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Rethinking risk

Volatility can be a good reminder to make sure your investment mix makes sense.

Fidelity Viewpoints

Key takeaways

> Market downturns may be a reminder that it's important to regularly review your portfolio and make sure your mix of investments is still appropriate.
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> If it's been a long time since you created your mix of investments or if your situation or feelings about risk have changed, you may want to review or update your plan.
>
> The goal is to have a plan that makes sense regardless of short-term market conditions.

For most people, stock market drops create uncertainty, sometimes even anxiety. It's natural to wonder if you should try to pull out of the market to avoid losses, or if the investments you hold are just too risky for you.

Market timing, trying to buy and sell based on short-term moves in the market, is not the answer. It's almost impossible to know when to sell to avoid a loss or when to re-enter the market after selling. For most people, a better approach is to have a financial plan for your particular goals, stick to that plan regardless of the short-term moves in the market, and periodically review your plan to keep it up to date.

But there are some times when it might make sense to adjust the risk level of your portfolio. Namely, if you have changes in your financial ability (risk capacity) or willingness (risk tolerance) to deal with your portfolio's level of market risk.

"The amount of risk that's appropriate for a person's portfolio isn't set in stone. Your risk tolerance is dynamic and changes over time along with changes in your situation," says Maura Humphreys, vice president of Financial Solutions at Fidelity.

Fidelity thinks you should choose an investment mix that works for your goals, how long you expect to remain invested, your financial situation, and your feelings about risk. But those things can change. Here are 3 situations where it may make sense to take a look at your portfolio and consider reducing your risk.

Feedback

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1. It's been a while since you chose your investment mix

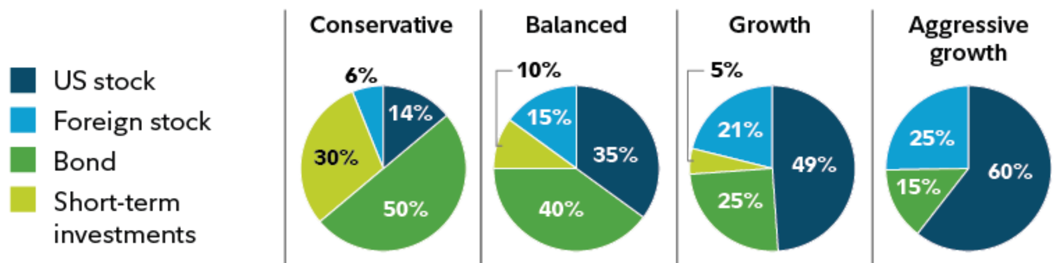
Markets tend to bounce back. Even dramatic selloffs like those during the dot-com bubble, the financial crisis, or the Depression have eventually become downward blips on a long-term uptrend for the US stock market. But in order to ride out those down periods, you need to be able to stay invested. That's why time is such a key part of your risk level.

If you chose an investment mix years ago and the time you can remain invested is shorter, your mix may not make sense anymore. You may also need to rebalance if the relative performance of different types of investments has moved your investment mix away from your plan. That's why a regular portfolio review is an important part of your financial life—in good, bad, or flat markets.

"We think you should look at your investment plan at least once a year," says Michael Christy, vice president of Advanced Planning at Fidelity. "If it's been a year or longer, you should review your strategy and investment mix in light of changes in your life. It may be time to make some changes."

If you are starting to approach your goal, say entering retirement, and will need to draw from your portfolio to cover living expenses, it may make sense to adjust your portfolio to become less risky. For example, you may want to be less invested in stocks and more in high quality bonds, or more cash savings to help cover your expenses without selling securities. See below to see how different investment mixes have performed historically.

Choose an investment mix you are comfortable with



ANNUAL RETURN %	Conservative	Balanced	Growth	Aggressive growth
Average annual return	5.78%	7.80%	8.84%	9.56%
Worst 12-month return	–17.67%	–40.64%	–52.92%	–60.78%
Best 12-month return	31.06%	76.57%	109.55%	136.07%
Worst 20-year return (annualized)	2.92%	3.43%	3.10%	2.66%
Best 20-year retum (annualized)	10.98%	13.84%	15.34%	16.49%
Historical volatility	4.57%	9.60%	13.07%	15.73%

Data source: Fidelity Investments and Morningstar Inc, 2024 (1926-2023). **Past performance is no guarantee of future results.** Returns include the reinvestment of dividends and other earnings. This chart is for illustrative purposes only. It is not possible to invest directly in an index. Time periods for best and worst returns are based on calendar year. For information on the indexes used to construct this table, see Data Source in the footnotes below. The purpose of the target asset mixes is to show how target asset mixes may be created with different risk and return characteristics to help meet an investor's goals. You should choose your own investments based on your particular objectives and situation. Be sure to review your decisions periodically to make sure they are still consistent with your goals.

