JTD
Financial Services, LLC

250 Commercial Street
Suite 3005-G
Manchester, New Hampshire 03101
Tel: 603-641-1010
Fax: 603-641-0707
e-mail: fdemaio@jtdfinancial.com
www.jtdfinancial.com

Classic Investing Mistakes

How many can you prevent yourself from making?

Provided by Frank DeMaio*

Year after year, in bull and bear markets, investors make some all-too-common blunders. They have been written about, talked about, and critiqued at some length – and yet they are still made. You can chalk them up to psychology, human nature, perhaps even a degree of peer pressure. You just don't want to find yourself making them more than once.

#1: Caving into emotion. The deVere Group, which consults high net worth investors around the world, recently surveyed 880 of its clients and found that even with their experience, some had made the equivalent of a rookie mistake – 20% had let fear or greed prompt them into emotional investment decisions.[1]

Investors use past performance to justify their greed – it did well recently, I better buy more of it – but past performance is merely history and represents a micro factor versus macroeconomic factors influencing sectors and markets. Fear prompts panic selling. How many investors draw on technical analysis or even stop-loss limits when shares suddenly decline? A stop-loss limit is handy for those who don't want to watch the market every day – it instructs a brokerage to sell a stock if it drops below a specific value, often in the range of 8-10% of the purchase price.[2]

#2: Investing without a strategy. Some people invest with one idea in mind – making money. An outstanding goal to be sure, but it shouldn't blind them to other priorities such as tax efficiency, managing risk and reviewing asset allocation. Even 22% of the investors in the deVere poll confessed to this.[1]

#3: Not diversifying enough. Have you ever heard the phrase "familiarity bias"? This is when investors develop a "home team" attachment to an investment. Just as sports fans stick by the Celtics and the Cornhuskers and the Cubs through thick and thin, some investors stick with a few core investments for years. Maybe they work for XYZ Company or their mom did, or maybe they like what XYZ Company represents, so having a certain percentage of the portfolio in shares of XYZ Company gives them a good feeling. If XYZ Company craters, they won't feel so good. You can hold too much of one investment, especially if a company rewards you with its stock.[2]

** Registered Principal Offering Securities through UNITED PLANNERS' FINANCIAL SERVICES OF AMERICA, A Limited Partnership. Member: FINRA, SIPC. JTD Financial Services and United Planners' are not affiliated.*

Conversely, some portfolios are overdiversified and hold too many investments. This is seldom the fault of investors; over time, they may end up with some shares of all the major companies in an industry group with a little help from Wall Street money managers. The core problem here is that not all of these companies can be winners.

#4: Slipshod tax management of investments. Sometimes certain investments within a taxable account will lose money, yet because of past gains they have made, the investor is stuck with capital gains tax. Some investments are better held in taxable accounts and others in tax-deferred accounts, as various types of investments are taxed at varying rates. When you retire and tap into your savings, you can potentially improve tax efficiency by drawing down your taxable accounts first, so that you'll face the capital gains tax rate (which may be 15% or even 0%) instead of the ordinary income tax rate.[3]

Also, when you pull money from your taxable accounts first, your tax-advantaged accounts get a little more time to grow and compound. If they are large, another year or two of growth and compounding could prove beneficial.

#5: Seldom reviewing portfolio allocations. A long-term asset allocation strategy starts with defined percentages. Over time – and it may not take much time – the percentage allocations go out of whack. A bull market may result in a greater percentage of your portfolio assets being held in stock, and while this overweighting may seem reasonable in the near term, it may not be what you want in the long term.

#6: Investing (or reinvesting) near a market peak. Many investors play the market in one direction, which is up – they buy with expectations that a sector or the broad market will keep climbing. Short selling stocks (i.e., seek to exploit falling stock prices) takes more skill than many investors have. A buy-and-hold philosophy may prove very rewarding, as long as you don't hold too rigidly or too long in the event of a sustained, systemic shock to the markets.

An even keel promotes a steady course. Fear, greed, bias, randomness, inattention – these are the root causes of the classic investing blunders. We have all made them; patience and experience may help us avoid them in the future.

Frank DeMaio, CPF®, CFA is a Registered Representative offering securities through UNITED PLANNERS' FINANCIAL SERVICES OF AMERICA, a Limited Partnership, Member FINRA, SIPC. Frank may be reached at 603-641-1010 or fdemaio@jtdfinancial.com. JTD Financial Services and United Planners' are not affiliated.*

Citations.

1 - thestreet.com/story/12733263/1/5-investing-mistakes-millionaires-make--but-theyre-still-rich.html [6/4/14]
2 - abcnews.go.com/Business/avoiding-sins-investing/story?id=18969850#.UXBFuco7bAJ [4/16/13]
3 - tinyurl.com/l6lkrfu [2/12/14]