Time Horizon & Risk Tolerance

Matching the Plan to You — Lesson Explainer

The Concept

Time horizon is how long until you need the money. A 25-year-old investing for retirement 40 years away can ride out a downturn - there's time for markets to recover. A 60-year-old retiring next year doesn't have that luxury.

Risk tolerance is a different question: how much volatility can you handle emotionally and financially without abandoning the plan? Even a young investor with decades to go can have low risk tolerance.

The two interact: a long time horizon generally supports taking more risk, but risk tolerance is the ceiling on how much of that capacity you should actually use. The right allocation sits at the overlap of both.

Illustrative Example: Same Goal, Different Stages, Different Mixes

Investor	Horizon	Stocks	Bonds	Cash
Age 25, 40 Years to Retirement	Long	90%	8%	2%
Age 45, 20 Years to Retirement	Medium	70%	25%	5%
Age 63, 2 Years to Retirement	**Short**	**40%**	**50%**	**10%**

As the time horizon shortens, the mix shifts steadily away from stocks toward bonds and cash - because there's less time to recover from a bad stretch before the money is actually needed.

5 Things to Know

1. Time horizon and risk tolerance are two separate questions - timeline versus temperament.

2. A longer horizon generally supports more risk, since there's more time to recover.

3. Risk tolerance is the ceiling, not the goal - exceeding it usually leads to panic-selling.

4. Horizon shortens as goals approach - the mix commonly shifts toward bonds and cash over time.

5. The 'right' allocation is personal - it depends on your timeline, income, and real behavior under stress.

4 Things to Check When Setting Your Mix

• Know your actual timeline - be specific about when you'll need the money.

• Be honest about your temperament - think about how you reacted to past downturns.

• Stress-test the downside - picture a 30-40% drop and size your risk to the honest answer.

• Revisit as your horizon shortens - shift the mix gradually as a goal approaches.

Worth knowing:
this explains the reasoning behind matching a portfolio to time horizon and risk tolerance using illustrative allocations - it isn't personalized financial advice. Speak to a licensed advisor about what's appropriate for your situation.

Quiz — Answer the questions, then check the key on the next page

1. What is "time horizon" in this context?

A. How long you've been investing so far
B. How long until you actually need the money
C. How many hours a day you spend researching stocks
D. The length of a typical market cycle

2. Why might a 25-year-old with 40 years to retirement still have low risk tolerance?

A. Because young investors are legally required to hold less risk
B. Because a long time horizon always means low risk tolerance
C. Because risk tolerance is about temperament, not just how much time is available
D. Because 25-year-olds have no income

3. In the illustrative example, why did the mix shift toward bonds and cash as retirement approached?

A. Less time remained to recover from a downturn before the money would be needed
B. Bonds always outperform stocks over any period
C. Stocks become illegal to hold after a certain age
D. Cash provides the highest long-term returns

4. Why is risk tolerance described as "the ceiling, not the goal"?

A. Because higher risk tolerance always produces higher returns
B. Because risk tolerance doesn't actually matter to portfolio construction
C. Because it's set by regulators, not the individual
D. Because taking on more volatility than you can stomach usually leads to panic-selling

5. What determines the "right" allocation according to this lesson?

A. A single formula that applies to everyone the same way
B. Whatever allocation had the best return last year
C. The overlap between how much risk you can afford to take and how much you can live with
D. Your age alone, with no other factors considered

Answer Key

1. What is "time horizon" in this context?

Correct answer: B. How long until you actually need the money

Time horizon is simply how long until the money is needed - a longer horizon means more time to recover from a downturn.

2. Why might a 25-year-old with 40 years to retirement still have low risk tolerance?

Correct answer: C. Because risk tolerance is about temperament, not just how much time is available

Risk tolerance is a separate question from time horizon - it's about what you can emotionally handle, regardless of timeline.

3. In the illustrative example, why did the mix shift toward bonds and cash as retirement approached?

Correct answer: A. Less time remained to recover from a downturn before the money would be needed

As a goal gets closer, there's less time to recover from a bad stretch, so the mix commonly shifts toward capital preservation.

4. Why is risk tolerance described as "the ceiling, not the goal"?

Correct answer: D. Because taking on more volatility than you can stomach usually leads to panic-selling

Exceeding your real risk tolerance tends to end in selling low during a downturn, locking in losses a calmer investor would have recovered from.

5. What determines the "right" allocation according to this lesson?

Correct answer: C. The overlap between how much risk you can afford to take and how much you can live with

The right mix sits where your financial capacity for risk and your emotional capacity for risk overlap.