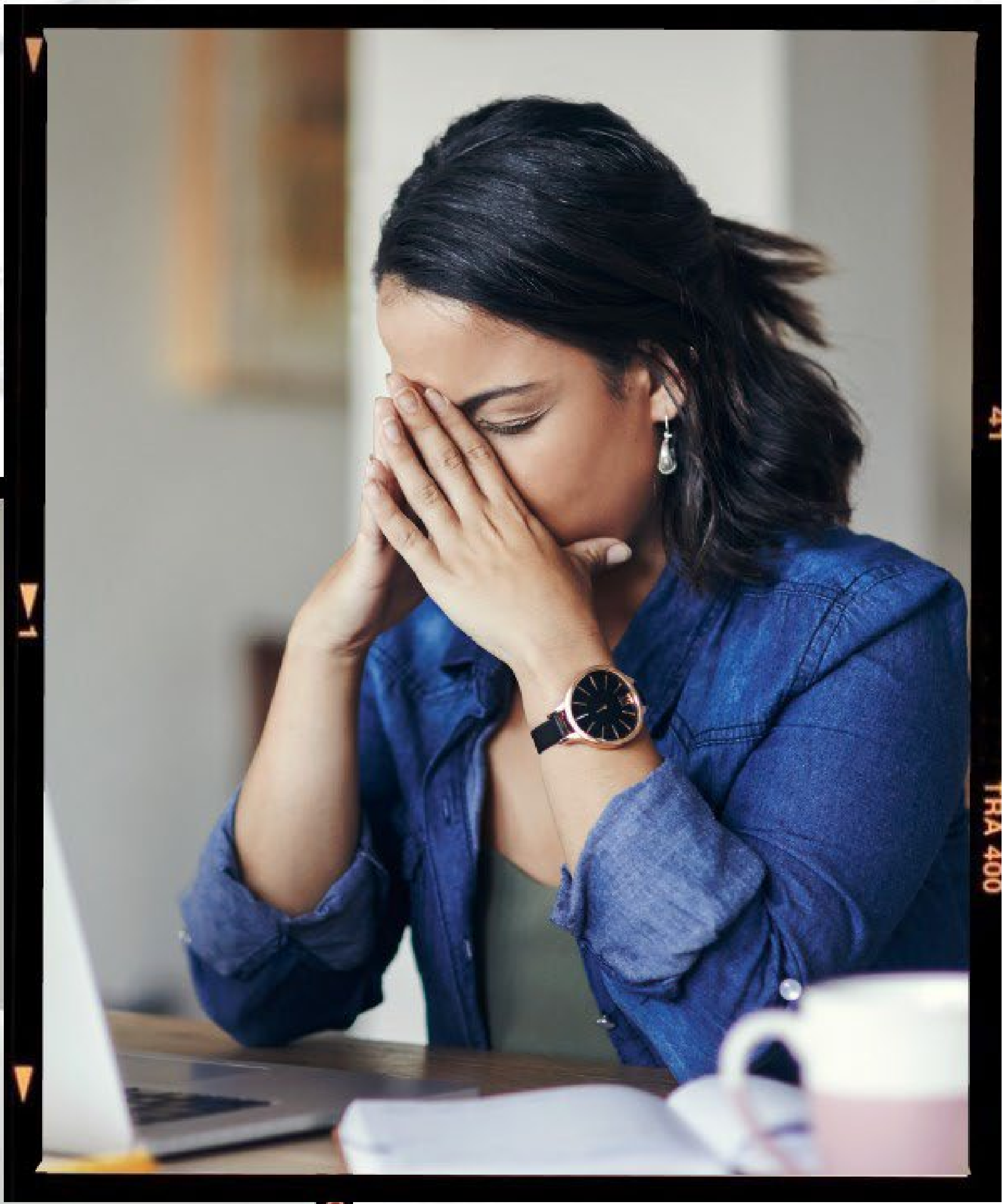
13 decision-making mistakes that investors make...

and how to avoid them



WealthAdviser

Contents

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Information in this handbook is no substitute for professional financial advice.

We encourage you to seek professional financial advice before making any investment or financial decisions. We would obviously love the opportunity to have that conversation with you, and at the rear of this handbook you will find information about our authorised representative and how to go about booking an appointment.

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Letter from the Wealth Adviser Library

Dear Reader

Welcome to the Wealth Adviser Library

This library was built specifically to facilitate the provision of sound financial information to everyday Australians.

Our mission is to build an accessible, comprehensively supported team of members who share our vision and commitment to providing tailored financial advice and a new foundation of financial understanding and security for everyone.

