

Riding the Market

Some of the lessons we learned as children have important applications for us as adults. Remember learning to ride a bike? You'd be sailing along – then suddenly hit a bump – and down you'd go without warning. Most of us had similar experiences, and taken over the course of our childhood, they were relatively few and far between. Despite our bruises, we'd get back on that bike. We didn't let one crash – or even several – keep us from the joy we found on the open road. In other words, the benefits outweighed the risks.

What goes up must come down

Investing in the market can be a lot like riding a bicycle. The ups and downs of the market can be as varied as the terrain we traveled as kids. We learned then that “what goes up must come down” – and if as investors we look at the big picture, we'll be better prepared to handle the bumps we're bound to encounter in the market.

Getting a handle on market terminology

To help keep a proper perspective about the market, every investor should be familiar with some widely used market terminology. For instance, what is the difference between the correction and a crash? What is a bear market? How can you anticipate changes in market activity?

A *correction* refers to a drop in the price of a stock, bond, commodity or the overall market, following a rise.

A *bear market* is more drastic, characterized by at least a 20% drop in the value of the market, which lasts for a prolonged period.

Crashes are much less common – though much more severe – and are characterized by an instantaneous plummeting of the value of the market. Two notorious stock market crashes are the Crash of 1929 and the 1987 crash.

Help guard against a fall

Though experts and amateurs alike can watch market trends and speculate, it is impossible to predict what the market will do next. Buy many experts agree that certain strategies, when implemented as part of a long-term investment strategy, can help work for the overall benefit of the investor.

Buy and hold

The “buy and hold” strategy has long been a recommendation of stock analysts and industry experts. This means purchasing a stock and holding onto it, even if the market is pitching and peaking. Although past performance is no indication of future results, historically, stocks have outperformed other types of investments (Ibbotson, December 31, 2004)

Risk targeting

Another prudent strategy is knowing your risk tolerance – and investing accordingly. Equities have a certain level of risk associated with them, because they offer no guarantee of return. Generally, the greater the risk, the greater the potential for return. If you are averse to the prospect of losing some – or all – of your investment in a market downturn, you may want to structure your investment portfolio with few or no high-risk equities. Attractive returns on aggressive or high-risk equities may tempt investors who are otherwise quite conservative. It's important to know an equity's history – and its potential for loss relative to its risk – before investing.

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Diversification

Diversification is the practice of spreading your investments – and thereby your risks – across a number of different types of equities. If one type of investment performs poorly, positive performance in other areas of your portfolio may help offset your losses.

Dollar cost averaging

Dollar cost averaging is an investment concept that can help make the market's ups and downs work for you. By making systematic, continuous investments over time, this strategy allows you to purchase more shares when prices are low, and fewer when they are high. The result is the opportunity to purchase more shares at a lower average price. Keep in mind that continuous or periodic investment plans neither assure a profit nor protect against loss in declining markets. Dollar cost averaging involves continuous investing – regardless of fluctuating price levels – so you should carefully consider your financial ability to continue investing through periods of fluctuating prices.

Charting your course

Your financial professional can give you additional information about investments and investing, and can help you determine an investment strategy that is suited to your needs, goals and personal risk tolerance.

Remember, investing in the market is a lot like riding a bike: If you're comfortable with the path you've chosen and are aware that there will be bumps in the road, it can be a great ride.

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