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Setting Investment Goals

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Setting goals is a very important part of life in general and in financial planning in particular. Before you actually invest your money, you should spend some time considering and setting your personal financial goals. For example, do you want to retire early? Would you like to start your own business soon? Do you need to pay for your children's college education? Would you like to buy or build a new house? In addition to these, there are several other questions you should consider to help you and your financial advisor develop an appropriate financial plan. First, what is your time horizon for your goals? Second, what is your investment risk tolerance? Third, what are your liquidity needs? Finally, what are the most appropriate investments to achieve your goals?

Time horizon

Probably the first question you should ask in setting your investment goals is: What is my time horizon? In other words, when will you need the money? Are you investing for your young child's college education, or for your retirement 30 years in the future? Or are your goals nearer, such as buying a house in 3 years, or starting your own business in 5 years? Your time horizon will have a significant impact on the type of investments you should make.

The general rule is: The longer your time horizon, the more risky (and potentially more lucrative) investments you can make. Many financial advisors believe that with a longer time horizon, you can ride out fluctuations in your investments for the potential of greater long-term returns. If that's true for you, you might be able to allot a greater portion of your portfolio in investments such as common stock or real estate. On the other hand, if your time horizon is very short, you may want to concentrate your investments in less risky vehicles, because you may not have enough time to recoup any losses you might experience.

Risk tolerance

Another question you should consider is: What is my investment risk tolerance? How do you feel about the potential of losing your hard-earned money? Many investors would forgo the possibility of a large gain if they knew there was also the possibility of a large loss (these investors are known as risk averse). This type of investor should concentrate on less risky investments, such as Treasury bills, money market accounts, high-quality bonds with short maturities, and other similar investments.

Other investors, so-called risk seekers, are more willing to take the chance of a large loss if there were also the possibility of a large gain. Such investors often focus on common stock, real estate, or other higher-yielding investments.

It is not always easy to determine if you are risk averse or a risk seeker. Before making any investment, each investor should think about how he or she feels about losing money. Keep in mind that, as noted above, your time horizon can affect your risk tolerance. For example, if investing for retirement 30 years down the road, you may be more willing to take chances than if you're saving to send your child to college in 4 years.

Liquidity needs

Another question you should ask when setting your investment goals is: What are my liquidity needs? Liquidity refers to how quickly an investment can be converted into cash (or the equivalent of cash). Real estate, for example, tends not to be very liquid; it can take a very long time to sell either residential or commercial real estate. Publicly traded stock, on the other hand, tends to be relatively liquid, though you might suffer a loss if you need to sell when the market is down. Cash and cash alternatives such as money market accounts are extremely liquid (though even here, some types of cash alternatives may be more liquid than others).

Your liquidity needs will affect the type of investments you might choose to meet your goals. For example, if you don't have short-term liquidity needs, you can probably afford to invest in less liquid investments where the

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potential for gain is much higher than for more liquid investments. However, if you have two children going to college in the next couple of years, you probably don't want all of their tuition money invested in less liquid assets. Like your risk tolerance, your liquidity needs are also related to your time horizon.

Matching investments to goals

Once you have determined your time horizon, risk tolerance, and liquidity needs, the final step is to match your goals with various investment options. Investment options now available to individual investors range from those generally considered relatively safe, such as Treasury bills and money market mutual funds, to the very risky, such as commodities futures, venture capital deals, and real estate. There are literally thousands of different investment vehicles. Just remember this: In general, the safer the investment (i.e., the less risk of loss), the less potential for future gain. And on the flip side, the riskier the investment, the greater potential for gain (but also the greater potential for loss).

> **Caution:** An investment in a money market mutual fund is not insured or guaranteed by the FDIC or any other government agency. Although money market mutual funds attempt to preserve the value of your investment at $1 per share, it is possible to lose money investing in one.

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