5 steps to successful investing

For investors, what does it mean by having sufficient preparation?

HSBC

Introduction

As the saying goes, opportunities are reserved for the prepared. For investors, what does it mean by having sufficient preparation? The following five steps should help you identify your needs, decide the most suitable asset allocation, and lead you toward your financial goals step by step.

Step 1: Assess your risk tolerance

Conservative? Balanced? Aggressive? Which approach suits you?

Making the first step right is crucial to the long road of investments. Of the five steps, the first is to assess your risk tolerance and decide the most suitable asset allocation for yourself.

Different people have different attitudes towards investment. Some are not willing to take any risks or withstand losses, and therefore would rather forgo potentially higher returns. Some are willing to take some risks but tend to avoid huge volatility. Some are willing to take risks in exchange for returns that outperform the markets.

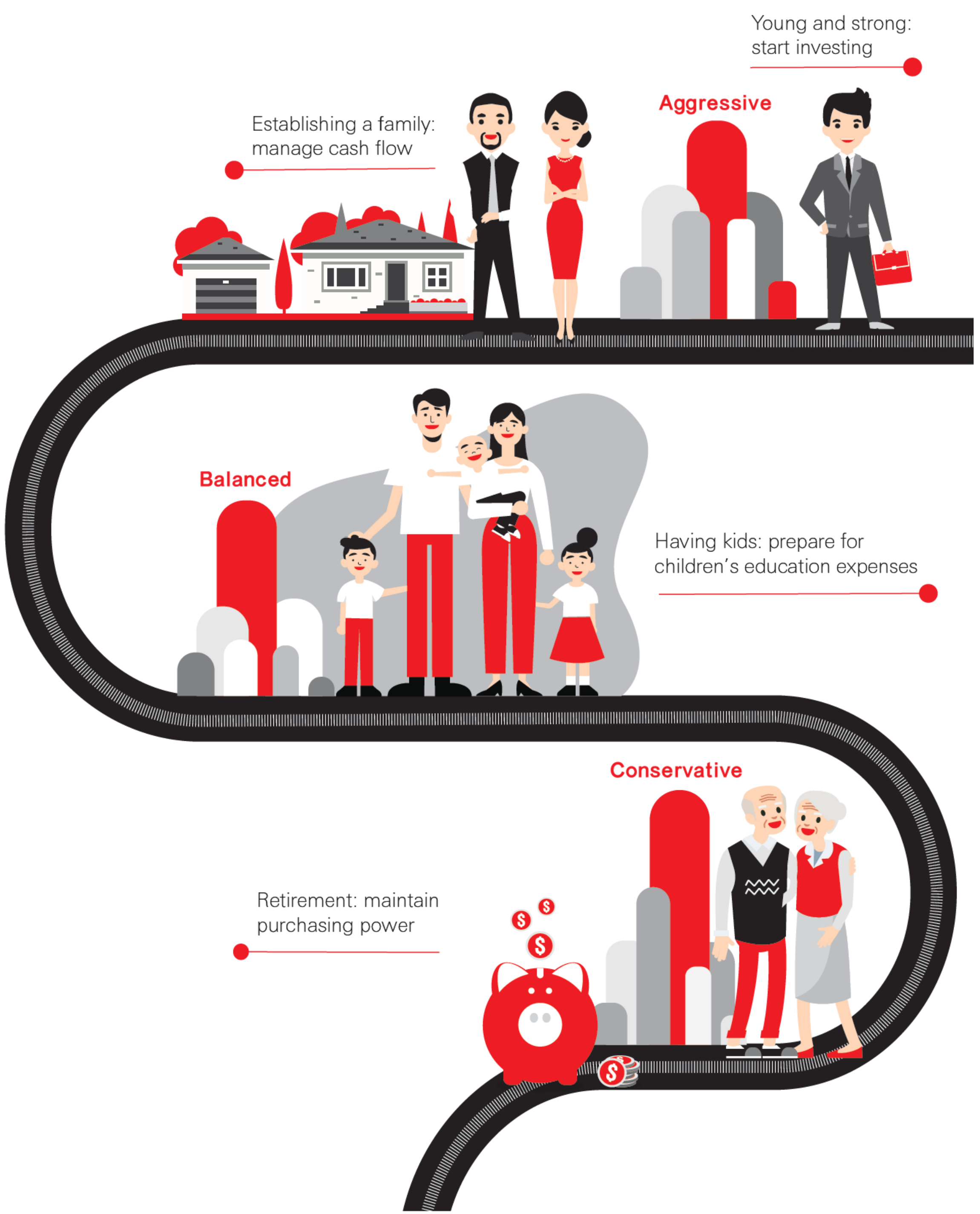
How to gauge one's risk tolerance? Look at your investment horizon. Put it simply, the longer your investment life, the higher the risk you can take because you can afford the time to last a cycle, which helps smooth out short-term volatility. For instance, a young person just starts working, who is still far from retirement, can take more risk.

