The 7 Most Common Investing Mistakes

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Financial Planning

Whether you're investing to build your savings for retirement, saving for your child's post-secondary education, or setting yourself up for a major purchase (i.e a house), your goals are simple - grow your investments in order to meet the goal you have set out.

But sometimes your portfolio doesn't grow as expected, and you're left wondering how you're going to meet your objectives.

While it's important to learn the best investment strategies, it also pays to learn from mistakes that others have made.

Mistakes are common when investing, but can be easily avoided if you spot them and quickly take action against them.

We've compiled the 7 most common mistakes that we have seen people make with their investments, and offer tips and strategies to help avoid these mistakes.

Mistake #1: Failing to Diversify Your Portfolio

The only way to create a portfolio that has the potential to provide appropriate levels of risk and return in various market scenarios is adequate diversification. Simply put, diversification is a strategy that mixes a wide array of investments within an investment portfolio in order to reduce the risk of being exposed to too much of one asset type. Often investors think they can maximize their investment returns by taking a large investment exposure in one security or sector, but when the market moves against such a heavily concentrated position, the results can be disastrous. The best course of action is to find a balance.

A diversified portfolio should include a variety of assets including stocks, bonds, real estate, gold, cash, and alternative investments. It should be diversified geographically in developed and emerging markets and not just focused exclusively in the U.S and Canada. And finally, it should include a combination of both large, small, and midsize companies.

While this strategy doesn't ensure a profit or guarantee you won't lose money, you can better manage risk and minimize volatility by spreading your assets among different investments and asset classes.

Investors may be tempted to pile their money into a few investments, or a few types of investments. But having a broadly diversified portfolio guarantees that some of your investments

will stay afloat when others sink, and vice versa. Ideally, some part of your portfolio should always be doing well. The advantage of this is that you will lose less with a diversified portfolio during major market corrections (like the Tech Bubble of 2000 and the Great Recession of 2008) than a portfolio concentrated solely in stocks.

Remember, an investment loss of 50% requires a 100% gain to get back to even.

For a good visual of how different types of assets behave, see the Asset Class Quilt on the following page. Different types of investments take the lead while others falter. Having a mix smooths your portfolio's returns over time.

For instance, as you will see, a portfolio holding only Canadian Large Cap stocks (red block) has had very volatile returns over the last 20 years. An investor holding only Canadian Large Cap stocks would have done very well in 2021 - returns of 17%, but very poor in 2001 with a loss of 12%. On the other hand, an investor holding a balanced portfolio (white blocks) would have had a higher 10 year average return and less volatility along the way as seen in two rightmost columns.

Asset Class Quilt

- Canadian Equity Large Cap
- Canadian Equity Small Cap
- US Equity Large Cap
- US Equity Small Cap
- International Equity
- Emerging Markets Equity
- Global Real Estate
- Canadian Fixed Income
- Global Fixed Income
- High-Yield Fixed Income
- Balanced Portfolio

