INVESTOR

Back to Investor Basics

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Many people changed their lifestyles during the global pandemic of 2020. As we hunkered down at home for long periods hoping to limit the spread of the virus, many of us turned to activities harkening back to a simpler era: breadmaking, tackling home renovations, pickling, gardening, doing puzzles and board games, and so on.

You could say that, as we kneaded our own dough or dug up our own vegetables, we went back to the basics. Often when times become complicated, or our lives do, going back to the basics can help us see where our priorities lie.

As we emerge in 2021 to a post-pandemic world, it may be time to revisit the basics of investing. For many of us, our priorities may have changed. Our incomes and our work environments may have changed. It's fair to say that surviving a global pandemic is a good time to reassess the basics of building wealth.

Here are the four basic steps as we see them:

1. Spend less than you earn

Previous generations who lived through the Great Depression or other difficult economic periods knew the value of living within their means. While taking on debt for a major purchase such as a house or car or education is often necessary and can pay off in the long run, living with a household budget deficit can make you more vulnerable to changes in your income or the economy in which you live.

As we learned to our chagrin in 2020—you never really know what's around the corner. The value of a financial cushion became painfully evident as lockdowns impacted millions of people's ability to earn an income. Those without a financial cushion were likely to have struggled much more than those with a little give in their budget.

Some actions you can take now:

- Track your spending and categorize your purchases between wants and needs. Some of those wants and needs may have changed recently. You may also want to prioritize your "wants" to get an idea of what is really important to you.
- Pay down your debt. You can do it in one of two ways, whichever works best for you: The "avalanche" method where you pay as much as possible to the highest-interest debt and the minimum amount to the rest, or the "snowball" method where you pay off your smallest debt first, then tackle the rest in order of size.

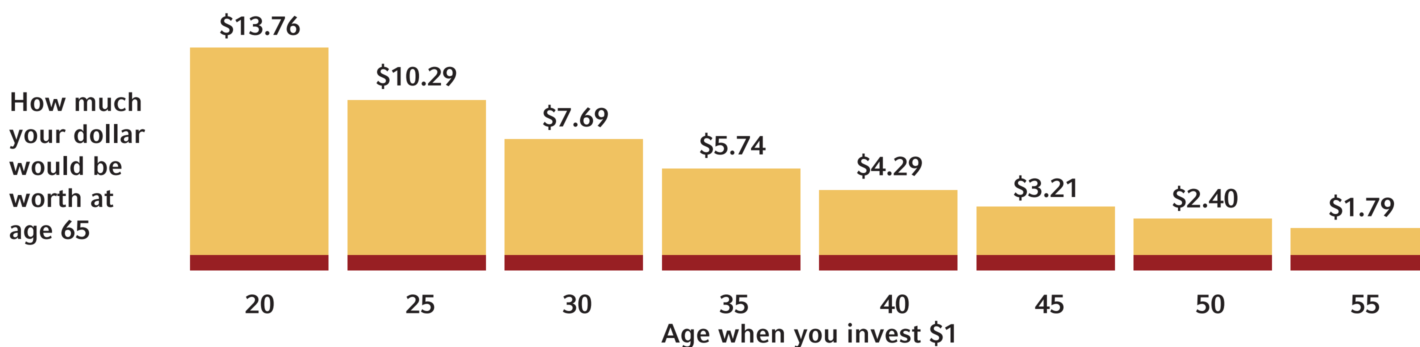
Spending less than you earn has another benefit beyond allowing you to sleep comfortably at night. It allows you to set aside money for the future.

2. Start early and stay invested

"Time is on my side, yes it is," sang the Rolling Stones. And when it comes to investing, time is indeed on your side. The earlier you start, the more time your investments have to grow.

Let's take a look at the following graph:

Start early / Make your retirement savings work hard for you



For illustrative purposes only. Assumes a 6% return.

Of course, it's important to invest your money appropriately, make a plan and follow it, and don't let the vagaries of the market nudge you from your path. Even the early bird investor will jeopardize their nest egg if they move in and out of the market, trade too often, take risks they can't afford, let their emotions rule their investment strategy or buy into the latest trendy investment without proper research and guidance. If you have access, consider participating in an employer-sponsored retirement plan early in your career. It's especially easy if your plan offers auto enrollment.

Getting your foot in the investing door as soon as you can is best, since time is the key ingredient a lot of investments need in order to grow. But staying invested is just as important.

3. Diversify your risk

We all know the aphorism that warns us against putting all our eggs into one basket. We understand the risk that implies if the bearer were to trip coming out of the chicken coop. In the same way, you would not invest all your money in one stock. That's the appeal of a mutual fund—it can diversify your risk among several different stocks or bonds.

But true diversification in investing goes a lot further. It's important to be sure your portfolio doesn't suffer from home-country bias or isn't heavily weighted in one sector just because you know it well. There are numerous options when investing: domestic equities, international equities, emerging markets equities, government bonds, investment grade credit, high yield credit, real assets, liquid alternatives, the list goes on. A well-diversified portfolio should cover different sectors, industries, countries, and investment products. That gives it a better chance to be more sustainable, provide smoother returns, and hedge you against unforeseen changes in the markets. With so many options, it can be daunting how to figure what's best for your investment goals. Many retirement plans offer target date funds that are pre-diversified or managed accounts that help identify appropriate asset allocations. A financial advisor can also help identify what asset classes work best for you and your needs.

Moreover, diversification can keep your money working for you at all times. When one area of the financial markets is doing poorly, another area is likely to be doing well.

4. Know what you are investing for

What is the ultimate use of the money you are saving and investing? Is it to fund your retirement? To buy a home, or help your children get an education? Is it for travel or a specific project, such as a new car or a renovation? Or is it a combination of all the above?

These questions are important because the reason you are investing will determine how long you need to invest for. If you are investing in order to buy a home or send your child to college, your timeline is shorter than if you are investing for your retirement.

Your time horizon is important because different investments behave differently. Risk is higher the shorter the time horizon. If you need your money within a couple of years you may not want to invest all of it in the stock market, which can move sharply in the short-term. A more stable investment, such as a money market fund, could be a better option. The stock market generally requires a long time horizon so your investments can weather the ups and downs and allow the magic of compounding to do its work.

The challenging market environment of 2020 highlighted the benefits of these building blocks of wealth. As we begin a new year that has its own challenges and uncertainties—the speed and efficiency of delivering the newly developed vaccines, the potential return to traditional workplaces, the opportunity to resume travel and other leisure activities—it may be valuable to review these investing basics to start off the Brave New World with a clear path forward.

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