Investing for Retirement

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✔ ***Invest for growth.*** Even a mild rate of inflation will increase your cost of living and erode the purchasing power of your money over the years. For example, with only a modest 3% average annual increase in inflation, what you can buy for $1,000 today will cost you $1,344 in ten years, and $1,806 in 20 years.

Over the long haul stocks have historically outperformed inflation, bonds, and other investments. That's why experts generally advise you to invest in a diversified portfolio that includes both bond and stock investments.

✔ ***Evaluate your investment mix.*** How your money is divided among the different types of savings and investments, and among the categories within these main types, is one of your most important investing decisions. So make it a priority to calculate what percentage of cash, bonds, and stocks you have in your portfolio and set your target asset allocation plan.

Because no one can regularly predict how investments will perform in the future, dividing your money among the different types of assets is a way to help reduce risk. And as has been proven again over the past few years, diversifying your investments can also smooth out your portfolio's ups and downs. That's because gains from one type of asset can offset declines in another. A well-diversified portfolio can still decline, of course, but it may be less volatile than a non-diversified portfolio.

Your target investment mix depends on your age, overall financial situation, and tax bracket. Importantly, it also depends on your ability to withstand losses and how much risk you need to take to meet your retirement goals.

✔ ***Review your portfolio.*** Once you've set your target asset allocation, review information about each of your investments, including mutual fund prospectuses, fund and company annual reports, and independent research analysis.

Then with this information at-hand, evaluate how your investments are performing by comparing returns to their appropriate benchmarks. For example, measure how U.S. large-company stock mutual funds are performing compared to similar type funds and the Standard & Poor's 500 Index, and compare U.S. small-stock mutual funds to funds in the same class and the Russell 2000 Index.

✔ ***Brace for down years.*** According to Crandall, Pierce & Company, there have been 21 corrections and nine bear markets since 1945, as measured by the Standard & Poor's 500 Index of large-company stocks.

Corrections, defined as a decline of between 10% and 20%, ranged from -10% to -19.92% and lasted from about two weeks to about a year

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and a half. Bear markets, defined as a decline of at least 20%, ranged from -21.63% to -49.15% and lasted from about three months to about three years.

The key to riding out the inevitable ups and downs: Maintain a diversified investment portfolio and focus on the long term. Also keep a reserve of cash for emergencies and major purchases. That way you won't have to dip into your retirement savings and sell your investments at a loss when they're down.

Although history can't predict the future, despite the downturns the market has always recovered. In fact, large-company stocks, as measured by the Standard & Poor's 500 Index, have outperformed all other types of investments since 1930, returning an annual average gain of about 10%.

Plus, time has been a stock investor's ally. In fact, out of the 68 rolling ten-year periods since 1926, there have only been two in which large and small company stock returns have been negative – and these were the years that included the Great Depression.

However, although time has eventually smoothed out the ups and downs over the long haul, returns varied greatly from decade to decade, and there's no guarantee that stocks will outperform in the future. Even if they do, you shouldn't count on the unprecedented double-digit returns of the 1990s.

✓ ***Invest regularly.*** Despite market conditions, start or continue to invest regularly through employer-sponsored retirement plans or mutual fund automatic investment plans. Investing a fixed amount of money at regular intervals, called *dollar-cost averaging*, turns the market's ups and downs to your advantage. That's because your money buys fewer shares when prices are up, and more when they're down.

While this strategy doesn't guarantee profits or protect against losses, over the long run it lowers your average investment cost and increases the potential for higher returns. Plus, regular investing is a disciplined way to avoid trying to time the market.

✓ ***Stay on track.*** Keep informed, but don't be swayed from your long-term investment plan based on market fluctuations or the barrage of conflicting commentaries from market analysts. Furthermore, don't be influenced by the latest trends, and resist the temptation to shift all your money into the winners of the day.

What about trying to sell before another market downturn, and then trying to get back in before an upswing? Or trying to predict market winners by shifting money among different types of investments? Unfortunately, there's no way to regularly predict where the market is headed or how investments will perform in the future.

Plus, one risk of jumping in and out of the market is that you'll miss the rebounds. That's because most of the stock market gains have occurred in short, unpredictable bursts.

✓ ***Maintain your balance.*** Review your portfolio at least once a year and consider rebalancing if your investment mix has strayed from your target mix by 5% or more. That means selling investments that have performed best and are overweighted, and buying investments that have become underweighted.

Granted, it may be counterintuitive to sell your winners and buy the losers. But here's why you probably wish you took this advice a few years ago: In addition to maintaining your target mix, rebalancing your portfolio forces you to buy low and sell high relative to past levels, as well as to lock in your gains.

You can rebalance your portfolio by directing new savings to investments that have become underweighted. Or you can move existing investments around in a tax-sheltered account, such as an IRA, employer-sponsored retirement plan, or annuity. If you reallocate investments in taxable accounts, first consider the tax implications and seek assistance from a tax advisor, if necessary.

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