Seeking Alpha

Long Term Investment: Definition, Types, & Strategies

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Long-term investing is when an investor plans to purchase and then hold investments for a longer period of time, usually 5-10 years or more. Learn more about long-term investing and the types of strategies most applicable for those with long-term investment horizons.

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What Is A Long-Term Investment?

A position that an investor enters into with an expected holding period of 5-10 years, or even longer, is usually deemed a long-term investment. Because long-term investors have the time horizon to wait out short-term price fluctuations, they are typically willing to accept more volatility and risk in the hopes of realizing higher investment returns over time.

> **Note:** *A long-term investment goal doesn't mean the investor should stay in higher risk investments for the whole duration of the holding period. People approaching retirement age typically reduce their portfolio risk gradually as their work career is nearing an end.*

What Is A Short-Term Investment?

When investors are trying to capitalize on what they view as pricing distortions and/or near-term upside potential, they may pursue investments with a shorter time horizon. There's no universal definition of what qualifies as a short-term investment, and some individuals will enter trades for periods of less than a year, several weeks, or even just one day.

> **Note:** *Long-term investments and short-term investments can make part of the same portfolio. There's no need to individuals to select only long-term positions or only short-term positions. If in doubt about your portfolio strategy, consider speaking to a financial advisor.*

Benefits of Long-Term Investing

Long-term investing has multiple benefits, including cost savings, compounding of returns, and tax advantages for U.S. Citizens.

The benefits of long-term investing are:

> **Cost savings:** Infrequent trading with a buy-and-hold investment strategy helps to reduce commissions and other trading costs.
>
> **Tax advantages:** In the United States, long-term capital gains are taxed at a preferential rate as compared to short-term capital gains. Also, retirement account such as individual retirement accounts (IRAs) and 401k plans are tax-deferred, which allows for greater growth over time.
>
> **Compounding:** Long-term investors can benefit from compounding by holding on to investments for longer and reinvesting dividends and interest.
>
> **Risk/return benefits:** Investing slowly over time with a dollar-cost averaging approach helps to smooth out the ups and downs of short-term volatility.

Types Of Long-Term Investments

Common long-term investments are stocks, bonds, mutual funds, ETFs, and real estate. Each investment type has a unique risk/reward profile that investors need to understand before investing.

1. Stocks

Stocks are equity securities that represent ownership in a company. Shares of stock give the investor or shareholder a claim on the company's earnings as well as certain rights such as voting on the future of the company.

> ***Note:*** *The average historical stock market return is about 10%; however, long-term investors should expect regular market corrections of 5% to 10%, and occasional bear markets, (a decline of 20% or more).*

2. Bonds

Bonds are fixed-income securities that represent a loan from an investor to a company or government agency. Since bonds pay a fixed amount of interest quarterly or semi-annually, they may be used as income investments. Bonds tend to be much more stable than stocks, especially for investment grade companies. Also, since bonds and stocks often have low or negative correlation, bonds can contribute diversification benefits to a portfolio.

3. Mutual Funds

Mutual funds are managed portfolios that typically hold dozens or hundreds of securities, such as stocks, bonds, or a combination of assets. Therefore, mutual funds can make it easier for an investor to gain diversified exposure to a broad market segment, helping to reduce risk while also reducing the inclination to switch investments into other securities.

> ***Note:*** *Mutual funds can be actively managed or passively managed. For example, an active approach involves an attempt to outperform an index, such as the S&P 500, whereas a passive approach attempts to match the returns of an index, less fees.*

4. Exchange-Traded Funds

Exchange-traded funds (ETFs) are investment securities that combine some of the attributes of stocks and mutual funds. Like stocks, ETFs trade intra-day on an exchange. Like passively managed mutual funds, many ETFs seek to track the performance of a benchmark index.

5. Real Estate

Real estate investments are historically long-term investments by default. Few people are going to buy a property today and sell it later that same year. Real estate investments include residential property, commercial property, and/or land.

Some investors prefer real estate investment trusts (REITs), which own or operate real estate property to generate income for the owners, partners, or shareholders. Since it is easier to enter and exit REITs, and to do so without incurring large commissions, some investors hold REITs for shorter time periods than they would for individual properties.

> ***Tip:*** *REITs are generally considered income investments and are required to pay out 90% of the trust's taxable income as dividends to shareholders.*

Long-Term Investing Strategies

Long-term investing strategies generally incorporate a buy-and-hold approach but may include a range of related strategies or styles, such as passive or active investing, as well as growth or value investing.

1. Buy & Hold

As the name implies, the buy-and-hold investing strategy involves buying investments and holding them for a long period of time, regardless of short-term market fluctuations. The most popular and generally the most recommended strategy for long-term investors, buy-and-hold typically seeks to achieve long-term growth of capital.

2. Growth Investing

Growth investing is a strategy that seeks capital appreciation and, through growth stocks, invests in companies that are less mature and seeing large-scale expansion of their business and revenues. Growth stocks are anticipated to grow faster than the market average. Growth investing can be appropriate for investors with a long-term mindset who see long-term value in companies that may not be delivering significant profits today. Growth stocks also trade with more volatility, making short-term investing a somewhat risky venture.

3. Active Investing

Active investing involves taking a hands-on approach including investment research, security analysis, and the timing of trades. Fund managers who actively manage will see their portfolio either outperform or underperform market indices like the S&P 500 (SP500) annually. The active management style or selections of a fund manager, or an individual investor, are likely to deliver underperformance in some years. Therefore, short investment time horizons tend to be less ideal for active management. A longer-term horizon allows the investor to wait out the years where the approach doesn't outperform.

4. Dollar Cost Averaging

Dollar-cost averaging (DCA) is an investment strategy whereby an investor makes multiple purchases of an investment over regular intervals, and possibly at lower prices when the short-term future of a certain investment looks bleak. Dollar-cost averaging makes more sense for those with a longer-term perspective, as it allows sufficient time for an underperforming security/company to rebound.

> ***Tip:*** *Dollar-cost averaging can be achieved via the setup of an automated investment program, or manually through an investor's judgment of when to make follow-up investments.*

5. Dividend Investing

Dividend investing is a strategy of buying stocks that pay dividends, equipping investors with the power of compound returns to create income from investments on top of price appreciation. Long-term investors may choose to reinvest dividends, which will go to buy more shares of stock, enhancing the compounding effect.

Bottom Line

A long-term investment is a security or asset typically held for a long period of time, 5-10 years or more. Long-term investing strategies often incorporate a buy-and-hold approach and focus primarily on achieving favorable rates of return over the holding period, while generally ignoring short-term market fluctuations.

As an investor's financial goal approaches, they may choose to invest in assets that are lower in risk to achieve more stable returns. For example, a 40-year-old saving for retirement may heavily weight their portfolio allocation toward stocks, but reduce exposure to riskier assets when they are within 10 years of their retirement goal.

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