Taking emotions out of the investment equation

*Sound financial security planning helps balance risk with the need to grow your assets*

Investing involves risk.

But a well-constructed financial security plan contains structural elements specifically designed to address potential risks while focusing on long-term growth. This approach relies on formulas, not emotions.

The foundation for creating a sound financial security plan is determining your risk tolerance. Financial security advisors and investment representatives require you to fill out questionnaires that estimate willingness to accept risk while exploring your financial objectives. The key is finding the right balance – and understanding this process is vital.

Here's a few ideas from Blake Linklater, Freedom 55 Financial and [www.blakelinklater.com](http://www.blakelinklater.com) to help take emotions out of investing.

***Why it is important to start investing at a young age***

Time is a powerful tool in reducing risk and an important reason to start investing early in life. Generally, the younger you are, the more aggressive you can be. As you get older, your portfolio should steadily shift to more conservative investing. This is a mathematical process.

Financial markets, especially stock (or equity) markets, can bounce around from day to day and sometimes they take sharp drops. Historically, markets recover over time, albeit with some short-term volatility.

***The value of mixing it up***

Diversification is a bedrock technique for mitigating risk. Holding many investments and types of investments can help lower the overall impact if a particular investment gets into trouble.

Take stocks: Owning shares in several companies spreads out risk. Moreover, you can offset the stocks of newer companies with those of more established companies. Low-risk investors may be willing to invest in a couple of higher risk technology start-ups with growth potential if the rest of their equity portfolio contains larger, more established companies.

Size is not the only factor. Investing in different industries adds another layer of diversification. If energy companies are facing short-term problems because a warmer winter is causing natural gas prices to fall, companies in other sectors may benefit from the drop. Investing in different countries is another way to diversify your portfolio.

Mutual funds and segregated funds are common solutions for diversification. They contain shares from a large number of publicly traded companies and may specialize in specific industries or countries. Funds available cover the gamut of risk, from high-risk emerging markets growth funds to conservative funds.

***The financial challenges of getting older***

As you age, your investment horizon shortens. At age 25, you have the ability to assume more risk in your portfolio. You can’t rely on time to smooth out bumps once you approach retirement. As a result, your portfolio should gradually become more focused on conserving capital and generating income. That means moving to less aggressive investments and eventually increasing your holdings of fixed income investments and cash.

***Using diversification to your advantage***

Asset allocation is another powerful diversification technique. Financial portfolios are divided into three main categories: equities, fixed income (which includes bonds) and cash. Fixed income investments offer less upside but they are generally more stable; this is especially the case when it comes to government or high-quality corporate bonds. Many people invest in bonds indirectly through mutual funds.

Cash is the third category. Cash or cash-like instruments, such as term deposits, offer limited but guaranteed growth. Individuals with a very low risk tolerance – such as people nearing retirement – may hold a significant amount of their portfolio in cash. Cash also offers a safe way to park money for shorter-term goals, such as saving to buy a house.

***Why it’s important to ignore irrational urges***

Even if you have the best-laid plans in place, investors can find themselves tempted to try something new. Common missteps include:

* Trying to time the market: Professionals can’t know when prices will go up and down and neither can you.
* Selling when an investment falls in value: In actual fact, this could be the time to buy.
* Chasing hot rumours. Best tip ever? Develop a solid financial security plan and stick to it.

***Going on autopilot with the right investment plan***

If your investment portfolio is set up properly, it should almost take care of itself over the long term. Contributions can be transferred automatically and proceeds, such as dividends, are reinvested.

Thoroughly examine your overall investments once or twice a year to make sure asset allocations remain at desired levels. A jump in stock prices can be good for the portfolio but you may find yourself overly invested in equities and needing to move some of the money into more conservative investment options.

Spending time working with a financial security advisor and investment representative to customize – and fully understand – a sound financial security plan allows you to spend less time thinking about money. It’s a big part of enjoying financial independence.

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