The Number 1 Retirement Mistake You Could be Making Today

Description

Although taking too much risk can lead to disappointing investment returns, so too can adopting an overly cautious strategy.

For many people who are building a portfolio that will one day provide them with a passive income in retirement, focusing on riskier assets such as stocks could be a better idea than holding cash or bonds.

In the long run, the stock market could provide significantly higher returns than other mainstream assets. For investors with a long-term time horizon, they are likely to have sufficient time to recover from the volatility which global stock markets exhibit.

As such, taking greater risks through buying stocks could be a sound strategy that improves your retirement prospects.

Return potential

With interest rates currently being low relative to their historic levels, the return differential between stocks and other assets such as cash and bonds is relatively wide. However, even over the course of a period of decades, stocks are likely to significantly outperform other mainstream assets.

Stocks have a solid track record of offering returns that are substantially higher than inflation, with an investor that purchases a range of companies potentially generating a high-single digit annual return. When compounded over a lifetime of buying stocks at regular intervals, this can lead to a surprisingly large nest egg.

Possible risks

As mentioned, investing in stocks carries greater risks in the short run than holding cash or other assets such as bonds. In the case of cash, no capital loss will be recorded. And, even though bonds are not always repaid, investment-grade issues are generally considered to be significantly less volatile than the stock market.

However, investing in lower-risk assets over the long run presents its own challenges for investors. Namely, they may struggle to obtain an inflation-beating return – especially with interest rates being low and monetary policy having the potential to remain accommodative over the coming years.

This may mean that while cash and bonds do not deliver capital losses, investments in them fall in value in real terms. This could produce a nest egg that ultimately provides an income which is insufficient for a retiree to live off, with the spending power of their portfolio having fallen during their lifetime.

Risk/reward

Clearly, taking more risk than an investor feels comfortable with is never a worthwhile idea. But it could be logical to consider the length of time you have until retirement, and ensure that your investments provide the opportunity to produce a portfolio valuation that delivers a generous passive income in older age.

Otherwise, while you may fail to lose money in the short run, your financial outlook in the long run could be relatively disappointing. Therefore, ensuring that the risk/reward profile of your investments matches your own time horizon could improve your retirement prospects.

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