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SEVEN INVESTING BLUNDERS TO AVOID

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The road to financial independence is often times wrought with little investing gaffes. Some mistakes are relatively harmless, while others can have devastating effects on the outcome of our portfolios. Before you begin to panic, the chances are that your financial health is in good stead, but ignoring these seven investing blunders may set an investor back and severely impact their financial stability. The consequences of glossing over these faults may result in having to work longer, lower one's accustomed standard of living, or the inability to pay for college. Avoiding the following blunders may help lead to a more rewarding financial life.

Blunder #1: Disproportionate Asset Allocation

"The only free lunch in investing is Diversification"

Asset allocation is one of the single most important investment decisions that an investor can make. An understanding of your exposure to domestic and international stocks, domestic and international bonds, alternatives, and cash is imperative. Alternatives include assets such as real estate, hedge funds, or commodities such as gold and silver. Investors tend to either be too conservative (i.e. holding too much cash or bonds) or too aggressive (i.e. holding a high percentage of your portfolio in one stock) and/or poorly diversified. Being too conservative during your working years may severely reduce the growth opportunity of your portfolio. Conversely, holding too much in volatile assets such as stocks during the retirement period of your life can have a negative effect on one's portfolio if there is a significant drawdown in the equity markets.

The appropriate asset allocation should be tailored to fit your risk tolerance, time horizon and expected withdrawals. The portfolio should be a diversified mix of uncorrelated asset classes, and the investor should seek to achieve the highest return for the right level of risk determined by your goals and investment horizon. You should look to diversify across different styles, sizes, and regions. By spreading out your risk, you reduce the chances of a significant drawdown and can potentially improve your return.

On the other end of the asset allocation pendulum is over-diversification or *diworsification*. Each time an investment is added it lowers the risk of the portfolio by a smaller and smaller amount. In addition, each additional investment also lowers the potential return. Adding too many assets to your portfolio negates the benefit of diversification because your potential gains will be diversified away. It is not without reason that diversification is labeled the only free lunch in investing. But it is possible to have too much of a good thing.

Blunder #2: Not rebalancing your investments periodically

"Rebalancing doesn't work every time. It works over time" – John Nersesian

A close relative of asset allocation is periodic rebalancing. After diversifying assets across a number of asset classes, it is highly recommended that investors rebalance their portfolios at least on an annual basis to bring them back in line with their original target allocation. For example, let's imagine that an investor has a 60% allocation to stocks and 40% to bonds. If equities have been performing well and bond returns have been lackluster, over the course of several years your original allocation would be skewed towards stocks and might resemble a 70/30% allocation mix. Rebalancing your investments periodically would bring your portfolio back to its original risk/return profile. Furthermore, it would force investors to be disciplined and to sell assets that have appreciated and add to those that have declined. Using this systematic approach of buying and selling ensures that investor's investment strategies are in line with their goals. According to *Business Insider*, investors who rebalanced their portfolios on an annual basis outperformed investors who did not rebalance by 60% over a 25 year time period[1].

Blunder #3: Sitting on the Sidelines

"October: This is one of the particularly dangerous months to invest in stocks. Other dangerous months are July, January, September, April, November, May, March, June, December, August and February."
– Mark Twain

The Crash of 2008 has had an incredible effect on the psyche of investors. Driven by a potential downturn in the markets, investors kept a significant amount of cash in their portfolios, which of course yields very little and is the equivalent of stuffing your money under your mattress. This may not seem like a "mistake" to some and certainly holding some cash can make sense in context of your overall asset allocation, time horizon, and goals. However, sitting on too much cash hampers your long-term growth potential. Cash is one of the least volatile asset classes, but has generated some of the lowest annual returns (other than that hot "tip" from your neighbor) of all the six major classes since the bottom of 2009[2].

Investors usually wait on the sidelines waiting for the "perfect" time to jump back into asset classes such as stocks. Unfortunately, an investing crystal ball does not exist. By the time an investor may feel good about jumping into equities, they have already missed the majority of the bull market. For example, the S&P 500 is up over 200% from the March 2009 lows but many investors have missed a good portion of

[1] "Importance of Rebalancing Your Portfolio." Business Insider 2014. Web. 13 May 2016. <http://www.businessinsider.com/importance-of-rebalancing-your-portfolio-2014-7>

[2] "Asset Class Returns." BlackRock 2015. Web. 13 May 2016. <https://www.blackrock.com/investing/literature/investor-education/asset-class-returns-one-pager-va-us.pdf>

this bull market run. Let me be clear, holding some cash can make sense but it has to be a part of your overall asset allocation, time horizon, and goals not your main focus.

