THE EIGHT BIGGEST MISTAKES INVESTORS MAKE

Are you a self-directed investor? If so, are you completely satisfied with the current performance of your investments? Or have you struggled to consistently meet your investment goals over time?

These are some of the questions that Kenneth Fisher seeks to address with this article so that one may become an informed investor.

“Common mistakes can add up and ultimately diminish the value of your portfolio. It’s my goal to increase investors’ awareness of common pitfalls and help you protect your precious assets.”

Chances are you feel that some level of improvement can be made. We all typically seek the same general objective: to maximise returns while protecting ourselves from downside risk. But for many, it is becoming increasingly difficult to reach this objective as we are flooded with more information and faced with more investment alternatives. Ultimately, the landscape has become more complex.

Fortunately, many investing fundamentals have remained unchanged. Through more than 30 years of managing money for many prestigious institutions and individuals, I have learned some important lessons on what brings success - and what can lead to failure.

Through this guide, it is my objective to help investors recognise these common mistakes - and provide insight on how to avoid them. In doing so, I’m confident the guide can help you increase your chances of reaching your investment goals.

Mistake # 1
Underestimating time horizon for your assets

How long do you think you’ll live?
How about your spouse?

Most people are far too conservative in estimating the length of their lives, and that can be a problem when planning your financial future.

...and how to avoid it.

It’s a simple fact. Breakthroughs in medicine happen so often we frequently don’t even hear about them. As the effectiveness of disease treatment, improvement in general nutrition, and higher standards of living continue to progress, most people will live longer than they think they will.

This means there are new and costly healthcare methods available for increasing life span as the population ages, which raises the costs of healthcare and of living longer.

For these reasons, we find that most people miscalculate on the low side how long they’ll live. As a result, many fail to make proper plans to accommodate their longer lifespan. Many run the risk of depleting their funds long before their lives are over.

It’s important to have a sound financial strategy that will provide for your financial stability and income needs. Or perhaps you’re aiming to grow your assets to gift to your loved ones and family members who survive you. In either case, a proper perspective on time horizon is vitally important.
Mistake # 2

Misaligning investment objectives and portfolio strategy

Aligning your portfolio strategy with your objectives is a critical factor in determining long-term investing success. This may sound obvious, but many investors employ strategies that work against their objectives.

...and how to avoid it.

A common error that investors make is improperly judging risk. Generally, the longer the time-horizon of your investments, the more risk you’re able to take on. But a typical mistake that investors make is to take on too little risk. That’s right. They focus on short-term volatility rather than long-term probabilities of achieving their objectives. This ultimately causes their portfolios to underperform their goals.

For example, persistently loading up the portfolio with low coupon Treasury bonds, due to fear that stocks will drop in the short term, will barely generate a return over the rate of inflation. This reduces the odds of achieving a long-term goal of growth - especially if withdrawals are also anticipated.

Conversely, those with short time horizon objectives are often overly exposed to risk, creating a danger of asset loss amid short term volatility. This can put their entire financial future in jeopardy.

Mistake # 3

Confusing income needs with cash flow needs

Income and cash flow are not the same thing, although many investors think they are. In fact, the two different concepts and the distinctions between them are extremely important.

...and how to avoid it.

Put simply, cash flow is how much money you need for living expenses and other personal uses of cash. Income, on the other hand, is the amount of dividends and interest earned by a portfolio that, in the case of a taxable account, you will pay current income taxes on. What’s the important difference?
The way in which you generate income can have a tangible effect on the growth of your assets and on the taxes you pay, which impacts your ability to get cash flows.

It's a mistake to think that you should get your needed cash flow from income only and never touch the principal. This is an emotional bias that many simply cannot overcome. Instead, you should focus on total after-tax return. For example, selling stock to meet income needs can allow you to stay fully invested and create "homegrown" dividends by selling selected securities.

Compared with some dividends, and interest from fixed income, selling stock may offer tax advantages. That's because the transaction is taxed at the capital gains rate rather than the client's marginal rate. Harvesting losses can also be tax advantageous.

**Mistake # 4**

**Overlooking unintended risk factors**

Managing a diversified portfolio of assets can be fraught with hidden risks many investors aren't aware of. Too often, we find that portfolios are over-exposed to certain risk factors that were never recognized. Don't let his happen to you.

...and how to avoid it.

Unintended concentration produces excess risk. This exposes you to larger fluctuations and the possibility of accelerated losses.

Factors such as sector, country, currency, valuations, and size all play a role in a properly diversified portfolio. What's more, some securities are highly correlated for other reasons (like interest rate movements or commodity prices).

For example, let's say you own one Japanese stock and one English stock. These seem unrelated, right? But have you considered the revenue source for each company? Are they both sensitive to interest rate fluctuations? Perhaps their performance is similarly tied to currency movements.

Too high a concentration of any of these or other factors can expose your assets to risks you never intended!

