INVESTING | Ten common pitfalls to steer clear of to derive a handsome reward

Benefiting from mistakes

Learning from others' mistakes is an important part of becoming a successful investor, writes Smart Money editor ANTHONY KEANE.

EVERYBODY makes mistakes, but when they are an investor a loss of money is usually involved.

While learning from your own errors is part of becoming a good investor, understanding what has burned others in the past can save you plenty.

Marinis Financial Group financial strategist Theo Marinis said it was human nature to make mistakes.

"If you're smart, you learn and grow from them,' he said.

"What I can't stand is people who make the same mistakes over and over again – that's the definition of insanity."

Today Smart Money outlines 10 investment mistakes that everyone should try to avoid.

Computer-generated image

NO RESEARCH

Investing blindly is just asking for trouble.

Commonwealth Financial Planning senior financial planner Janet Webber said would-be investors needed to take time to educate themselves in the fundamentals.

She said the internet was a good place to start, with sites such as www.asx.com.au providing a valuable source of information. "It is essential to be able to make informed decisions such as what you want to invest in, the level of risk you are willing to take and the amount of money you want to put into an investment," she said.

Following a hot tip heard from a friend could be dangerous.

Ms Webber said people wanting to take a chance with a stock tip should find out if the company was in a growing industry, whether it was profitable, whether it had any problems in the past and whether it had a high price-earnings ratio.

"If the person giving you the hot stock tip does not provide you with the answers to these simple questions, don't take their tip too seriously," Ms Webber said.

KNEE-JERK REACTIONS

Prescott Securities adviser Nick Loxton said one of the biggest mistakes was to act based on fear or greed.

"Some investors chase the wrong investments out of pure greed with a get-rich-quick goal in mind, often ending up paying too much for an asset," Mr Loxton said.

"Another common mistake is selling out of an investment too early when it experiences a temporary correction. These panic sellers tend to react because of fear and short-term concerns without considering the fundamentals of the investment at hand and in doing so are often missing out on strong longer-term gains."

For example, somebody who sold their Australian share portfolio during the 15 per cent market correction in August missed out on 16 per cent growth in the past three months as it rebounded strongly.

SPECULATING

Mr Marinis said many people did not understand the difference between investing and speculating.

"Most people don't really appreciate that investing requires self-discipline and a long-term perspective. It requires that you stick to your strategy, regardless of what is happening around you," he said. "That is not to be greedy when markets are booming and not to get spooked when markets are falling."

Good investors have discipline to stay the course and not chase the latest hot stock or managed fund, which can be the next poor performer.

"If you want to speculate, why bother playing in the market? Just go to the casino and put everything on red or black – you will soon find out if you are going to be rich or not," he said.

"On the other hand, if you want to invest you have to play the game like the casino, not the punter. The house always plays the averages, spreads its risks and bides its time – even taking short-term losses – because in the long run it always wins."

THE WRONG STRUCTURE

Whether it's tax, superannuation or simply owning an asset in a spouse's name, investing in the wrong structure can be a big waste of money.

Mr Marinis said superannuation was a good example.

It made no sense for a thirtysomething to be pumping all their money into super and have it locked away until they turned 60, but it was a different story for those approaching retirement.

"From 55 to 65, you start to migrate assets from non-super structures to super structures," Mr Marinis said.

This is because earnings in super were taxed at 15 per cent, and once the super became a retirement pension there was no tax on earnings.

Holding assets in the main breadwinner's name is another common mistake. It is usually much better for the lower-income earner to own shares and bank accounts because earnings from these are taxed at a lower rate or nil.

With shares, a low-income earner may even receive a tax refund because fully franked dividends have already been taxed at 30 per cent. If the spouse's income is almost zero, they will get that 30 per cent back.

FAILURE TO DIVERSIFY

Goldsborough Financial Services director and adviser John Oliver said a lack of diversification was a common mistake made by investors.

"If people have $20,000 to invest, they might just buy two shares, instead of investing in a managed share fund which diversifies across 60 companies or more," he said.

The more diversification you have, the less risk there is to your portfolio if one company goes bust.

CBA's Ms Webber said it was important to spread risk across different investment types such as shares, property, fixed interest and cash.

"In other words, don't put all your eggs in one basket," she said.