Blunder #4: Paying Excessive Fees

"If investors could rely on only a single factor to select future superior performers and to avoid future inferior performers, it would be fund costs. The record could hardly be clearer: The more the managers and brokers take, the less the investors make."– John C. Bogle

The majority of investors are unaware of how much they pay in investment management fees or fund fees. Unfortunately, these fees can be "hidden" within investment products and can be much more expensive than they realize. Not accounting for excessive fees can have a significant drag on investment returns over the long-term.

According to *Morningstar*, the average mutual fund charges 1.25 percent[3]. However, funds may tack on additional charges such as sales loads, which are paid to the broker that sells the product. Taking into account these additional fees may start to push the expense ratio of the mutual fund above 2 percent. High fees are a significant hurdle to overcome! One of the few things an investor can control is how much they pay in fees. Utilizing cheaper alternatives such as index funds or ETFs, can positively impact your net of fee performance by keeping more of your money in your own pocket.

Blunder #5: Not Utilizing Tax Efficient Vehicles

"What is the difference between a taxidermist and a tax collector? The taxidermist takes only your skin." -Mark Twain

Not taking advantage of retirement plans such as 401(K), 403(B), IRA's, or a Roth 401(K) can take a significant chunk out of the growth ability of your retirement fund. These tax free vehicles offer tax-deferred growth to investors, which is one of the few gifts bestowed by the US government. The power of compounding lets your investments, reinvested dividends and income grow without the drag of taxes. In addition, potential matching contributions from employers further enhance your ability to accumulate wealth. Not taking advantage of your company's retirement plan and company match can cost an investor financial Elysium.

Moreover, Investors can utilize the use of an IRA to help with estate tax planning. Naming a beneficiary of your IRA means that the assets are transferred upon the owner's death outside the estate. They are not considered a part of one's estate for estate tax purposes. Furthermore, by naming your estate as the beneficiary could potentially subject your portfolio to creditors' claims and your former IRA would not be distributable to your heirs until the probate process concludes. In very few cases is this ever an effective estate planning solution.

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[3] "2015 Fee Study: Investors Are Driving Expense Ratios..." Morningstar 2016. Web. 13 May 2016. <https://news.morningstar.com/pdfs/2015_fee_study.pdf>

Blunder #6: Chasing Yield

"More money has been lost reaching for yield than at the point of a gun" - Raymond F. DeVoe

Chasing income can lead investors to construct portfolios concentrated in high yielding assets. However, this can have unintended consequences of overconcentration in particular industries such as utilities and telecommunication companies which tend to pay above-average dividends. If one of these sectors experiences a slowdown, this may be harmful to your overall portfolio because of the lack of diversification. In the case of bonds, investors are compensated for risk (such as default risk, interest rate risk, or inflation risk) by offering higher yielding instruments. Investors looking to increase their income may unwittingly increase the risk profile of their fixed income portfolios by chasing high yielding lower quality instruments. In addition, interest from bonds is taxed as ordinary income, which could also increase your tax bill. Maintaining a diversified mix of short and long term investment grade and high yield bonds may shield your portfolio from unnecessary risk.

Blunder#7: Having a quick trigger finger

"Patience and perseverance have a magical effect before difficulties disappear and obstacles vanish"
– John Quincy Adams

Saving for retirement or college is a long term goal and investment decisions need to be based on the end goal, not the everyday gyrations of the market. Warren Buffet said, "Games are won by players who focus on the playing field, not by those whose eyes are glued to the scoreboard." Having a long-term outlook, you may be able to weather market volatility and even recessions. Pullbacks and down ticks in the market will always happen but keeping a long–term view may help resist the urge to sell assets at the slightest inclination of a down draft or if the assets are not performing as well as you would like. Maintaining a properly diversified mix of assets and keeping in mind overall risk and objectives may help investors from jumping in and out of the markets like a game of hopscotch. Having a plan does you no good if you do not stick with it.

Financial stability is within reach!

If you have made one of the mistakes above, you are not alone. Investing is challenging and by developing a systematic approach to it by diversifying among different asset classes, having a long-term view, maximizing your 401(K) or IRA, and keeping fees low, you have a higher chance of financial success. Merely doing your best to avoid the seven blunders listed above may keep you on course to hit your financial objectives.