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	10 Yr. Avg	10 Yr. Vol
8.9%	15.3%	34.4%	27.9%	31.2%	41.8%	18.5%	31.1%	62.4%	35.1%	9.7%	25.8%	48.1%	26.3%	21.6%	38.5%	28.7%	7.7%	24.8%	17.9%	19.8%	17.7%	20.1%
8.1%	8.7%	28.1%	16.8%	24.1%	32.1%	9.8%	6.4%	57.5%	20.2%	8.3%	16.0%	41.3%	23.9%	20.0%	21.1%	17.4%	4.2%	22.9%	16.6%	17.3%	15.2%	15.9%
7.9%	1.8%	27.8%	14.5%	12.5%	26.4%	3.7%	-17.2%	52.0%	17.6%	4.6%	15.6%	31.6%	14.3%	19.5%	17.5%	13.8%	3.8%	19.2%	16.3%	14.2%	10.0%	13.3%
4.5%	-1.9%	26.7%	11.9%	11.2%	17.9%	2.2%	-18.3%	35.1%	15.2%	4.4%	15.3%	17.2%	12.0%	16.1%	17.1%	9.1%	1.4%	16.8%	12.9%	12.9%	9.1%	13.3%
4.2%	-3.5%	20.5%	10.9%	10.6%	17.3%	0.9%	-21.2%	17.4%	14.1%	-0.4%	13.8%	13.0%	10.6%	14.6%	8.3%	8.5%	-1.3%	16.5%	8.7%	12.0%	9.1%	11.8%
3.8%	-7.0%	15.1%	9.7%	9.7%	15.4%	-2.3%	-26.4%	17.1%	13.0%	-1.8%	13.4%	11.4%	9.7%	8.2%	8.1%	7.5%	-2.3%	15.9%	8.7%	7.0%	7.4%	11.6%
2.2%	-8.0%	13.8%	9.3%	6.5%	15.3%	-5.3%	-28.8%	12.5%	10.2%	-3.5%	10.3%	7.6%	8.8%	3.5%	7.7%	7.1%	-3.0%	15.8%	7.3%	6.1%	7.3%	10.8%
-2.7%	-12.4%	12.6%	7.1%	2.7%	11.8%	-7.0%	-33.0%	8.0%	9.1%	-8.7%	7.2%	7.4%	7.0%	2.4%	1.7%	4.1%	-5.6%	14.4%	6.4%	4.6%	6.5%	7.3%
-6.4%	-16.5%	6.7%	6.5%	2.3%	11.6%	-10.5%	-34.6%	7.4%	6.7%	-9.5%	3.6%	4.3%	4.1%	-4.6%	1.4%	2.8%	-6.5%	12.9%	6.2%	3.7%	4.6%	7.2%
-12.6%	-21.3%	5.3%	2.8%	1.9%	6.2%	-16.5%	-41.4%	5.4%	2.6%	-16.1%	2.0%	3.9%	2.5%	-8.3%	-1.4%	2.5%	-8.9%	6.9%	5.6%	-3.5%	3.9%	7.1%
-16.3%	-22.9%	-8.0%	1.3%	-6.9%	4.1%	-21.1%	-45.5%	-9.2%	0.0%	-16.4%	-2.2%	-1.2%	-2.3%	-13.3%	-2.0%	0.3%	-18.2%	1.4%	-9.8%	-5.9%	3.6%	4.0%

Source: Morningstar Research Inc. As of June 30, 2021. Balanced Portfolio is based on 18.5% Canadian Equity Large Cap (S&P/TSX Composite TR), 2.5% Canadian Equity Small Cap (S&P/TSX Small Cap TR), 17.9% U.S. Large Cap (S&P 500 TR CAD), 3.1% U.S. Equity Small Cap (Russell 2000 TR CAD), 2% Emerging Markets (MSCI EM GR CAD), 16% International Equity (MSCI EAFE GR CAD), 8% High-Yield Fixed Income (ICE BofAML U.S. High Yield TR USD), 18% Canadian Fixed Income (FTSE Canada Universe Bond), 5% Global Real Estate (FTSE EPRA/NAREIT Developed TR), and 9% Global Fixed Income (BBgBarc Global Aggregate TR CAD).