On the contrary, the shorter the investment period, the lower the risk one can take. Assuming you are going to retire next year, and not receiving any regular income, you just do not have the time to recover all losses if your investments take a nosedive all of a sudden.

Besides, your risk tolerance is dependent on your life goals. Ask yourself if you need to set aside funds for your children's education? Are you going to buy a property in the near future? These factors will have an impact on your cash flow. After all, we all need to reserve some cash at all times just in case there are emergencies.

source: HSBC Global Asset Management (HK) Ltd.

The winding path of making investments



Step 2: Diversify your investment

Balancing risk and return is the key to long-term investment

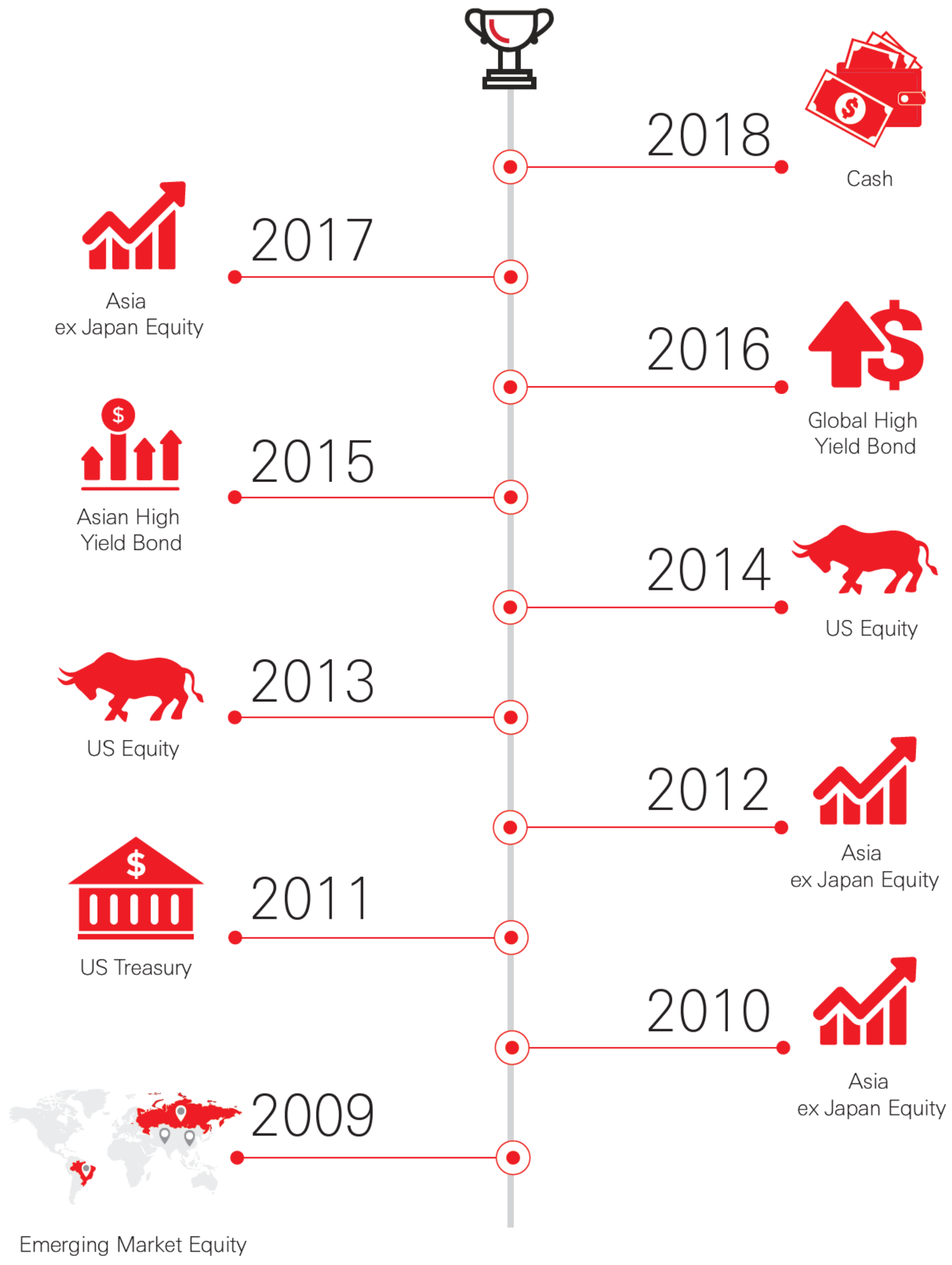
Isn’t it perfect to have an investment tool that always tops the performance league, and investors can stay worry-free just by holding it? The truth is that there are ups and downs in all economic cycles and the markets are capricious. Even investment experts find it hard to predict the performances of all asset classes.

