Is This The Biggest Investing Mistake You're Making Right Now?

Description

After over a decade of stock price growth, it is perhaps unsurprising that investors are generally feeling bullish. After all, an investment in the majority of stocks in recent years is likely to have led to a sizeable profit.

This, though, could cause investors to become somewhat complacent about the outlook for the world economy. With tariffs set to hurt GDP growth over the next few years and a rising US interest rate having the potential to disrupt the performance of a range of economies across the world, there are clear risks facing investors. Here's why focusing on risk, as well as reward, could be crucial over the next few years.

Uncertain outlook

While the US economy has been growing rapidly during the course of 2018, this could mean that further interest rate rises are ahead. The Federal Reserve may seek to try and cool the economy's growth rate, while also dampen fears of higher inflation. In doing so, however, there is a risk that it will cause a slowdown in growth. A higher interest rate may impact negatively on US consumers and businesses, as well as on the wider world economy.

Tariffs placed on imports by countries such as the US and China may cause a slowdown in world GDP growth over the next few years. There is, of course, the potential for further tariffs, and this could lead to investor sentiment becoming weaker over the medium term. Given the difficulty in predicting whether new tariffs will be put in place, investors may seek wider margins of safety in the coming months, which could hurt the prospects for stock markets such as the S&P 500 and FTSE 100.

Risk/reward

While many investors may feel that the stock market is strong enough to overcome the risks it faces after a 10-year bull run, the reality is that a degree of caution may be beneficial over the next few years. Certainly, global growth could remain resilient, but a number of cyclical stocks may now be overvalued. Their prices may include an assumption that global growth will remain robust, which may prove to not be the case.

Defensive stocks, on the other hand, may now offer more compelling risk/reward opportunities. They have been relatively unpopular in recent years due in part to their lower growth rates versus cyclicals. But with low valuations, more dependable business models and higher dividend yields in some cases, they could offer an impressive long-term investment outlook. While potentially less exciting than cyclicals, they may be able to generate higher total returns if the stock market experiences a more challenging period.

Takeaway

While global stock markets have experienced a stunning rise in the last decade, there are risks facing their future prospects. As such, investors should be wary of becoming complacent after past successes, with defensive stocks having the potential to deliver improved performance versus cyclicals over the medium term.

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