2. You've had a big change in your life

Everyone faces big changes from time to time. Maybe you adopted a child, or your child moved out and got a job. Maybe you quit your job to start a new business, or spent some of your emergency savings when you needed a new car. Whatever the reason, major financial changes can have a big impact on your financial ability to handle the risks that come with investing.

Why? Well, just like you need time to be able to ride out down periods in the markets, you need the financial ability to leave your money invested. If you lose your job in a recession, you may need to tap into your savings sooner than you expected, and you don't want the mortgage money tied up in stocks. As legendary investor Peter Lynch told *Viewpoints*: "If you need your money in less than 3 years, it shouldn't be in stocks."

So every time you have a major life event, it's worth a check-in with your investment plan. If things have changed for you or your family since you created your strategy, it may be time to take a look and make some adjustments.

3. Your feelings about risk have changed

How you feel about risk also plays a big part in being able to stick with your plan. And your feelings may change over time. For some folks, a 20% drop in the markets seems like no big deal when their goal is still many years away. But when retirement is around the corner or tuition bills start, that same market move may keep them up at night.

It's important to check in on how you feel about risk and how those feelings have changed over time. Of course, most people feel some discomfort during market downturns; that's natural, but most people need some growth potential in their portfolio. That potential may make it worth living with some discomfort and you may not require a change in your plan. But if you can't tolerate the volatility of your portfolio it may be time to turn down the percentage of stocks in your investment mix. That means you might not be as involved in any potential market recoveries down the road, but it should reduce the risk level of your portfolio.

Chart a new path, don't start to wander

For many other people who already have a solid plan in place, simply sticking with the plan might be the right move. For others, taking the time to revisit their plan makes sense, and for some people, reducing the risk in their portfolio may be the right move. But that doesn't mean you should react to every economic report or each time the market goes up or down.

"Volatility can be a good reminder to give your strategy a checkup, but instead of reacting to short-term moves, think of trying to find a new normal," says Christy. "You don't want to sell because the markets hit a rough patch, or buy stocks because the market is going up, but you do want to regularly check in to make sure you have an investment mix that you can live with and will help you achieve your long term financial goals."

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Data Source: Fidelity Investments and Morningstar Inc. Hypothetical value of assets held in untaxed portfolios invested in US stocks, foreign stocks, bonds, or short-term investments. Historical returns and volatility of the stock, bond, and short-term asset classes are based on the historical performance data of various unmanaged indexes from 1926 through the latest year-end data available from Morningstar. Domestic stocks represented by IA SBBI US Large Stock TR USD Ext Jan 1926-Jan 1987, then by Dow Jones US Total Market data starting Feb 1987 to Present. Foreign stocks represented by IA SBBI US Large Stock TR USD Ext Jan 1926–Dec 1969, MSCI EAFE Jan 1970-Nov 2000, then MSCI ACWI Ex USA GR USD Dec 2000 to Present. Bonds represented by US Intermediate-Term Government Bond Index Jan 1926–Dec 1975, then Barclays Aggregate Bond Jan 1976 - Present. Short-term/cash represented by 30-day US Treasury bills beginning in Jan 1926 to Present. Past performance is no guarantee of future results. The purpose of the target asset mixes is to show how target asset mixes may be created with different risk and return characteristics to help meet an investor's goals. You should choose your own investments based on your particular objectives and situation. Be sure to review your decisions periodically to make sure they are still consistent with your goals.

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In general, the bond market is volatile, and fixed income securities carry interest rate risk. (As interest rates rise, bond prices usually fall, and vice versa. This effect is usually more pronounced for longer-term securities). Fixed income securities also carry inflation risk, liquidity risk, call risk and credit and default risks for both issuers and counterparties. Lower-quality fixed income securities involve greater risk of default or price changes due to potential changes in the credit quality of the issuer. Foreign investments involve greater risks than U.S. investments, and can decline significantly in response to adverse issuer, political, regulatory, market, and economic risks. Any fixed-income security sold or redeemed prior to maturity may be subject to loss.

Foreign markets can be more volatile than U.S. markets due to increased risks of adverse issuer, political, market, or economic developments, all of which are magnified in emerging markets. These risks are particularly significant for investments that focus on a single country or region.

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