Based on historical data, the same asset can perform drastically differently during different investment cycles. The best-performing asset in 2017 can turn out to be the worst laggard in 2018. That suggests no particular asset can be an all-time winner.

Investors should therefore avoid putting all eggs in one basket but allocate assets across different sectors and geographies. That could help diversify the risk of an investment portfolio, and capture investment opportunities at different times for more stable returns in the medium- to long-term.

To make diversification works, an investment portfolio should include assets that are complementary, that tend to react differently to the same macro condition. More precisely, some negative elements in the market might cause an asset to decline sharply, but pose little threats to another. In the world of investment, such pairs are called lowly-correlated assets. They can effectively balance the risk and return of an investment portfolio.

No particular asset can be an all-time winner*



*Source: Morningstar, HSBC Global Asset Management, data as at 31 December 2018. All returns in USD, total return. For illustrative purpose only and does not constitute investment advice. Asset classes used for comparison: Cash (ICE LIBOR 3 Month USD), US Treasury (BBgBarc US Treasury TR USD), Global Government Bond (FTSE WGBI USD), Global Investment Grade Bond (ICE BofAML Global Corporate TR USD), Global High Yield Bond (ICE BofAML Gbl HY TR USD), Emerging Market Hard Currency Bond (JPM EMBI Global TR USD), Emerging Market Local Currency Bond (JPM GBI-EM Diversified Composite TR USD), Asian Bond (ICE BofAML Asian Dollar TR USD), Asian High Yield Bond (ICE BofAML Asian Dollar HY TR USD), Global Equity– Developed Markets (MSCI World GR USD), US Equity (S&P 500 TR USD), European Equity (MSCI AC Europe GR USD), Global Emerging Market Equity (MSCI EM GR USD), Asia ex Japan Equity (MSCI AC Asia Ex Japan GR USD), Commodity (TReuters/CoreCommodity CRB TR USD)

source: HSBC Global Asset Management (HK) Ltd.