**Mistake # 5**

**Ignoring foreign securities markets**

The United States isn't the only country worth investing in. In fact, it only accounts for about half of the value of world equities in terms of market capitalisation.

As a result of globalisation there are a great number of innovative companies and investing opportunities available to take advantage of. Don't make the error of limiting yourself!

...and how to avoid it.

It's a mistake to think that you're diversified properly by simply choosing stocks across differing sectors. That's not enough. Return of stocks is partially related to the overall economic performance and political climate of the home country. A sagging domestic economy makes it difficult for many companies to thrive. Without giving consideration to country and region, you may incur the excess risks associated with doing business in that country.

Many average investors suffer from "home country bias," which means they tend to invest only in the country they live in. For example, if you were to purchase stocks diversified across all sectors located within the US, performance might often depend more on how the country performs than the quality of the individual companies chosen.

Diversification is a key part of building a well-constructed portfolio to grow your assets. Investing abroad helps to strengthen your portfolio by expanding the efficient frontier. It also creates a larger pool of possibilities from which to find worthy investments.

**Mistake # 6**

**Forgetting the fundamental importance of supply and demand**

The fundamentals of supply and demand of securities are easy to overlook. Analysts and pundits cite an endless list of theories about what mechanisms drive stock prices. But the simple fact remains: supply and demand of securities will always be the fundamental driver of share prices.

...and how to avoid it.

Basic economic theory states that the relative supply and demand for goods in an open market will determine their prices. For example, holding supply equal, the demand for ski equipment increases around the winter months, and thus the price for skis increases at that time. But in the other months of the year, when people ski less, demand decreases and prices fall. Stocks are no different: we think it is common sense that their prices fluctuate based on demand in the short term.

Supply of equities is relatively fixed in the short run because it takes time for companies to create new issues of stock. Therefore, shifts in demand primarily cause price changes in the markets in the short term. However, supply has the ability to change almost infinitely in the long run, making it the dominant factor in stock prices over longer time periods. Understanding the relationship between the supply and demand of securities is vital in choosing whether to be invested in stocks or not.

The ability to accurately track, analyse, and evaluate this fundamental tenet of economic theory is vital in our view to making successful forecasts in the markets because it allows you to screen out unimportant noise.

**Mistake # 7**

**Making investment bets based only on widely known information**
...short time horizon objectives are often overly exposed to risk...

What sources of information do you use when considering an investment? With the possible exception of the "hot tip" that you pick up at a dinner party, your information probably comes from sources that are widely available. And that's a problem.

...and how to avoid it.

Whether it's the morning newspaper, research from your broker, commentary on radio, television, or the Internet, or any other source made available to the public, they're all essentially useless.

Why? Because the markets are efficient discounters of all widely known information. This means that as soon as a piece of information is made broadly available to the public, it's reflected in share prices. But despite this fact, many investors still make the mistake of trading on widely known information.

In order to generate excess returns, you must either know something everyone else doesn't or interpret widely known information differently and correctly from the crowd. In other words, something that isn't already reflected in share prices. The ability to generate this knowledge takes experience, research and discipline.

Mistake # 8

Experiencing over-confidence in your investing skills

When investing your personal assets, it's natural to experience a lot of emotion as you watch the ups and downs of the markets each day. After all, it's your financial future you're dealing with.

But for that very reason, a slew of cognitive biases come into play,

...you must know something that everyone else doesn't.

clouding people's judgment and hampering their ability to make rational, impartial decisions.

...and how to avoid it.

Let's face it. The human brain is not wired for investing. Our Stone Age ancestors evolved and survived by focusing on whatever helped them hunt and gather food. Their biases shaped their beliefs, creating and reinforcing their understanding of the world.

The fact is, like our ancestors, we see the world today through a screen of biases. For example, most investors will focus on their successes and try to forget the mistakes they've made, consistently confirming their personal views rather than maintaining objectivity.

One particular shortcoming of investors is their innate tendency towards over confidence. We naturally put up barriers that allow us to forget the mistakes we've made in the past while at the same time focusing on the successful investments we've made - which makes us overly confident. This leads to taking on excessive portfolio risks.

None of us are immune to these biases. That's why it's vital to create an environment for investing that is detached from emotion - one that relies on data and impartial analysis to make the right decisions for your financial future.

Have you made any of these mistakes?

It's difficult to avoid all investment pitfalls - even for the savviest of investors. That's because many investors simply don't have the time to process the vast amount of information available today and apply it to their complex investment needs. But it is worth your while, knowing what these eight mistakes are so that you can avoid them and attain the best value for your investments.

Note: founder, CEO and Chief Investment Officer of Fisher Investments, Kenneth L. Fisher has written three finance books and numerous articles in business and scholarly journals. He is most widely known for his Forbes "Portfolio Strategy" column which he's been writing for twenty years.

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