7 Common Investor Mistakes

By Jay Yoder | Updated March 7, 2017 — 6:00 AM EST

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Of the mistakes made by investors, seven of them are repeat offenses. In fact, investors have been making these same mistakes since the dawn of modern markets, and will likely be repeating them for years to come. You can significantly boost your chances of investment success by becoming aware of these typical errors and taking steps to avoid them.

1. No Plan

As the old saying goes, if you don't know where you're going, any road will take you there. Solution?

Have a personal investment plan or policy that addresses the following:

- *Goals and objectives* – Find out what you're trying to accomplish. Accumulating $100,000 for a child's college education or $2 million for retirement at age 60 are appropriate goals. Beating the market is not a goal.
- *Risks* - What risks are relevant to you or your portfolio? If you are a 30-year-old saving for retirement, volatility isn't (or shouldn't be) a meaningful risk. On the other hand, inflation – which erodes any long-term portfolio – is a significant risk.
- *Appropriate benchmarks* – How will you measure the success of your portfolio, its asset classes and individual funds or managers?
- *Asset allocation* – Decide what percentage of your total portfolio you'll allocate to U.S. equities, international stocks, U.S. bonds, high-yield bonds, etc. Your asset allocation should accomplish your goals while addressing relevant risks.

- *Diversification* – Allocating to different asset classes is the initial layer of diversification. You then need to diversify *within*each asset class. In U.S. stocks, for example, this means exposure to large-, mid- and small-cap stocks.

Your written plan's guidelines will help you adhere to a sound long-term policy, even when current market conditions are unsettling. Having a good plan and sticking to it is not nearly as exciting or as much fun as trying to time the markets, but it will likely be more profitable in the long term.

2. Too Short of a Time Horizon

If you are saving for retirement 30 years hence, what the stock market does this year or next shouldn't be the biggest concern. Even if you are just entering retirement at age 70, your life expectancy is likely 15 to 20 years. If you expect to leave some assets to your heirs, then your time horizon is even longer. Of course, if you are saving for your daughter's college education and she's a junior in high school, then your time horizon is appropriately short and your asset allocation should reflect that fact. Most investors are too focused on the short term.

3. Too Much Attention Given to Financial Media

There is almost nothing on financial news shows that can help you achieve your goals. Turn them off. There are few newsletters that can provide you with anything of value. Even if there were, how do you identify them in advance?

Think about it – if anyone really had profitable stock tips, trading advice or a secret formula to make big bucks, would they blab it on TV or sell it to you for $49 per month? No – they'd keep their mouth shut, make their millions and not have to sell a newsletter to make a living.

Solution? Spend less time watching financial shows on TV and reading newsletters. Spend more time creating – and sticking to – your investment plan.

4. Not Rebalancing

Rebalancing is the process of returning your portfolio to its target asset allocation as outlined in your investment plan. Rebalancing is difficult because it forces you to sell the asset class that is performing well and buy more of your worst performing asset classes. This contrarian action is very difficult for many investors.

In addition, rebalancing is unprofitable right up to that point where it pays off spectacularly (think U.S.equities in the late 1990s), and the underperforming assets start to take off.

However, a portfolio allowed to drift with market returns guarantees that asset classes will be overweighted at market peaks and underweighted at market lows – a formula for poor performance. The solution? Rebalance religiously and reap the long-term rewards.

5. Overconfidence in the Ability of Managers

From numerous studies, including Burton Malkiel's 1995 study entitled: "Returns From Investing In Equity Mutual Funds," we know that most managers will underperform their benchmarks. We also know that there's no consistent way to select – in advance – those managers that will outperform. We also know that very few individuals can profitably time the market over the long term. So why are so many investors confident of their abilities to time the market and select outperforming managers?

Fidelity guru Peter Lynch once observed: "There are no market timers in the Forbes 400." Investors' misplaced overconfidence in their ability to market-time and select outperforming managers leads directly to our next common investment mistake.

6. Not Enough Indexing

There is not enough time to recite many of the studies that prove that most managers and mutual funds underperform their benchmarks. Over the long-term, low-cost index funds are typically upper second-quartile performers, or better than 65-75% of actively-managed funds.

Despite all the evidence in favor of indexing, the desire to invest with active managers remains strong. John Bogle, the founder ofVanguard, says it's because: "Hope springs eternal. Indexing is sort of dull. It flies in the face of the American way [that] 'I can do better.'"

Index all or a large portion (70%-80%) of all your traditional asset classes. If you can't resist the excitement of pursuing the next great performer, set aside a portion (20%-30%) of each asset class to allocate to active managers. This may satisfy your desire to pursue outperformance without devastating your portfolio.

7. Chasing Performance

Many investors select asset classes, strategies, managers and funds based on recent strong performance. The feeling that "I'm missing out on great returns" has probably led to more bad investment decisions than any other single factor. If a particular asset class, strategy or fund has done extremely well for three or four years, we know one thing with certainty: we should have invested three or four years ago. Now, however, the particular cycle that led to this great performance may be nearing its end. The smart money is moving out, and the dumb money is pouring in. Stick with your investment plan and rebalance, which is the polar opposite of chasing performance.