Step 3: Have a plan for asset allocation

Hit your investment targets with the right approach

Once you have identified your investment targets, you can put your cash into different asset classes and construct a portfolio based on your risk tolerance. The idea of asset allocation is to include equities, bonds and other investment tools in a basket. Since different investment vehicles come with different risk-return profiles, asset allocation is never easy.

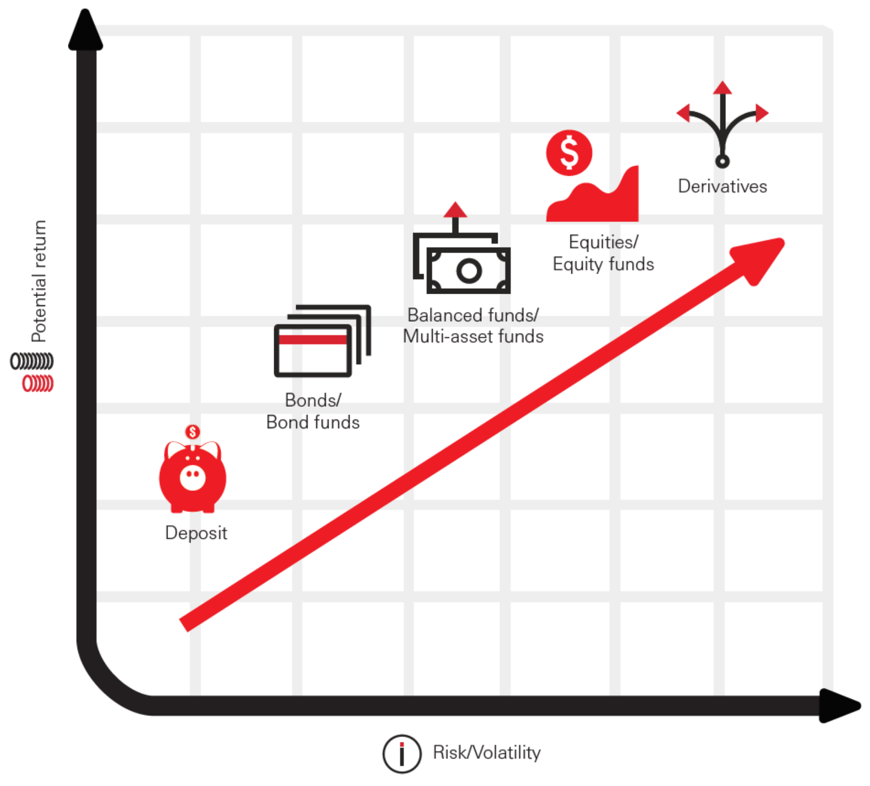
Generally, the higher the potential return of an asset class, the higher the risks it carries.

Asset class	Potential risk	General characteristics
Equities	High	Relatively high return, depending on economic cycles
Bonds	Medium to low	Relatively low return and low volatility compared to equities; tend to pay interests regularly and generate fixed income
Cash	Low	Return on savings is dependent on deposit rates, which might not be able to catch up with inflation

Investors who are willing to take risks tend to see their investment portfolios heavier in equities, while those wishing to avoid huge volatility tend to take a more balanced approach. For conservative investors, bond fund is a good option because of its relatively lower risks.

source: HSBC Global Asset Management (HK) Ltd.