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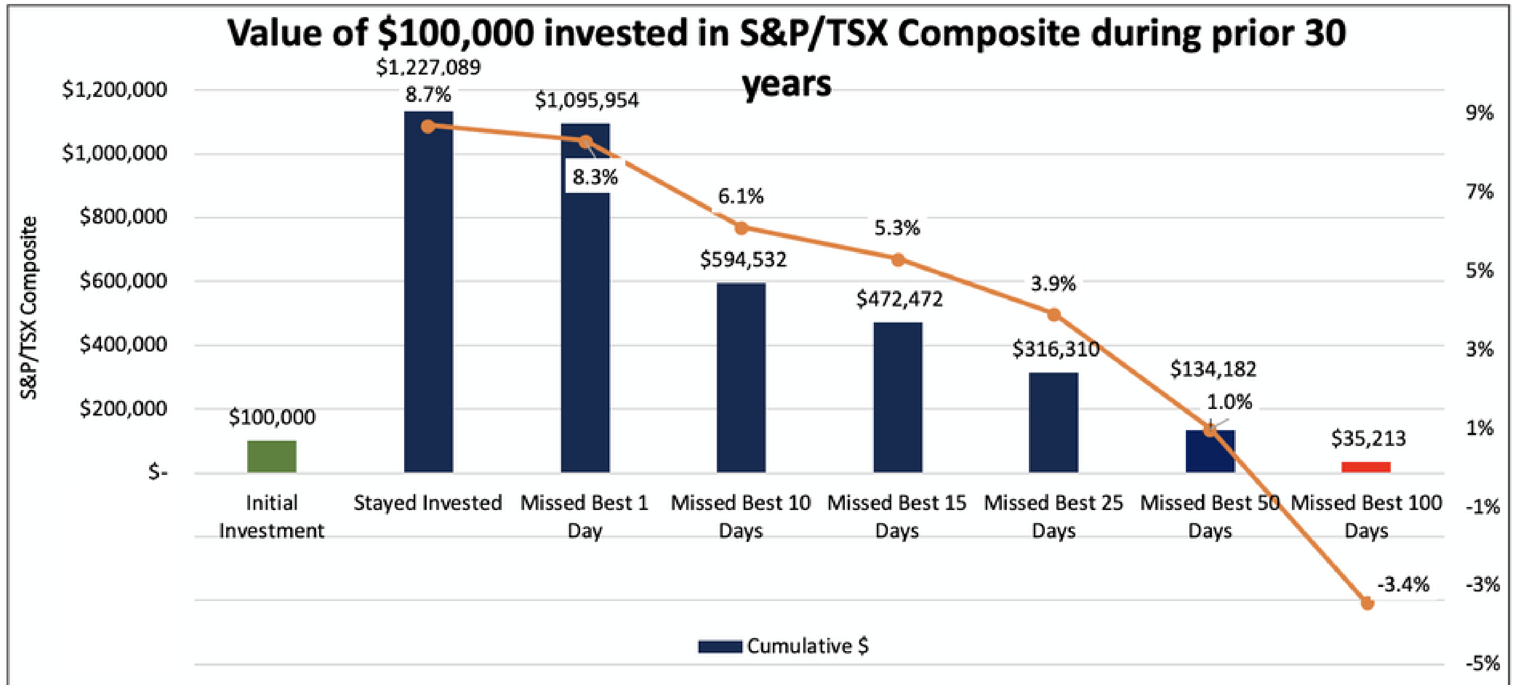
Mistake #2: Trying to Time the Market

Successfully timing the market is extremely difficult. Even institutional investors often fail to do it correctly. In fact, trying to time when to get in and out of the market reduces your returns over the long term. In a well known study, on average 94% of the variations of returns of an investment portfolio over time was explained by the investment policy decision (see footnote #1 below).

In other words, most of a portfolio's return can be explained by the asset allocation decisions you make, not by timing the market or even the security selection within an asset class that you make. It is the time in the market that leads to success, not timing your entry and exit in the market itself.

As you can see from the diagram on the next page, timing the market is difficult. An initial investment of $100,000 in 1991 in the S&P/TSX Composite can actually realize a loss on the investment by missing out on the 100 best days over the past 30 years. The more you try to time getting in and out of the market, the more you risk missing out on the best days in the market.

1. "Determinants of Portfolio Performance" (Financial Analysts Journal, 1986), conducted by Gary P. Brinson, L. Randolph Hood, and Gilbert L. Beebower covered American pension fund returns)



Source: Morningstar Research Inc., CI Global Asset Management. S&P/TSX Composite TR from July 1, 1991 – June 30, 2021 using daily returns.

Any attempts to catch the top or the bottom of the market can be quite frustrating. In this process, people often lose money or do not invest at all while waiting for the right opportunity. Investors trying to time the market often sacrifice some profits due to late entry or early exit. This is why monthly dollar cost averaging programs are useful as they bring in financial discipline and average out the cost of purchase, eliminating timing distortions to some extent (see footnote #2 below).

2. Dollar cost averaging is a technique that entails investing a fixed amount of money in the same fund or stock at regular intervals (i.e. monthly) over a long period of time.

Mistake #3: Having Unclear Financial Goals

People often invest without clear investment objectives or an appropriate time horizon, focusing instead on short-term returns and price swings. Investors who don't have clearly defined investment goals over an appropriate investment time horizon are much more likely to have "knee-jerk" reactions to short-term market events. That means they must rely on luck to achieve their goals rather than a portfolio strategy with a higher probability of success.

Investing to make more money should rarely be the goal. Instead, people should see money as a tool for meeting their other goals in life. Whether that be for retirement, the purchase of a cottage, travel, or some other financial objective. Making investing all about returns is a common mistake.

You don't always necessarily need to get the highest returns. Chasing higher returns means taking on more risk. By first establishing your financial goals you can determine the amount of return you need to reach those targets. It is very well likely that you may adequately meet your goals with less risky investments.