"A good approach would be to spread your investments across more than one asset class to even out our returns over time and not leave you vulnerable to fluctuations in a particular sector.

"Managed funds can reduce risk by spreading your money across a number of investments including asset classes, companies, industries, sectors, countries and fund managers."

NOT PROTECTING PROPERTY

Residential property remains one of the most popular forms of investment, but Terri Scheer Insurance Brokers marketing and operations manager Carolyn Majda said some people failed to protect their asset.

"Risk management strategies for rental property investors include appropriate landlord insurance, appointing a property manager, regular property inspections and prompt response to maintenance issues," she said. Ms Majda said investors without landlord insurance were likely to suffer financial loss if anything happened to their property or to a tenant living there.

"Our claims experience shows that the landlord's financial loss, in many cases, exceeds the bond amount," she said.

Terri Scheer Insurance Brokers said specific risks associated with owning rental property included malicious or accidental damage, theft, legal liability and loss of rental income if a tenant absconded or left a property unable to be re-let while damage was fixed.

> **As a basic rule, if you don't understand it, don't invest in it**
> – Janet Webber

BLURRING SUPER ASSETS

Self-managed superannuation is a fast-growing form of investment but Cavendish Superannuation joint managing director Andrew Hamilton said many people with SMSFs risked heavy penalties because they did not correctly attribute ownership of the fund's assets.

"Trustees of self-managed super funds often wrongly place the fund's assets in their own name or a related party instead of the name of the fund," he said.

"Money and assets of the super fund must be kept separate from personal assets or assets held by employers contributing to the fund. Not doing so is in breach of the regulations and the penalties can be quite severe.

"Investors with self-managed super funds must be aware of their roles and responsibilities as fund trustees to avoid costly compliance mistakes."

COMPLICATED INVESTMENTS

Investors are spoiled for choice these days, whether investing in property, shares or even bank accounts.

Experts say it is important to understand what you are investing in. If an investment seems overly sophisticated or complicated, it may be because the promoters are trying to hide something.

Thousands of investors were badly burned by the recent collapses of property groups including Westpoint and Fincorp. They thought they were investing directly in property but in fact their money was going into more complex debt instruments.

"A company advertises a promised rate of return, then on-lends to another company will all these property projects, and you often don't know where your investment is going," Mr Oliver said.

He said the Australian Securities and Investments Commission had a three-point check list that people should ask before making an investment:

WHO is the money going to?

IS the interest rate higher than 8.5 per cent? If it is, the investment has extra risk.

DO you plan to put all your eggs in one basket?

Ms Webber said average investors often did not have the expertise or knowledge to analyse complex investments such as futures, derivatives or hedge funds.

"As a basic rule, if you don't understand it, don't invest in it," she said.

"Stick with simple investment options or go to a financial planner for advice on building a more complex investment portfolio."

WASTING INTEREST

How many people have hundreds or even thousands of dollars sitting in everyday transaction accounts?

These accounts often pay an annual interest rate of less than 1 per cent.

Cash in the bank can be far better deployed among the fast-growing range on online savings accounts.

Interest rates on these accounts at present are up to 7.25 per cent per annum, and are likely to go higher in the coming months because the Reserve Bank of Australia is expected to continue lifting interest rates. The money is at call. All depositors need is access to the internet.

Term deposits also vastly outperform transaction accounts and some are offering rates above 7 per cent for one year. Some people argue they don't want bank interest because they don't want to pay tax on it, but most Australians are paying tax only at 30 per cent – so that still leaves a net gain of at least 70 per cent.

"Why do people let money sit there earning nothing?" asked Mr Oliver.

DOING NOTHING

Arguably the biggest mistake anyone can make is failing to invest at all.

The share market and property market have averaged growth of at least 10 per cent a year for several decades – much higher than cash in the bank.

Mr Marinis said people often thought investing was "all too hard".

"But if you don't do something, inertia is what kills you," he said.

Goldsborough's Mr Oliver said the biggest risk was to take no risk.

"People who keep all their money in a no-risk savings account are going to get nowhere," he said.

Ms Webber said people who started investing early in life would see bigger benefits from compound interest

"This means for each dollar you invest that earns a return, if you reinvest that return, it earns more dollars – like a snowball effect," she said.

"For compound interest to really work, start investing early to give your investments a chance to pick up momentum."

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