

Invest

Improving Long-term Investment Results

In investing, success is never guaranteed. However, avoiding common errors and focusing on the basics can potentially improve long-term investment performance.

Chasing Performance

Even though an investment has had outstanding returns during the past month or year, there's no guarantee that it will continue performing well in the future. Unfortunately, that reality can be difficult to accept. Convinced that an investment's stellar performance will continue, people often buy when prices are near their peak and sell when they are at or near the bottom. Losses that might have been avoided are the unfortunate result.

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A study by the consulting firm DALBAR examined the effect of chasing performance between 1984 and 2003. Investors in stock mutual funds who frequently traded out of funds during that period

earned an average annual return of 3.51%. In contrast, the market (as measured by the S&P 500 Index) earned a 12.98% average annual return during the same period.

Chasing performance has a second drawback. The transaction costs involved in frequent trading also tend to reduce returns.

Overreacting to the News

Another common investing mistake is to let the news or investor “buzz” influence investment decisions. Reports of high earnings, analyst recommendations, and many other influences can quickly push up a stock's price. When a stock's share price is rapidly rising, lots of people want to get on board to share in the gains. But prices can fall again when the news or buzz fades. Most of the run-up in price may already be past by the time some people are reacting. There's no way of telling whether the price will continue to advance.

The announcement of a stock split can make a company's stock seem more attractive. Good media coverage and the



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increased demand that often follow a split can boost the stock. But a stock split doesn't change a company's fundamental value. Once the split is no longer news, the value of the stock continues to reflect the company's earnings, market position, management, and other factors. So basing a buying decision on news of a split without carefully considering the stock's quality can be a mistake.

Focusing on the Basics

If relying on past performance and reacting to investment news aren't reliable strategies for making investment decisions, what can help improve performance? The reality is that tried and true, common sense strategies are more likely to improve an investment portfolio's long-term results than any investing fad.

- **Investing more.** All else being equal, years of compounding can result in a lot of growth. And regular increases in the amount being saved can maximize the long-term benefits of compounding.
- **Investing for growth.** Since low-risk investments generally earn low returns that may barely keep pace with inflation, people who are investing for retirement and other long-term goals generally need to own some investments that have the potential to earn inflation-beating returns over the long term.
- **Tracking performance.** Regularly reviewing investment statements with a financial professional is helpful in determining whether annual returns are high enough to meet investing goals.
- **Focusing on the future.** Instead of reacting to short-term swings in the investment markets, it may be better to hold steady during temporary periods of declining prices. However, it may be appropriate to make adjustments to a portfolio's investments when an investing goal draws closer.

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