With a national network of likeminded experts, we have the potential to provide the financial building blocks for future generations.

Knowledge gives you a huge advantage

We believe that knowledge gives you a huge advantage in creating and effectively managing wealth; in planning to reach your goals; and in being prepared for whatever unexpected twists and turns life may present.

That’s why our team of experts has created this series of digital handbooks and manuals that seek to inform you of not only the benefits but also the potential risks and pitfalls of various strategies and investments.

We trust you enjoy this publication and find it informative and professionally presented. Of course, your feedback is always welcome as we strive to continually offer content in a format that is relevant to you.

Take the next step

Wealth Adviser (a division of WT Financial Group Limited) supports more than 400 privately owned and operated advice practices around the country. We invite you to engage with one of our advisers to discuss what it was you were hoping to achieve when you obtained this handbook, and to establish if they can help you achieve your goals and objectives.

At the rear of this handbook you will find details on how to book an appointment.

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Introduction

Investing is the best way to build your long-term wealth provided you make smart investment decisions and you take a long-term view. However, we're often our own worst enemies when it comes to investment decision-making. Poor investment decision-making can be very costly. These decisions can be the result of our psychological biases.

It's important to understand common investment decision-making mistakes and how you can avoid them. At the end of the day, good investment decision-making lowers your risk and improves your returns.

Common Mistake #1 - Overconfidence

There is an element of risk in any investment. Smart investors don't discount risk. They are not overconfident and are aware that things can go wrong with their investments. They take steps to minimise their risk or keep it at acceptable levels (for example, by diversifying their investment portfolios to include a mix of different asset types).

Diversification is a fundamental investment strategy. It's the investment equivalent of "not putting all your eggs in one basket". If you spread your investments across different types of assets (for example, shares, property, and fixed interest), then when one of these sectors is struggling, any losses may be offset by gains in another sector.

You should also aim to diversify your assets within investment categories (for example, by investing in the shares of companies operating in different industries so that if one industry struggles, it can be offset by others).

Common Mistake #2 - Not getting as much relevant information as possible

We live in the information era which means that plenty of information is at our fingertips, especially online information. Unfortunately, it also means that we're at risk of information overload, so it's a double-edged sword. It's crucial to get as much relevant investment information as possible before you make investment decisions. It's just as crucial to not get distracted by irrelevant information.

One example of potentially irrelevant information is minor daily share market movements, especially if you're taking a medium to long-term view of your share investments. Short-term fluctuations are far less important in investment decision-making than long-term trends. American Nobel Prize-winning economist Paul Samuelson once said that "investing should be more like watching paint dry or grass grow. If you want excitement, take $800 and go to Las Vegas."

Another potential problem in the online information era is the quality of the information we get. You should base your investment decisions on information from credible, trusted sources. Unfortunately, there is plenty of dubious investment information out there from non-reputable sources. This information can spread rapidly online to unsuspecting investors via social media and lead to poor investment decisions.

Common Mistake #3 - Focusing on Avoiding losses rather than making gains

If you're too focused on avoiding losses, sometimes you can lose more money because you hang onto poor investments for too long, hoping that they'll bounce back. And if you do that, you can miss out on in investing in more lucrative opportunities. In economic terms, that is known as the opportunity cost.

Common Mistake #4 – Not evaluating risk versus reward

If an investment is making higher than average returns, there is usually a higher element of risk associated with it. Always consider all potential investment outcomes and be prepared for the worst if necessary.

Unfortunately, many investors only evaluate the potential reward without factoring in the risk. This can lead to a lot of speculative investment. Speculative investment is inherently risky, and the more that investors do it, the more overpriced the assets that they invest in can become. This often leads to investment bubbles that inevitably burst, leaving those who invested with significant losses (especially those that invested late at higher prices).

Common Mistake #5 – Not taking enough risk

Just as it's important not to take too much risk with your investment decisions, not taking enough risk can be costly as well (especially if you're a younger investor and you have time on your side). Low-risk investments (like fixed interest investments) provide the lowest returns.

Ideally, you should have a balance of low, medium, and high-risk investments in your portfolio unless you are an older investor and you don't have the luxury of time to ride out any investment market fluctuations.

Common Mistake #6 – Oversimplifying things

The investment world can be complex. If you don't understand the fundamentals of an investment, it's a wise idea to avoid it. For example, don't buy shares in companies if you don't know understand their business model. Don't oversimplify it in your own mind to justify investing in it. If you do, you're just speculating, not making a well-informed investment decision. Invest in things that you know about or that you have the ability to quickly understand.

There is nothing wrong with stepping out of your investment comfort zone once in a while. But if you do that, do it in small doses and use it as part of your investment education process.

