Principles of Investing

Back to basics

The past couple of years have seen some sharp changes in fortune for investment markets.

In early 2020, COVID-19 emerged at pace as a pandemic, upending lives, economies and markets around the world in a matter of weeks.

Then, after a period of rapid market recovery, downturn came again as longer-term impacts of the pandemic combined with those of the war in Ukraine set inflation rising around the world.[1]

As an investor, it's perfectly normal to be worried during a market downturn and more challenging economic times. Investing is normally about building a long-term plan designed to achieve your financial goals. So, the right financial plan for you should aim to match your expectations for investment returns, against your risk comfort over the appropriate time horizon to help smooth out these peaks and troughs.

When the going feels tough it may prompt you to revisit the principles of investing.

Getting back to basics

1. Balancing savings and investments

While it's always important to remember what's happened before is no guarantee of what will happen in the future, history has taught us that, over the long run, investments have tended to perform better than savings when it comes to keeping up with rising prices. That's through recessions, depressions, financial crises, world wars and countless other events. However, savings and investments both play an important role and the secret is striking the right balance between them. What that looks like for you will depend on your circumstances, your goals and your timescales.

[1] Investing.com, 30 June 2022

2. It's time in the market that really matters

If you're investing for the long-term, which is considered to be for five years or more, reaching your long-term goal matters most. Agreeing how comfortable you are with investment risk at the outset will help to align your long-term investment solutions and ignore day-to-day fluctuations in the market. Allocating sufficient money for emergencies and short-term goals, will also help avoid emotional reactions to short-term market ups and downs, avoiding 'selling low and buying high' and focusing on your long-term investment goals. Time and again, studies have shown that staying invested throughout is likely to lead to better outcomes. **Though past performance is not a guarantee of future performance, the longer you stay invested, the more likely you are to see positive returns.**

3. Spreading your investments helps manage risk

Different types of investment behave in different ways, at different times. For example, during the sharp COVID-19 downturn of early 2020, as share prices dipped, many bond prices rose.[2] Some sectors fared better than others too. The airline, tourism and travel sectors were among the biggest losers.[2] Pharmaceuticals, logistics firms and online service providers, on the other hand, benefitted.[2]

The point is, if you're holding a mix of investments, perhaps through one or more funds, it increases the likelihood that you're always invested in something that is going up, even when other investments may be doing down. A downturn isn't good news, but in context your investment portfolio may not be as badly affected as you first think.

Remember the risk-return trade-off?

The higher the level of risk you take with your investments, the higher the potential returns if things go your way and the higher the potential losses if they don't. Conversely, the lower the level of risk you take, the lower the potential for both returns and losses.

If you chose an investment fund or funds to match your personal risk-return trade-off, that should be reflected in how your investments are performing now, as at any other time. This is where the expertise of your fund manager can make a positive difference for you, managing the fund to keep it within its risk-return profile in all market conditions.

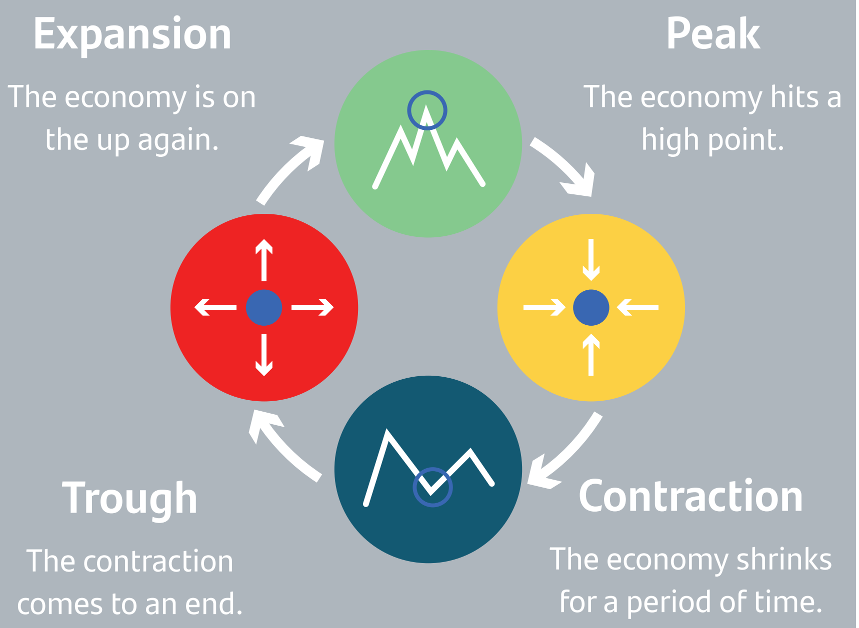
For more on the risk-return trade off you can read our **Risk matters: an introductory guide**.

[2] Refinitiv Datastream, 30 June 2022

4. Downturn is followed by recovery

It's a fact that markets and economies run in cycles. Between 1854 and 2020 there were 34 of them, according to the US National Bureau of Economic Research[3]. That's why ups and downs are an unavoidable part of the investment journey, whatever causes them. It's also why we can be confident that a downturn will be followed by recovery, although we can't tell how low the downturn will go and how quickly and what the shape of a recovery would be.

The four stages of an economic cycle



Shares tend to fall out of favour as the cycle is contracting. Investments like gold, cash and government bonds may become more popular. But shares tend to regain popularity quickly. That's because investors want to buy them at lower prices in hopes of benefitting when the economy expands.

Do I need to take action?

This will always depend on your personal circumstances. For example, if you have savings you've retained for emergency purposes, you can use these to cover short-term needs and they can often be the best place to turn first if you need. Based on the investment principles we've just revisited, the right choice for many people would be to leave your investments as they are - hold tight and stay focused on the longer-term. Recovery and growth will come again.

But it isn't always possible to do this and there are exceptions to every general rule. It is important to review your investments reguarly and if you're at all unsure about what to do you may find it helpful to talk things through with a financial adviser.

Read more

You can find out more about the **Principles of investing** [here](.).

[3] NBER - 19 July 2021.

Let's be clear!

Investment terms explained

Bear: A bear market is often defined as having seen falls of at least 15-20% over at least two months. An investor who is 'bearish' is one who feels pessimistic about the outlook.

Bonds: A bond is a loan issued by a government or a company. When you buy a bond, the issuer promises to pay a certain amount of income until the bond redeems and is repaid by the issuer. The strength of that promise varies by the issuer of the bond. This is known as creditworthiness.

Diversification: Spreading your money across different investments to help manage risk.

Index: A way of tracking the overall performance of a basket of individual investments of a similar type. For example, the FTSE 100 index tracks the performance of shares in the 100 largest companies by market value on the London Stock Exchange.

Portfolio: a group of investments that are managed together to meet a particular objective.

Shares (often referred to as equities or stocks): In investing, this is a share of ownership in a company. Investing in a fund gives exposure to underlying share prices without investors actually owning the shares themselves.