Your *Trust* Matters

March 2021 Newsletter

MidWestOne™ TRUST SERVICES

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"Successful investing is about managing risk, not avoiding it." -Benjamin Graham.

There are several keys to managing risk and each key is an important piece to successful investing. A successful investor maximizes gain and minimizes loss. Though there can be no guarantee that any investment strategy will be successful, and all investing involves risk, including the possible loss of principal, here are three basic principles that may help you invest more successfully.

Endure short-term pain for long-term gain

Riding out market volatility sounds simple, doesn't it? But what if you've invested $10,000 in the stock market and the price of the stock drops like a stone one day? On paper, you've lost a bundle, offsetting the value of compounding you're trying to achieve. It's tough to stand pat.

There's no denying it — the financial marketplace can be volatile. Still, it's important to remember two things. First, the longer you stay with a diversified portfolio of investments, the more likely you are to reduce your risk and improve your opportunities for gain. Though past performance doesn't guarantee future results, the long-term direction of the stock market has historically been up. Take your time horizon into account when establishing your investment game plan. For assets you'll use soon, you may not have the time to wait out the market and should consider investments designed to protect your principal. Conversely, think long-term for goals that are many years away.

Second, during any given period of market or economic turmoil, some asset categories and some individual investments historically have been less volatile than others. Bond price swings, for example, have generally been less dramatic than stock prices. Though diversification alone cannot guarantee a profit or ensure against the possibility of loss, you can minimize your risk somewhat by diversifying your holdings among various classes of assets, as well as different types of assets within each class.

Spread your wealth through asset allocation

Asset allocation is the process by which you spread your dollars over several categories of investments, usually referred to as asset classes. The three most common asset classes are stocks, bonds, and cash or cash alternatives such as money market funds. You'll also see the term "asset classes" used to refer to subcategories, such as aggressive growth stocks, long-term growth stocks, international stocks, government bonds (U.S., state, and local), high-quality corporate bonds, low-quality corporate bonds, and tax-free municipal bonds. A basic asset allocation would likely include at least stocks, bonds (or mutual funds of stocks and bonds), and cash or cash alternatives.

There are two main reasons why asset allocation is important. First, the mix of asset classes you own is a large factor — some say the biggest factor by far — in determining your overall investment portfolio performance. In other words, the basic decision about how to divide your money between stocks, bonds, and cash can be more important than your subsequent choice of specific investments.

Second, by dividing your investment dollars among asset classes that do not respond to the same market forces in the same way at the same time, you can help minimize the effects of market volatility while maximizing your chances of return in the long term. Ideally, if your investments in one class are performing poorly, assets in another class may be doing better. Any gains in the latter can help offset the losses in the former and help minimize their overall impact on your portfolio.

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Buy and hold, don't buy and forget

Unless you plan to rely on luck, your portfolio's long-term success will depend on periodically reviewing it. Maybe economic conditions have changed the prospects for a particular investment or an entire asset class. Also, your circumstances change over time, and your asset allocation will need to reflect those changes. For example, as you get closer to retirement, you might decide to increase your allocation to less volatile investments, or those that can provide a steady stream of income.

Another reason for periodic portfolio review: your various investments will likely appreciate at different rates, which will alter your asset allocation without any action on your part. For example, if you initially decided on an 80 percent to 20 percent mix of stock investments to bond investments, you might find that after several years the total value of your portfolio has become divided 88 percent to 12 percent (conversely, if stocks haven't done well, you might have a 70-30 ratio of stocks to bonds in this hypothetical example). You need to review your portfolio periodically to see if you need to return to your original allocation.

To rebalance your portfolio, you would buy more of the asset class that's lower than desired, possibly using some of the proceeds of the asset class that is now larger than you intended. Or you could retain your existing allocation but shift future investments into an asset class that you want to build up over time. But if you don't review your holdings periodically, you won't know whether a change is needed. Many people choose a specific date each year to do an annual review.

In the end, no investment strategy is fool proof but by following sound investment principles you can give yourself a very good chance of being successful. Setting goals, having patience and following the keys outlined above will help you not only succeed, but be a confident and comfortable investor.