Remember when you were a kid and someone told you not to pull a face in the wind in case it changed direction and you were left permanently disfigured from the neck up? Well may you laugh, but many investors still fall prey to lingering poisoned fairy tales about how to invest. Admittedly, not all investors heed the advice of their financial planner. But Jordi Garcia director with NZ Financial Planning claims most people are much more likely to make dumb investment decisions by taking a DIY approach.

Ten Investment **faux pas we make**

By Mark Story

Unfortunately it's the fear that's often fuelled by Chinese whispers which spooks investors into abandoning sound financial advice when the going gets tough. That's why Garcia says bad investment decisions tend to get handed down from generation to generation. Here's a look at ten of the most common mistakes investors make, how many of them did you made this year?

1. **Having cash invested on term deposit at a lower rate than you're paying on the home-loan.** It's important to have emergency funds available at no cost. But Brent Procter financial planner with PricewaterhouseCoopers says it's illogical to get 4% on term deposit and pay twice that on your mortgage. "Due to a false sense of security most investors do this despite the revolving credit facilities available on their home loan.

2. **Falling prey to scams and "get-rich-quick-schemes".** The Serious Fraud Office estimates over 2000 people, covering the entire socio-economic spectrum have invested over $110 million in mainly overseas-based frauds over the past few years. What convinces intelligent investors to get caught up in Nigerian-based email chain letters, the prime bank scams (or Ponzi scheme) or scams closer to home says Procter is the expectation of above average earnings. "Rule number one, if it looks too good to be true – it probably is."

3. **Selling winners and hording losers:** Retail investors have a great habit of buying equities after institutional investors have piled into the stock and all the good news is already factored into the share price. After getting impatient they decide to sell out of the stock once the share price has fallen well below what they paid for it. The risk of taking a short-term view says Garcia is that investors will always tend to buy in boom and give up in gloom when they should do the opposite.

   Once they finally appreciate that markets run in cycles he suggests investors find the discipline needed to wait and buy-in at a good price. That's why he says it's important to have a firm grip on historical ranges and wait for opportunities when the price-to-earnings ratio (P/E) is low.

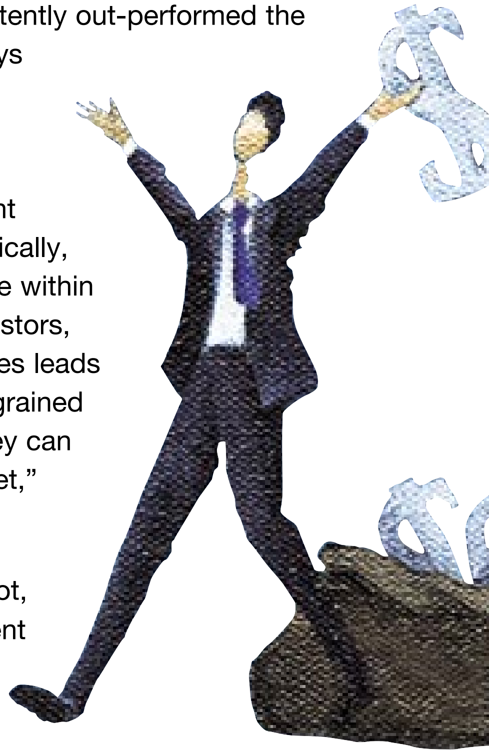
He also reminds investors that patience also applies to the decision to sell and warns them not to give up too early. "It may take time for the share price to move in your favour but your patience will be rewarded," says Garcia.

4 **Leaving an employer with a sizable lump sum payment and blowing a lot of it frivolously.** There's nothing wrong with treating yourself. But digging into a lump sum simply because it's suddenly available advises Procter isn't always the best option. "It's amazing how many people want to suddenly buy a coffee shop or run a small business. It would be better to use that lump sum to put into place a plan that provides more dependable income."

5 **Selling down managed funds too early:** History suggests retail investors are far too easily spooked into exiting a managed fund after the unit price suddenly falls. This is one of two main reason advises Garcia why share funds repeatedly out-perform most individual investors. In fact, results to a survey by US-based financial research house, Mercer show the annualised returns from the average US share fund delivered 13.1% between 1984 and 2000 – while the average investor's return was a paltry 5.3%.

