Not Getting it Wrong - A Guide to Smarter Investing

Investing is often seen as the pursuit of big returns – the kind that can change lives. However, what is equally if not more important, is avoiding significant losses. Avoiding costly mistakes can have a profound impact on financial outcomes.

While getting things right is crucial, the importance of “not getting it wrong” should never be underestimated. Mistakes, whether from action (errors of commission) or inaction (errors of omission), can be costly. While missing out on an opportunity might sting, losing hard-earned money hurts much more.

Key Strategies for Avoiding Investing Pitfalls

1) Control Emotions - Fear and greed can lead to poor decisions like selling too early or buying too late after the best gains have already been realized. Maintaining a disciplined, long-term perspective is essential.

2) Avoid the Herd Mentality - Do not blindly follow trends. Do own research or consult a trusted expert to understand the fundamentals of an investment. The crowd is often wrong especially when emotions are running high.

3) Risk Management - No investment comes without risk, so understanding and managing risk is crucial. Mistakes are inevitable hence managing exposure can help limit potential losses.

4) Regularly Review and Rebalance - Regular reviews and rebalancing ensure that investments remain aligned with goals and risk tolerance. This proactive approach helps keep the strategy on track, even as markets fluctuate.

Mind the Gap - The Reality of Investor Returns

An enlightening analysis by Morningstar reveals a common issue: the gap between fund returns (often presented on a buy-and-hold basis) and what investors actually earn. Using the US market over a 10-year period ending 31 December, 2023, investors earned 1.1% less per year than the average fund's total return, largely due to poor timing in buying and selling the funds.

This gap was consistent across all 10 calendar years, underscoring the impact of investor behaviour on outcomes. A clear example occurred during the COVID-19 pandemic. Many investors who bought funds in late 2019 and early 2020 panicked as markets plummeted, pulling out their money and missing out on a portion of the eventual recovery.

Conclusion

The investment journey fraught with challenges, but success doesn’t hinge on perfection. Avoiding major mistakes by controlling emotions, thinking independently, managing risk, and regularly reviewing portfolios, helps to improve outcomes. Sometimes, the best way to win, is simply by not losing.

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