Common Investing Mistakes

There are a number of mistakes that many of us make when it comes to managing our finances. While it is always very easy to make mistakes, it can be very hard to live with the consequences. One thing we should try to avoid is making the same mistake twice. Here are some very real pitfalls to be aware of.

Failing to Set Goals

Without clear targets, you will lack motivation to save and invest. But remember: all your objectives need not be high-minded or long term.

Small victories pave the road to larger successes. In fact, many financial advisors find that a good way to get in the habit of moving toward goals is to establish a few near-term achievable ones with pleasurable payoffs, such as saving for a trip to Hawaii, the Caribbean, Barbados or Idaho! Small rewards and extravagances can be very nice. There can be great incentive in setting aside some cash for these personal getaways. Once you've set your aims, establish an unshakable routine for putting aside cash to keep on track.

"Small victories pave the road to larger successes."

Giving Up All Decisions to an Advisor

Yes, it's okay to hire a tax professional to handle your state and federal returns or a stockbroker to suggest investments, but no one knows as much about or is as interested in your finances as you are. Take advantage of that fact and devote the couple of hours a week or so that financial planners say is required for most people to stay on top of their money.

Failing to Find a Sensible Investment Strategy

Most people build an investment portfolio the same way they collect shells at the beach. They pick up whatever happens to strike their eye. It may be a hot tip from a friend or a friend of a friend, a slick magazine advertisement or a fancy, colored brochure. As a result, they wind up with investments that often reflect only the fashion of the moment, not their goals or their investing temperament.

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Decide first how much risk you are willing to take and then hunt for investments that will let you sleep at night and provide the return you need to meet your target on time. Unless you are starting very late in working toward your major objectives, you should be able to find investments well within your comfort zone.

Remember that your investment style should reflect the time you have to devote to it and your financial expertise. If you don't know much about picking stocks or bonds or if you cannot spend a couple of hours a week researching individual equity issues, put your money in mutual funds or hire a money manager.

Failing to Understand Risk and Diversify Adequately

Investors often focus on one or two obvious risks and neglect to protect themselves against other threats. For example, if you invest the bulk of your assets in Treasury bills to avoid risks in the stock and bond markets, your returns may not keep you adequately ahead of inflation long term. Solution: a well-balanced portfolio of investments with different traits, such as stocks, bonds, money-market funds, real estate and, perhaps, precious metals.

Trying to Time the Stock Market

Few investors, professionals included, can catch a climbing stock or mutual fund just before it takes off, or can bail out at precisely the right instant. So don't try. Instead, be a buy-and-hold investor.

Driving Your Investment Strategy with Taxes

Don't allow seductive tax advantages to blind you to an investment's basic strengths and weaknesses. Before you buy a product that promises to save you taxes, compare it with taxable alternatives. To find out how much a taxable investment would have to return to edge out a tax-exempt one, use this formula.

Divide the tax-exempt yield you are considering by 1 minus your tax bracket expressed as a decimal. So if you are in the 28 percent federal tax bracket and want to find out how much you'd have to earn from a taxable asset to equal the return on a tax-exempt investment yielding 7 percent, divide 7 by 0.72 (1 - 0.28). Conclusion: to beat the return

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on the tax-exempt investment, you'd need to earn more than 9.72 percent on a taxable one.

Aggressively Seeking the Highest Yield

Trying to catch the highest yield is a strategy that can work well in the risk-free confines of savings accounts and CDs. Elsewhere, however, you can chase high yields down a very deep hole. That's because in more variable income investments such as bonds and bond mutual funds, the interest payments—which determine your yield—make up only part of your total return. The other part is change in the value of your principal, so a drop in a bond or a bond fund's principal value (because of rising interest rates or a default) can dent and even wipe out any higher yield it may have offered. If you only search for high yields, you may not always get high total returns—and total return is the only true measure of whether you've made money.

Relying on Past Performance Only for Investment Choices

The problem with pursuing hot performers is that last year's star all too frequently turns out to be this year's dog. Here, the lesson to be learned is to judge investments on future prospects, not past glories.

Underestimating the Effect of Commissions

High fees and commissions can shave the value of your investments and financial services very fast. Costs that sometimes sound insignificant can add up. If you are over the age of 50 and put $3,000 into an Individual Retirement Account in a mutual fund that has a no-load, low-expense policy, you'll be miles ahead of placing the same dollars in a fund with an 8.5 percent load and a 2 percent annual expense cost.

Failing to Keep Accurate Tax Records

Yes, it's a pain when you first begin this task! Accurate records can help you cut taxes by reminding you of deductible expenditures. They can also help you weed out poor investments. And, of course, they will aid your heirs after you're gone.

Not Setting Aside Adequate Cash for Emergencies

Make sure you've stashed three to six months' worth of living expenses in an account that allows fast withdrawals without penalty.

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The best place for the extra money is in a money-market mutual fund.

Underestimating Your Retirement Obligations

In planning for retirement, few people pay enough attention to two potential time bombs: their own life expectancy and inflation. At age 60, according to those who know, the median life expectancy is 20 years for a man and 25 for a women. But those are only medians and, for that reason, you really need to plan for 30 years or so.

And in far less time than that, inflation can make sizable savings seem insignificant. According to experts, if living costs rise at a moderate 5 percent, a pension payment of $1,000 a month when you were 60 would have only $277 of today's purchasing power when you hit 85.

Excessive Worrying about the Small Things

Be cost-conscious, but don't fret. If your neighbor's bank CD pays a quarter of a point more in interest than yours, don't worry about it. That deal will earn him or her just $2.50 more this year pretax for each $1,000 invested. Instead, focus on your goals and on carrying out a long-term strategy for reaching them.

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