6 **Backing yesterday's winners**. Then there are the investors who simply chop and change between managed funds in the expectation that last year's top performing managed funds will repeat the same success next year. Mark Brighouse chief investment officer with Spicers suggests investors question any investment or asset class that's had an exceptionally good run. That means being wary and having realistic expectations on what constitutes a good return within prevailing markets. "Odds are they won't be next year's star performers. That's why investors should be both knowledgeable and sceptical and get a good feel for market cycles."

7 **Opting for a DIY approach instead of seeking professional advice**. There's plenty of anecdotal evidence to suggest that DIY investors significantly under-perform those who seek professional advice. In fact, since issuing the challenge 17 years ago Garcia says no DIY investor has been able to prove they've consistently out-performed the market. He says DIY investors are also more likely to have a badly thought out plan. "Ironically, overconfidence within many DIY investors, especially males leads to a deeply ingrained fallacy that they can beat the market," says Garcia.



But like it or not, there's sufficient evidence to suggest that risk-averse female investors achieve better returns over time. What investors should remember, advises Garcia is that the cost of getting it wrong is far greater than simply getting it right. "What investors don't realise is that the emotional pain of a financial loss is three times greater than the effect of a gain."

What investment advisers bring to the table that DIY investors don't says Brighouse,

is structure around the investment decision making process. It's this structure explains Brighouse that helps investors align investment strategies with personal goals.

He suspects investors who have trouble distinguishing between "product-pushers" at one end of the industry and professional advisors at the other, probably aren't getting the level of independent advice they thought they were.

Sadly, when seemingly intelligent investors get disillusioned with, (or just neglect) professional advice, they end up putting all their investment eggs in one basket, and that often means residential property.

The high risk of permanent loss associated with this strategy – especially with residential property coming off the boil - says Procter means investors can easily ruin their retirement savings plan. "A 90% loan on a residential property that's vacant can start hurting very quickly."

8 **Exiting the share market when the going gets tough:** There's no shortage of data to defend the old truism that (providing you pay fair value) it's time in the market, not timing the market that's most important.

To Garcia it's disappointing that so many investors will only re-enter local equities once they start looking fully or over-valued. While there is some merit in trying to time the market Procter says this is an art best left to quality fund managers.

9 **Misunderstanding the levels of security associated with certain classes of debt issues and taking advertised returns at face value.** There's a general feeling amongst the investment community that returns being offered are out of whack with the inherent risk. Unbeknown to many investors Procter says the investment industry has started to build products that cater to two fundamental investor instincts:

A) The desire for the long-shot and

B) the fear of losing money.

He cites last year's preoccupation with hedged funds and "absolute return investments" as a prime example. This year the attraction is debenture stock and high yielding deposits, (mostly linked to property) offered by finance companies. Part of the problem says Brighouse is the huge explosion of finance companies (around 57) now competing aggressively within a very small market.

Procter says it's important for investors to scrutinise the level of security behind individual products on offer. That's especially true if a change of ownership means well known brands no longer provide the high level of security they once did. He says investors should also understand the difference between a return and a yield and realise that an interest rate can vary according to the performance of the underlying asset.

It's not uncommon, adds Garcia for investors to focus exclusively on income or capital gains, rather than the total after-tax return from their portfolio. For example, a managed fund increases its annual distribution to 15% and investors are extremely happy with the additional income. But what they often fail to realise is that the increase was due to the realisation of capital gains within the trust. When the unit price falls 3% to reflect the asset sales, investors panic and think the investment has gone sour, when in fact their total return is largely unchanged at 12%.

10 **Misunderstanding the unevenness of the tax playing-field and overlooking the impact fees can have on managed fund returns.** There's research to suggest that over the last 10 years between a third and quarter of total returns would have been taken up in fees alone.

The key says Procter is to know whether the fund manager is adding value. "Depending on the asset class you choose there are ways to minimise tax and fee exposure.

For example, UK Listed Trusts and Listed Property Trusts pay no capital gains tax and charge lower management fees."

What's in store?

So what sort of investment market are we in right now and what's the best strategy to adopt?

The cost of borrowing is expected to dampen long-term returns from equities globally. With interest rates on the rise Garcia recommends being overweight in cash and underweight in bonds.

But despite rising interest rates he expects Australian and NZ equities (now carrying lower debt levels and running at high capacity) to continue doing well.

"The only real dampener is rising interest-rates, so take a 'steady as she goes approach' and avoid taking too many risks."