Many investors use the S&P 500 or TSX indexes as a benchmark for their investment performance, but using an index is often not a fair comparison against individuals' actual portfolios.

While indexes serve as an easy proxy for how ‘the market is doing,’ it is important to remember that the design of your portfolio and performance should be aligned to meet your goals — not an index that doesn’t know your financial situation, goals or time horizon.

Mistake #4: Following Bad Advice from Media (Social Media Included)

There is a tremendous amount of misinformation out there surrounding investing and finances in general, especially on social media.

The overall guidance from experts is simple: Don't take investment advice from those who don't know your personal financial situation. For example, you may feel compelled by someone on social media to start investing in a certain company/stock/fund, but these social media "influencers" aren't aware of your financial objectives and the other investment options you may have. You may be better off putting your money in your employer-sponsored retirement account (recommended especially if your company matches contributions up to a certain percentage of your salary).

Stop watching the daily market news. While it's normal (and generally advised) to keep an eye on what's happening in the overall economy, it's easy to get swept up in the excitement or doom and gloom of it all (see the "Cycle of market emotions" on the following page).

The markets are constantly moving and trying to follow along in real-time can lead you to continuously check or change your investments when you're better off leaving them alone for the long haul.

Source: Darst, David M. (Morgan Stanley and Companies, Inc.). The Art of Asset Allocation, 2003.

Remember, only you (and ideally, your financial advisor) know your unique situation and how adding or removing new investment assets will impact your ability to meet your goals. Don't always assume what is being discussed in social media and the news will help you achieve your objective.

Mistake #5: "Diworsifying" Your Portfolio

Diversifying your portfolio is probably the single most important thing you should consider when investing but just as important is to ensure you do not over-diversify. Diversification is a valuable risk management tool, but only when used properly, and only adds value when the new asset added has a different risk profile.

“Diworsifying” is the process of adding investments to one's portfolio in such a way that the risk/return trade-off is worsened. Diworsification occurs from investing in too many assets with similar correlations that add unnecessary risk to a portfolio without the benefit of higher returns. For example, adding one or two individual U.S. stocks to an already existing U.S. equity mutual fund portfolio is diworsification. For example, when diversifying a U.S. stock portfolio, you may want to consider non-related markets like gold, real estate, bonds, commodities, and other asset classes that exhibit low or inverse correlation to the U.S. equities.

Diworsification can occur in a number of ways. Some factors include impulse investing, style drift and generally favouring a particular sector. With impulse investing and sector overweighting, investors over-weight their portfolios based on impulse investing tips or high expectations for a specific sector.

Mistake #6: Lack of Patience with Unrealistic Expectations

The old saying applies here: "slow and steady wins the race". A slow and steady approach to portfolio growth will yield greater returns in the long run. If you were running a marathon, it wouldn't make sense to track your mileage in 50-metre increments. The same can be said about long-term investing, particularly in retirement accounts, which traditionally have the longest time horizon.

A common mistake investors make is being impatient with an investment and bailing out because they did not achieve what may be an unrealistic return. Expecting a portfolio to do something other than what it is designed to do is a recipe for disaster.

Impatience is often the killer of many wise investments. Not waiting out a downturn in the economy or assuming a stock or mutual fund has seen its prime and selling it too soon, even though it's a well-known and stable investment, could leave you with regrets.

Some investors have the far-fetched expectation that an investment like a stock or mutual fund will go up as soon as they buy it. The long-term average return for the stock market as a whole is approximately 10%. That means that if you are expecting

an "average" return, your stock will take an entire year to go from $30 to $33. Of course, that 10% long-term return that's often quoted for the stock market is merely a long-term average. It's entirely possible that even if you buy an index fund, you'll lose money over the short-term.

Think about it this way: If you buy a stock or fund that goes down 10% the first year, goes down 20% the next year and returns 85% in year three, you'll have just about your 10% per-year average return. Sometimes, you have to be quite patient to earn your returns from your investments and selling at the wrong time could cause you to miss out on a huge future gain.

Ideally, you should hold investments for as long as you can to maximize your returns. Investing is something you do with the expectation of reasonable returns over a long-term period. Viewing negative performance without context can lead to rash decision making, while positive performance can instill overconfidence.

