Preventing Investment Mistakes: Ten Risk Minimizers

Most investment mistakes are caused by basic misunderstandings of the securities markets and by invalid performance expectations. The markets move in totally unpredictable cyclical patterns of varying duration and amplitude. Evaluating the performance of the two major classes of investment securities needs to be done separately because they are owned for differing purposes. Stock market equity investments are expected to produce realized capital gains; income-producing investments are expected to generate cash flow.

Losing money on an investment may not be the result of an investment mistake, and not all mistakes result in monetary losses. But errors occur most frequently when judgment is unduly influenced by emotions such as fear and greed, hindsightful observations, and short-term market value comparisons with unrelated numbers. Your own misconceptions about how securities react to varying economic, political, and hysterical circumstances are your most vicious enemy.

Master these ten risk-minimizers to improve your long-term investment performance:

1. Develop an investment plan. Identify realistic goals that include considerations of time, risk-tolerance, and future income requirements--- think about where you are going before you start moving in the wrong direction. A well thought out plan will not need frequent adjustments. A well-managed plan will not be susceptible to the addition of trendy speculations.

2. Learn to distinguish between asset allocation and diversification decisions.   Asset allocation divides the portfolio between equity and income securities. Diversification is a strategy that limits the size of individual portfolio holdings in at least three different ways. Neither activity is a hedge, or a market timing devices. Neither can be done precisely with mutual funds, and both are handled most efficiently by using a cost basis approach like the Working Capital Model.

3. Be patient with your plan. Although investing is always referred to as long- term, it is rarely dealt with as such by investors, the media, or financial advisors. Never change direction frequently, and always make gradual rather than drastic adjustments. Short-term market value movements must not be compared with un-portfolio related indices and averages. There is no index that compares with your portfolio, and calendar sub-divisions have no relationship whatever to market, interest rate, or economic cycles.

4. Never fall in love with a security, particularly when the company was once your employer. It's alarming how often accounting and other professionals refuse to fix the resultant single-issue portfolios. Aside from the love issue, this becomes an unwilling-to-pay-the-taxes problem that often brings the unrealized gain to the Schedule D as a realized loss. No profit, in either class of securities, should ever go unrealized. A target profit must be established as part of your plan.

5. Prevent "analysis paralysis" from short-circuiting your decision-making powers. An overdose of information will cause confusion, hindsight, and an inability to distinguish between research and sales materials--- quite often the same document. A somewhat narrow focus on information that supports a logical and well-documented investment strategy will be more productive in the long run. Avoid future predictors.

6. Burn, delete, toss out the window any short cuts or gimmicks that are supposed to provide instant stock picking success with minimum effort. Don't allow your portfolio to become a hodgepodge of mutual funds, index ETFs, partnerships, pennies, hedges, shorts, strips, metals, grains, options, currencies, etc. Consumers' obsession with products underlines how Wall Street has made it impossible for financial professionals to survive without them. Remember: consumers buy products; investors select securities.

7. Attend a workshop on interest rate expectation (IRE) sensitive securities and learn how to deal appropriately with changes in their market value--- in either direction. The income portion of your portfolio must be looked at separately from the growth portion. Bottom line market value changes must be expected and understood, not reacted to with either fear or greed. Fixed income does not mean fixed price. Few investors ever realize (in either sense) the full power of this portion of their portfolio.

8. Ignore Mother Nature's evil twin daughters, speculation and pessimism. They'll con you into buying at market peaks and panicking when prices fall, ignoring the cyclical opportunities provided by Momma. Never buy at all time high prices or overload the portfolio with current story stocks. Buy good companies, little by little, at lower prices and avoid the typical investor's buy high, sell low frustration.

9. Step away from calendar year, market value thinking. Most investment errors involve unrealistic time horizon, and/or "apples to oranges" performance comparisons. The get rich slowly path is a more reliable investment road that Wall Street has allowed to become overgrown, if not abandoned. Portfolio growth is rarely a straight-up arrow and short-term comparisons with unrelated indices, averages or strategies simply produce

detours that speed progress away from original portfolio goals.

10. Avoid the cheap, the easy, the confusing, the most popular, the future knowing, and the one-size-fits-all. There are no freebies or sure things on Wall Street, and the further you stray from conventional stocks and bonds, the more risk you are adding to your portfolio. When cheap is an investor's primary concern, what he gets will generally be worth the price.

Compounding the problems that investors face managing their investment portfolios is the sensationalism that the media brings to the process. Step away from calendar year, market value thinking. Investing is a personal project where individual/family goals and objectives must dictate portfolio structure, management strategy, and performance evaluation techniques.

Do most individual investors have difficulty in an environment that encourages instant gratification, supports all forms of speculation, and gets off on shortsighted reports, reactions, and achievements? Yup.

About the Author

Steve Selengut http://www.sancoservices.com http://www.kiawahgolfinvestmentseminars.com Author of: "The Brainwashing of the American Investor: The Book that Wall Street Does Not Want YOU to Read", and "A Millionaire's Secret Investment Strategy"