Russell Investments

Investor

Summer 2017

Staying the course

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Using Risk Tolerance to Make Clear Decisions

Why going too far outside of your comfort zone can be risky for investors

One of the factors to consider when constructing an investment portfolio is how you balance the potential for risk with reward. It's just as important to be aware of how your portfolio is constructed to *not lose* money as it is to be aware of how it *makes* money.

Financial professionals commonly use the term "risk tolerance" to refer to the amount of risk that an investor is comfortable taking. Defining your level of risk tolerance up front, and reviewing it regularly, can help provide better context for your investment choices—especially when market activity makes the future seem uncertain.

Today, for example, there's a fair amount of momentum in the markets. However, recent activity indicates that could change:

- There might not be as much room for growth in the equities market as there has been in recent months. Valuations, or the estimate of a stock's worth, appear stretched—especially compared to historical averages and those of other regions.
- The Fed is increasing interest rates. Historically, this has increased borrowing costs for both consumers and businesses.
- Many investors view the unemployment rate as a key indicator of an economy's overall health. That figure fell slightly when last reported in May, to 4.3%. Markets tend to react to changes in this data.

If you've already designed your portfolio according to your risk tolerance, you're likely prepared to handle potential market swings. If you haven't taken that step, and a potential change in the market is unsettling to you, here are a few moves to consider:

1. **Diversify your portfolio, possibly including** more non-traditional sources of return (keep in mind these may come with additional risks not found in more traditional assets). Look for assets that don't rely on movements in stocks or interest rates to generate returns.
2. **Increase allocations to less volatile assets** such as cash or bonds.
3. **Target your market exposure**, especially in equities, towards segments that are less sensitive to market movements.
4. **Stay invested for the long-term**. The decision to stay with your plan is often better than timing when to sell and buy.

What works best for your portfolio will depend on your needs, lifestyle, and comfort zone, so here's our suggestions for what you should consider before seeking any changes:

› How much **return** are you seeking? How much are you willing to risk to get it?

This will help you better understand how to balance your long-term return goals with your appetite for risk. If you can accept a lot of fluctuation in the value of your investments for potentially higher returns, you'll want to seek out different assets than if you feel anxious when markets begin to fall.

› **How soon** do you want to achieve your investment objectives?

This can help you determine if you should evaluate your investments against a short-term view of the market or a more long-term, holistic view.

It's also important to remember that perhaps the riskiest thing you could do is not invest. That exposes you to the risk of inflation—an erosion of your money's purchasing power due to rising prices of goods and services.

Finding a fit for your portfolio

Only you can determine your investment goals, and exactly how you want to balance risk and return in your portfolio.

Though your investment strategy shouldn't be set in stone—life changes happen, and a regular review is important—your goal should be to select a plan that you're comfortable with. This may help you feel calmer in the midst of market storms. It may even prevent you from making rash decisions that could prevent you from accomplishing your long-term goals.

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