Best plans meet goals, timeframe, risk tolerance

Q: I want to create a good investment plan and I'm hearing conflicting advice. Should I try to select individual stocks or create a portfolio of actively managed mutual funds? I've read that index funds are good. What's the better way to invest for the long term?

A: The best investment plan meets the goals, timeframe, and risk tolerance of the individual. An investment plan is only good if it's followed – through good market returns and bad.

Stock pickers attempt to identify stocks that are mispriced. Forecasting is an effort to select undervalued securities and time the market. This strategy often generates higher expenses, excess trading costs and potentially a concentrated stock position that increases risk.

Globally balanced mutual funds provide shareholders with lower risk through greater diversification. Fees and taxes may be higher with actively managed mutual funds because of frequent trading.

Index funds attempt to closely follow different stock indices. The S&P 500 is a 'national' index of America's 500 largest companies listed on the stock exchange. The Dow Jones Industrial Average is composed of only 30 (blue chip) stocks, yet it's the most widely quoted. Determining the appropriate index is a topic of great debate for investors and getting the returns of the indices is challenging because investors pay fees and taxes.

The terms "benchmark" and "index" are often used interchangeably, but they describe different things.

A stock index is a statistical tool designed to measure a specific section of the stock market.

The benchmark is a combination of different indices created to resemble the portfolio. It provides a standard to measure investment performance. We all need a reference point or my photo might trick you into thinking that my fish is the biggest.

As our favorite investment experts have articulated recently in the press, index funds are a good choice. By coming close to matching index performance, investors are rewarded with the returns of the capital markets. For instance, the S&P 500 has returned an average of about 5% annually for the last decade. Certainly not every year, but an average over the last ten years. There are good years and bad years and investors are rewarded for sticking with their plan.

Consider focusing on your personal goals. Living a purpose driven life is usually more fulfilling than dying with the most money. Unless, of course, that's your goal!

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