Common Mistake #7 – Investing based on the past, not the future

Past investment returns are no guarantee of future success. We live in a rapidly changing world and you should always have an eye on the future when you make your investment decisions. COVID-19 has changed the investment landscape for the foreseeable

future for all three broad investment categories – shares, property, and fixed interest. For example, investments in many airlines would once have been viewed as solid investments, but they are speculative in the COVID-19 environment.

Common Mistake #8 – Jumping on the bandwagon

Racing to invest in an asset just because others are doing it can be a risky strategy. You should always base an investment decision on sound fundamentals (i.e. risk versus return), rather than on speculation. Always do your own independent research before making investment decisions, don't just listen to popular opinion. Be thoughtful and analytical, rather than impulsive.

It's important to understand that if you're buying when everyone else is, it's likely that you're buying at the peak of the market.

That usually means you're paying too much. It's like arriving late at a party. You've missed the best part. You should aim to buy when the market is low and sell when it is high, not the other way around.

A famous Warren Buffett quote in relation to share investment is the following: "The worst mistake you can make in stocks is to buy or sell stocks based on current headlines.

Common Mistake #9 – Waiting too long to start

Procrastination can be one of the biggest investment mistakes you make. The later you start investing, the less time that you have for compound interest to work its magic. The power of compound interest is best explained using a simple example. Imagine that you invest $10,000 long-term and achieve an average annual return of 5%. Also assume that you reinvested those earnings each year.

After 10 years, the total value of your investment would be $16,470.

After 20 years, the total value would be $27,126.

After 30 years, the total value would be $44,677.

Notice how the pace of investment growth increases over time.

In the first 10 years, the investment earns $6,470 (i.e. $16,470 minus the original $10,000 investment).

In the next 10 years, it earns $10,656 (i.e. $27,126 minus $16,470).

In the final ten years, it earns $17,551 (i.e. $44,677 minus $27,126).

This is the power of compound interest in action. Albert Einstein once described compound interest as "the eighth wonder of the world".

This example shows that you don't need a lot of money to start investing these days, and the sooner you start doing it, the better. You should also aim to invest regularly by budgeting and setting aside a regular amount to invest to build your wealth.

Common Mistake #10 – Making emotional investment decisions

When it comes to investments, you need to be analytical, not emotional. Don't get caught up in hype, panic or 'doom and gloom' when you make investment decisions. Instead, be calm and logical in your research and analysis of the investment's fundamentals (i.e. its risk versus potential return, as well as its 'fit' within your overall portfolio and investment strategy).

For example, if you're monitoring share prices on a daily basis, it can be easy to get emotionally caught up in short-term fluctuations and to make short-term decisions that aren't in your best long-term interests. Similarly, don't buy shares in a company just because you love their products or what they do. Buy based on their solid financial performance instead. At the end of the day, you're investing to make money, not to blindly support companies due to emotional attachments.

Common Mistake #11 – Not being patient

Slow and steady tends to win the long-term investment race. There's an old saying that "if an investment sounds too good to be true, it probably is". There are no such things as "get rich quick schemes", despite what some spruikers may claim. Avoid schemes that advertise outlandish returns. Invest in solid assets with good fundamentals instead and be patient.

Similarly, don't go into investments with unrealistic expectations. If you do, you'll inevitably be disappointed.

Common Mistake #12 – Focusing too much on the tax implications

You should always consider the tax implications of any investments you make, but it shouldn't be your only consideration. If you're investing to save tax rather than to maximise your returns, you can end up worse off financially overall.

Common Mistake #13 – Not having a plan to base your investment decision around

There's another old saying that "people don't plan to fail; they fail to plan". It's especially true when it comes to investment decision-making. The best way you can avoid these common investment mistakes is to seek independent professional advice and to develop an investment plan.

This investment plan should be based on both your current financial situation as well as your future needs and goals. It should then be used as the basis for your investment decision-making. It should also be regularly reviewed as market conditions and your individual financial circumstances, needs and goals change over time. Adjustments should be made to your plan if or when necessary.

The bottom line

As you can see, there are many investment decision-making mistakes you can make. Smart investors are aware of these mistakes and take the necessary steps to avoid them. If you've already made some of these mistakes, it's never too late to start rectifying them. The main things are to learn from them and to avoid making the same mistakes again in the future.

Take the next step

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Next you will find details on how to book an appointment with an adviser.

We look forward to meeting you soon.

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Please nominate your preferred day, date and time to meet with us. One of our client services representatives will call you to confirm your appointment.

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Date ______________________________

Time ______________ am/pm __________

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