Look for the best mix



Risk tolerance is a function of investment objectives

Step 4: Assess investment performance

Investments need health check too

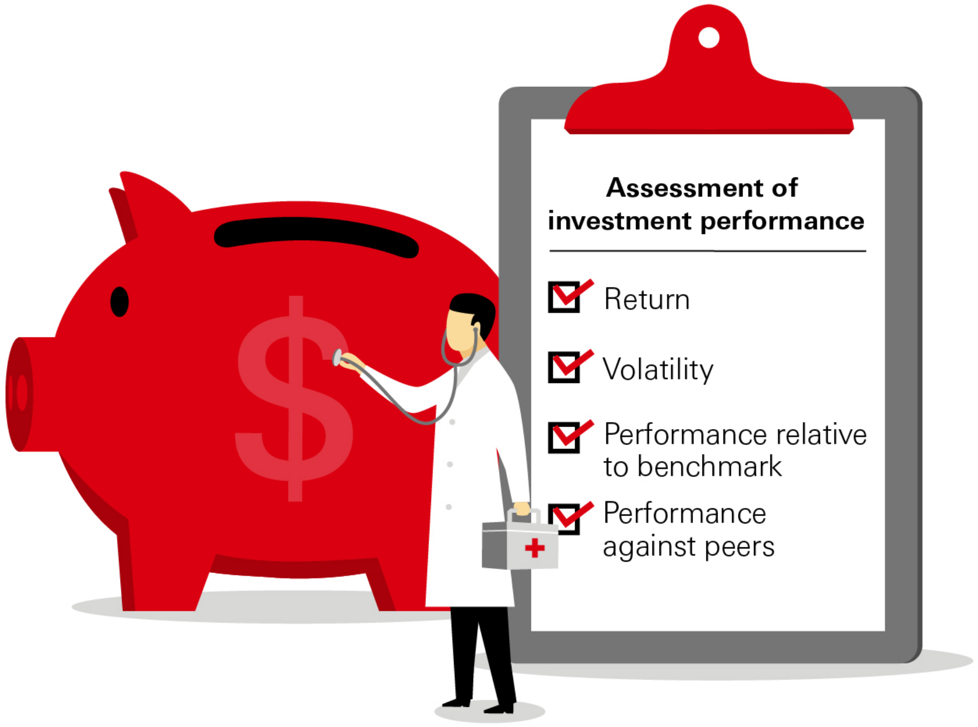
Generally, a well calibrated investment portfolio can help investors reach his or her risk-adjusted investment goals progressively. But market changes with time. Macroeconomic situations and financial events can profoundly affect the market. The fundamentals of each and every industry will also change, bringing varying impacts on different asset classes within a portfolio.

For instance, central banks from around the world adjust their monetary policies from time to time. The change in interest rate trajectory will affect the prices of equity, bonds, foreign exchange, as well as real estate to varying degrees. When economic environment and market condition change, those expected to perform handsomely might turn out to become laggards, and vice versa.

Over time it is therefore very important to assess the performance of your portfolio against your investment goals regularly. If one is investing though professionally managed funds, one should pay attention not only to its return alone, but also how it fares against its benchmark and peers.

Just like body checks – only through regular assessments can the wellbeing of a portfolio be known and whether it is on track to meet expectations.

Examine your portfolio regularly



source: HSBC Global Asset Management (HK) Ltd.

