Five Rules of Long-Term Investing
These best practices can help you stay invested during the market's ups and down

The COVID-19 pandemic helped put an end to the longest bull market in history. The stock market plunged, and many investors were tempted to pull their money out of the market to avoid additional losses. But periods of uncertainty offer a good reminder to investors that investing is a long-term proposition. Your ability to stay calm and stick with your plan during the market's inevitable ups and downs can have a big impact on your investment returns in the long run.

Here are five best practices for long-term investing that can help you stay the course and avoid costly mistakes as you pursue your financial goals.

Understand your risk tolerance

Risk is an inevitable part of investing, and temporary market declines happen often, even outside a global crisis like COVID-19. Your risk tolerance is the amount of market risk—the possibility of experiencing losses—that you are comfortable with.

Your risk tolerance will help guide your *asset allocation*—the mix of stocks, bonds and cash in your portfolio. For example, investors with a higher risk tolerance might hold a greater proportion of stocks, which offers more potential for growth but also are more likely than bonds or cash to lose value. On the other hand, investors with a lower risk tolerance might prefer a greater allocation to bonds, which offer smaller returns, but are less likely to decline in value.

Building an asset allocation that factors in your risk tolerance can make it easier to stick with your plan during more challenging market environments. In turn, you'll be more likely to avoid emotionally driven decisions such as panicking and selling when the market drops.

Embrace diversification

Once you've determined your risk tolerance, diversifying your assets can help reduce the chance that the performance of any particular investment will have an outsized effect on your portfolio. For example, if you hold five stocks and one of them does poorly, your portfolio may take a big hit. But if you hold hundreds of different stocks, bonds and cash investments, you'll be better

protected if one of your assets goes south. Incorporating a mix of stocks, bonds and other assets, can help you mitigate risk and weather the market's ups and down.

Rebalance as needed

Market shifts can have an impact on your asset allocation. For example, your equity allocation may balloon following a stock market rally, exposing you to more risk than you'd planned. Rebalancing your portfolio on a regular basis can help bring your portfolio's asset allocation back in line with your goals and timeline.

You can rebalance by selling those investments that are above your target allocation and investing the proceeds in assets that are below your target. Or you can simply direct new investments to areas that are below your target. You can rebalance periodically—say, every year or once a quarter—or you may choose to rebalance when your asset allocation changes by a predetermined percentage. Your advisor can help you choose the best rebalancing strategy for your situation.

Avoid trying to time the market

It can be tempting to consider pulling money out of the market if you predict a market setback, but doing so can hurt your returns in the long run. Market downturns are notoriously hard to predict, as are market rebounds. Research firm DALBAR says investors' tendency to try and time the market—particularly during market downturns—is a major reason why the average equity fund investor underperformed the S&P 500 during the past 10 years, earning a 9.4% annual return compared to the S&P's 13.6% return.

Remember your goals

Your portfolio was built with your long-term financial goals in mind. Making short-term decisions—such as pulling out of stocks—can disrupt your financial plan and reduce your chance of meeting these goals in your chosen timeframe. When you feel tempted to react to market swings, reminding yourself why you chose your investments and how they will help you reach your goals can help you stay disciplined and focused.

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