Northwestern Mutual®

Why Being Conservative with Your Money may be Riskier than You Think, and Three Things You Can Do About it

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I was having a conversation with my client "Joe" about his retirement account. He's 43, and he's not planning to retire for at least another 20 years. He had an IRA that is was being managed at another financial institution. We reviewed it and found a glaring concern given his age, risk tolerance, other assets and income streams. His asset allocation was approximately 30% equities and 70% fixed income. He told me he still remembers 2008 and doesn't feel comfortable taking risk in his investments. He also said he was nervous about the economy and a coming recession.

I asked him if he knew what the value of the S & P 500 index was the day he was born. He didn't know. He couldn't believe it when I told him it was around 105, and today it's at roughly 3000. The potential for growth in stocks is much higher than other fixed income alternatives. However, that potential needs to be balanced with the risks. With longer time horizons, there is more opportunity for recovery of the more volatile investments. This is why a comprehensive risk assessment is important. Based on Bloomberg data, there has never been a rolling 20-year period going back to 1872 when the S&P 500 group of companies have lost value. After a thorough discussion about his goals and timelines I helped him to reframe his perspective on risk.

Here are three things you can do to make sure you are taking the right approach to your investments:

1) Match the risk of your money to when you will use it. Are you going to retire in 25 years? As long as you can stomach the volatility, consider owning stocks. Are you saving to buy a boat in the next three years? The boat dollars should probably be in a lower risk account such as a money market or CD.
2) Don't get too focused on the noise you hear on the media. The news media does not have an incentive to help you succeed as an investor. Think long term, because most of the "crises" end up blowing over. Work with an advisor that can help you reduce the urge to make emotional decisions with your finances
3) Always keep three to six months' worth of your expenses in a liquid savings or money market account. Having cash will help you get through any emergencies and allow you to avoid pulling money from your investments at the wrong time when their value is less than optimal

Let me know if you'd like a complimentary review of your investment strategy to make sure your allocation aligns with your goals.