It's best for investors to avoid tracking their performance (both good and bad) too frequently. While it's easier than ever to get instant information on your portfolio's progress, it doesn't mean that it is necessary.

Keep your expectations realistic about the timeline for portfolio growth and returns. Before investing, ask yourself: "can I hold

these positions for a long period of time?" Investing should be boring; look at your investments on a quarterly basis, which should be more than enough for most investors.

Mistake #7: Don't Pick Stocks - Asset Allocation is More Important

Multiple research studies agree that at least 90% of the variance in a diversified portfolio's returns can be attributed to asset allocation. What's surprising, however, is that most people mistakenly focus 90% of their efforts on the remaining 10% by trying to pick individual securities. It simply doesn't make any sense.

Don't make the mistake of spending all your time on the decisions that will make little difference in your overall performance. Don't try to pick the next hot stock or top performing mutual fund when the experts who live and breathe this are consistent failures at the same task.

Instead, spend your limited time and resources determining your correct allocation to asset classes and strategies, and you'll be putting Pareto's Law (the 80-20 rule where 80% of your results come from 20% of your efforts) to work for you.

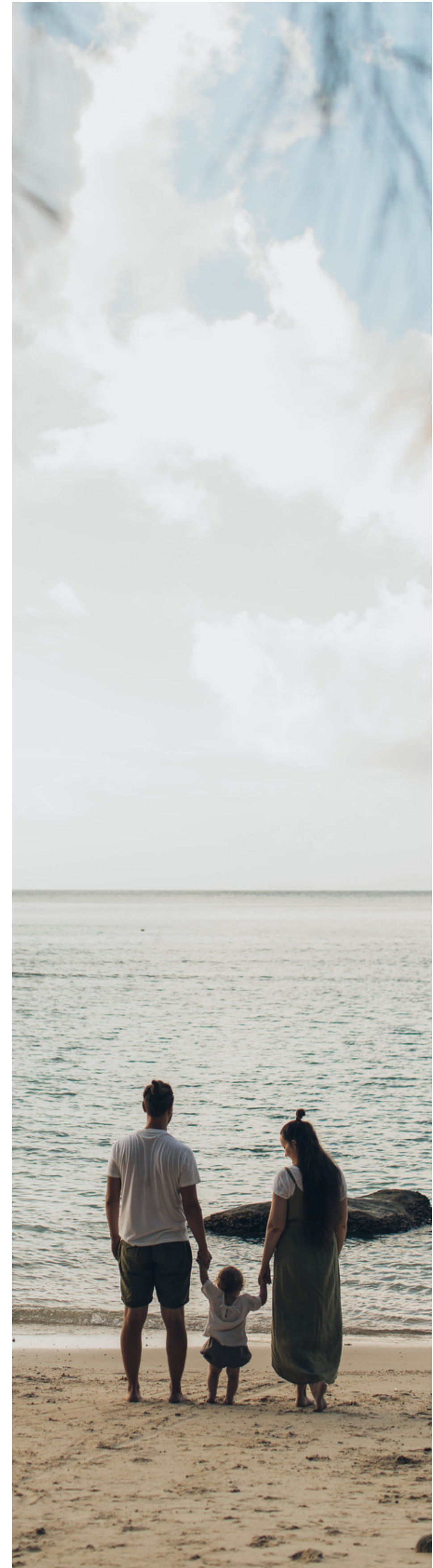
While establishing an appropriate asset allocation is a dynamic process, and changes over the course of your investment lifetime, determining the correct asset allocation for your situation can make a big difference in how your investments grow over time. It helps ensure you have a balanced portfolio and helps you stay diversified, the benefits of which we have mentioned already.

Steering clear of these mistakes can potentially make the difference between missing and hitting your financial goals.

Avoiding these mistakes can be easy, but certainly takes discipline with the right approach: setting the right expectations and timeline for your goals, creating the right portfolio with the right asset allocation, and periodic re-balancing to make sure you're well diversified.

Of course, having a financial advisor in your corner can certainly help ensure that you're set on a path towards your financial goals, and making the right moves at the right time. Ultimately, the key is to make sure your investments fit within your personal situation and your goals, and that they're part of an overall comprehensive approach to your financial well-being.

If any of these mistakes sound familiar to you, it might be time to review your portfolio to make sure it still suits your goals. We would be pleased to provide a complimentary second opinion of your investment portfolio to help determine if it is the optimal mix to help meet your financial goals.



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