Step 5: Rebalance your investment portfolio

Don't forget to always maintain the allocated weightings of your assets

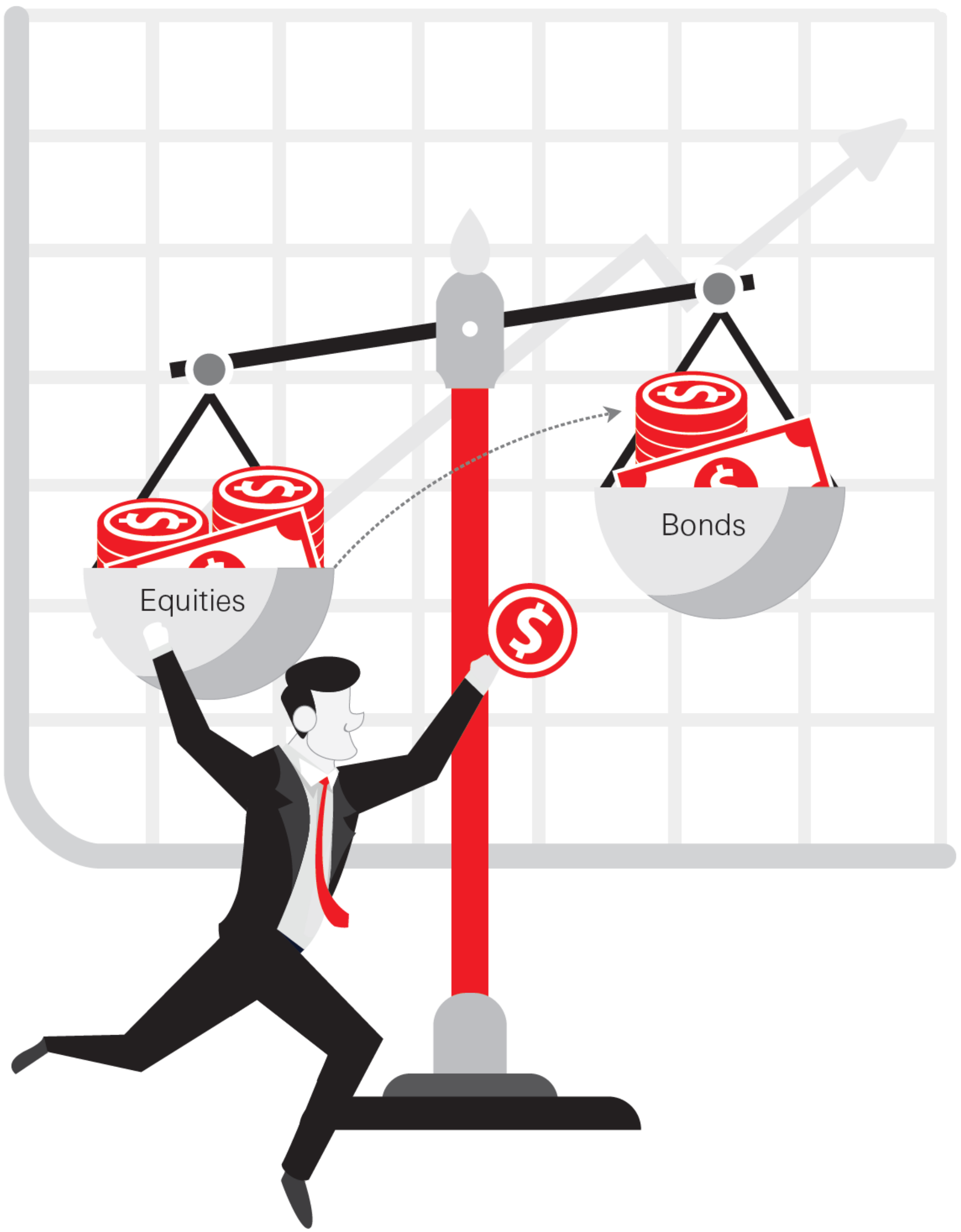
A lot of people understand the importance of asset allocation. Yet many fail to maintain their allocations persistently, and therefore unable to realise their long-term goals.

The proportions of different assets within a portfolio change over time as their prices tend to move in line with market vagaries. For instance, during market bull run, the prices of equities will naturally rise while those for other asset classes might stay stable or even drop. That will tilt the weighting of the portfolio towards equities, increase its associated risks, and cause deviations from the original investment strategy.

If no adjustments being made, the balance between different assets will be upset. That will undercut the ability of a portfolio to meet its long-term objectives.

The key to long-term investment is therefore to rebalance the portfolio regularly. Such process involves selling assets that have realised gains (or a certain percentage of the portfolio) and buying undervalued assets. Only through making adjustments regularly can the risk levels and investment goals of a portfolio be aligned for wealth accumulation.

Rebalance your portfolio



source: HSBC Global Asset Management (HK) Ltd.

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