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5 Common Mistakes That Cost New Investors Money

Investing can be intimidating. Especially for beginners.

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The deck seems stacked against new investors. The stakes — a relaxing retirement, a new home, a child's college tuition — are high. Time is short; judgment difficult; and having unlimited options is confusing.

Although no two investors have the same goals, almost all investment plans can benefit from a long investment horizon. The biggest mistake, then, is to not begin at all.

But let's say you are ready to start investing. How do you proceed with confidence?

Below we review new investor's most common mistakes and, more importantly, how to avoid them.

INVESTMENT PITFALL #1: DON'T INVEST BEFORE CREATING A PLAN

What are your investment goals?

Planning is essential to attaining your goals and knowing what you can realistically achieve. Among the items to consider are: income and expenses; existing investments; risk tolerance; time horizon; and insurance needs. Planning can begin only once your complete financial picture is understood.

This is where an investment professional can help. Discussing your financial situation with an expert will allow for a realistic assessment of your return potential and risk tolerance. From there, goals can be prioritized, scaled back, or enlarged accordingly.

Finally, an investment plan helps minimize emotional decisions. Market declines can trigger panic selling. However, if declines are accounted for in advance they will be psychologically easier to handle.

INVESTMENT PITFALL #2: AVOID MAKING INVESTMENT DECISIONS EMOTIONALLY

Losses hurt. And they hurt more than the equivalent gains feel good.

This asymmetric mind set is called *loss aversion* and has important implications for investors.

Extreme loss aversion makes sense during more dangerous times. If a small mistake can jeopardize survival, then avoiding losses is more meaningful than any possible gain.

But that's not how modern financial markets operate. Markets naturally go up and down. Investment professionals counsel investors to ignore day-to-day market movements. Our instincts are not optimized to handle draw downs.

Having an investment plan will provide a road map to deal with the urges created by natural turns in the market cycle.

Making emotional decisions rarely yields good results in any situation, let alone when your money is at stake.

INVESTMENT PITFALL #3: DON'T TRY TO TIME THE MARKET OR PICK WINNERS

A falling knife has no handle. It's a fool's errand to call market tops or bottoms.

Trying to time market cycles is likely to lose money. Research published by JP Morgan Asset Management found just how costly it is to time the market.* The data showed that being out of the market for just the ten best days over a 15-year period from 1998-2017 reduced total returns by 50%. *Time in* the market always beats *timing* the market.

Picking individual winners is similarly difficult. Companies with wildly popular products don't necessarily make the best investments.

It's not easy to do once. It's nearly impossible to maintain. It's no wonder that most stock pickers can't beat the indices.

INVESTMENT PITFALL #4: NOT PROPERLY DIVERSIFYING YOUR PORTFOLIO

Imagine your portfolio consists of a mix of debt and equity holdings, across a variety of industries, and spread over many different companies.

Are you sufficiently diversified?

Not if a large portion of those holdings are located in the typhoon corridor of South East Asia.

Everyone knows not to put all their eggs in one basket. Investment diversification formalizes this folk wisdom to create "the only free lunch in finance." That is, through non-correlation, an investor can reduce portfolio risk without lowering overall returns. This is the key insight to Modern Portfolio Theory that earned its inventor Harry Markowitz a Nobel Prize in 1990.

Still, not all risks can be diversified away. Systematic risk from inflation, exchange and interest rate changes, and geopolitical uncertainty affect every company. The risks that can be reduced using diversification are risks specific to certain companies, industries, or geographies

The value of diversification is about non-correlation. While diversification does not guarantee against losses, lower-correlated assets like private credit, gold, real estate, or commodities are less reactive should the stock market suffer from extreme volatility.

INVESTMENT PITFALL #5: ACTING ON INVESTMENT ADVICE FROM THE WRONG SOURCES

There are so-called investment experts everywhere. The free advice from TV money-mountebanks and message board Buffets-wannabes is generally worth its cost. Touts should be ignored.

Many experts are actually promoters. They are either talking up their own book or being compensated for an endorsement. That doesn't mean their advice is wrong, just that they don't have your best interest in mind.

* JPAM Guide to Retirement – 2018 Edition

Every investment decision must be made in the context of the broader portfolio. A random stock being shilled on a message board is unlikely to fit your specific needs. This is where an investment plan and a dedicated financial advisor can help.

Only you and your financial advisor know your unique financial situation and the ideal path towards your investment goals. As an investor, you must be diligent not only with your investment choices but also with your sources of financial advice.

Life is short, mastering the art of investing is long, and investing without a plan is perilous.

As you begin your investing career you have to consider what your priorities are for the future. Questions about your goals will require many decisions along the way.

If you stick with your plan and avoid the mistakes outlined above, you will be better positioned to achieve your investment goals.

To learn more please contact your financial advisor.

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