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Investments take a beating in 2022? Review your long-term strategy before making changes

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You could review performance data about investment markets to evaluate the difficult year that stocks and bonds had in 2022. The recent statistics, however, might not be as useful to you going forward as a deeper understanding of risk and returns over time.

The statistical measures might show you that your investment portfolio declined meaningfully. The broad U.S. bond market index had its worst calendar-year return (-13 percent) since its creation in 1976. The total U.S. stock market had a relatively more common, but equally unsettling, decline of almost 20 percent in 2022. International stock and bond returns also were negative.

Keep in mind, however, that just because account balances are generally lower to start 2023 than they were to start 2022, doesn't mean that your strategy was wrong, or is ill-suited to bounce back. Results over any short period are essentially incomplete. The turning of the calendar did not indicate a finish line to measure success or failure. Those incomplete results can't tell you whether your investment rationale was right or wrong. They just present one outcome out of many possible outcomes that could have happened or will happen in the future. Sometimes, short-term outcomes skew in your favor. Sometimes they don't. Over time, a disciplined process and thoughtful investment approach should win out.

During difficult years and years with robust returns, you should review not just the absolute return of each investment, but how your investment selections have performed compared to relevant index benchmarks or category peers. You should also evaluate your investments for the level of risk they take compared to alternative options.

A relevant evaluation of risk and returns for individual stocks requires understanding many factors. Mutual funds and exchange-traded funds, though, have a relatively informative, simple data point that can be found at Morningstar.com. Enter the ticker/trading symbol for any fund in the search box to reach its profile page then choose the risk tab in the navigation.

In this area, you can see how Morningstar identifies the level of risk and return compared to the fund's category. Morningstar uses a five-level scale from low to below average, average, above average and high. An index fund covering a broad market segment should be average for both the risk and return measures since it is largely representative of the whole category. A more optimal blend of risk and return might be found with funds that have lower risk vs. category ratings and higher return vs. category ratings.

It's possible for a fund to be attractive if it has high risk and high return because the return might well be compensating for the extra risk. What you would prefer not to see in the funds you own are risk ratings that are higher than return ratings. If your fund is above average in the risk rating and below average in the return rating, it is not compensating you well for the level of risk it is taking. These are the types of funds that should be considered for replacement.

Morningstar requires a fund to have at least a three-year performance record before it assigns these ratings. There is even a very small percentage of funds that have the optimal mix of the lowest risk rating and the highest return rating. There is no guarantee that the risk/return profile remains as optimal going forward. Also, be aware that the ratings are category-relative. For instance, Fuller & Thaler Behavior Small Cap Fund (FTHSX) has a low risk rating and high return rating compared to the 364 other funds in the small-cap blend category. But this stock fund would have much higher risk than most bond funds.

Taking a little time to review your investments in this way might confirm they are on the right track despite the negative returns of 2022 or can help you understand where better alternatives might be available. While it is important to review your investments periodically to ensure ongoing fit, it might be fine not to make changes unless your personal circumstances have evolved or you can find a clearly superior option to add to your portfolio.

Trying to determine future prospects from past performance is difficult. Confidence in investment decision-making is often a challenge because we never know enough to be sure that one course of action will be more prosperous than another.

What is clear is that the least effective approach is to turn short-term setbacks into long-term trouble by stopping your contributions to investment accounts or repeatedly changing strategies as your optimism or pessimism swings, usually based on factors that might be out of your control and possibly of little influence on your long-term financial security.

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