerations when investing your hard-earned dollars. Each investor may want to develop an investment strategy that carefully balances between risk tolerance, investment objectives, and time horizon.

Risk tolerance – Risk tolerance has to do with how you really feel about the affects of risk on your investments. Are you concerned when the market dips? How anxious do you get? Do you have patience to ride out these periods? Some people are just naturally conservative. Others are aggressive risk takers. Still others are somewhere in between. Decide on what type of investor you are and invest according to your willingness to accept risk. Remember, though, that most investment choices have some degree of risk. Some risk, such as inflation, aren't quite so apparent to the average investor, so be sure to take them into consideration.

Investment Objectives – What retirement lifestyle are you trying to achieve? Will you lead a relatively similar lifestyle? Will you travel frequently, or engage in expensive hobbies? Or will you downsize to a smaller home?

Time Horizon – What is your time horizon for each of these objectives? Younger individuals typically have more time to save to meet their retirement goals and make up any short-term investment losses that might occur. As retirement gets closer, many people generally have less tolerance for risk because they have fewer years in which to meet their goals.

The goal is to balance these variables in a way that may help you meet your investment objectives, while maintaining an acceptable amount of risk. One of the most effective ways to establish this equilibrium is to build an investment strategy with **asset allocation**.

Asset Allocation is the strategy of diversifying your account over a variety of asset classes or investments. Today, individuals are challenged to fund and self-direct their own retirement investments through vehicles such as group retirement plans.

Strategies

Once you take into account the considerations that accompany long-term investing, you may start thinking about the investment strategy that will help you reach your retirement savings goals.

Buy and Hold

The "buy and hold" strategy has long been a recommendation of stock analysts and industry experts. This means purchasing a stock and holding onto it, even if the market is pitching and peaking. Although past performance is no indication of future results, historically, stocks have outperformed other types of investments (Ibbotson, December 31, 2004)

Risk Targeting

Another prudent strategy is knowing your risk tolerance – and investing accordingly. Equities have a certain level of risk associated with them, because they offer no guarantee of return. Generally, the greater the risk, the greater the potential for return. If you are averse to the prospect of losing some – or all – of your investment in a market downturn, you may want to structure your investment portfolio with few or no high-risk equities. Attractive returns on aggressive or high-risk equities tempt investors who are otherwise quite conservative. It's important to know an equity's history – and its potential for loss relative to its risk – before investing.

Dollar Cost Averaging

Dollar cost averaging is an investment concept that can help make the market's ups and downs work for you. By making systematic, continuous investments over time, this strategy allows you to purchase more shares when prices are low, and fewer when they are high. The result is the opportunity to purchase more shares at a lower average price.

Keep in mind that continuous or periodic investment plans neither assure a profit nor protect against loss in declining markets. Dollar cost averaging involves continuous investing – regardless of fluctuating price levels – so you should carefully consider your financial ability to continue investing through periods of fluctuating prices.

Another strategy to riding a volatile market is Diversification.

Diversification

Diversification is the practice of spreading your investments – and thereby your risks – across a number of different types of equities. If one type of investment performs poorly, positive performance in other areas of your portfolio

Diversification is a technique used to help reduce risk. When you diversify your investments, you decrease the chances of having them at least partly in the wrong place at the wrong time. By spreading your investments over a variety of asset classes, you help reduce your overall investment risk if any one asset class performs poorly.

Fed101

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