Top Investment Myths vs Reality

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Executive Summary

Separating fact from fiction is just as important with your investments as it is with any other aspect of your life.

When making investment decisions, try to keep these facts in mind:

- Seek slow, steady gains versus a series of big-wins
- Understand what you've invested in, not what the entire market is doing
- Manage risk by diversifying globally, don't 'stay home' and expect to avoid risks
- Since most investors want long-term performance, don't focus solely on the most recent results for a fund or individual company
- Look for 'buys' you want to 'hold' and be sure to fully understand why you bought them, and why you want to keep them

Most myths are driven by ignorance, so either increase your understanding, simplify your decisions, or better yet, opt for both!

What you need to know

Myth #1 – You should focus on finding opportunities that could turn into very lucrative "home run" investments.
Reality: You will make more over time by not making mistakes and limiting losses than by trying to hit home runs. This is because losses hurt more so than gains help. Consider it this way: if you lose 50% in an investment, you will need to earn a 100% return in order to get back to where you were before the loss.

If you are a stock investor, consider strategies such as placing stop-loss orders to reduce losses in a volatile market, subscribing to services that email you company specific news as it happens, and setting up loss review trigger points to review your investment.

If you are a mutual fund investor, consider investing in less volatile funds – ones with a low beta. The beta is a measure of how volatile your fund is compared to the market.

Myth #2 – The more you study the market, the better you will do within the market.
Reality: While you do need to know what the market is doing, the most successful investors study themselves and the companies they buy much more than they study the overall market.

Spend time studying successful investors such as Warren Buffet, arguably the greatest investor of all time thanks to his skill as the master of annual reports. There lies his edge: not on timing the market, but rather studying the companies he invests in.

Learning from the ones who do it best and studying how you make decisions is time well spent.

Myth #3 – International investing is too risky, you should stay domestic.
Reality: In today's global economy, it is risky not to invest some of your portfolio internationally. The average investor holds between about three-quarters of their stock investments in the domestic market.

The accepted thinking has been to limit international investing to not more than 15% of a portfolio. That has been true for the past 25 years but going forward that may actually limit returns. As the local economy struggles, second and third world countries emerge as first world countries entering the global economy.

The easiest way to invest internationally is through Mutual and Exchange Traded Funds. It may be worthwhile to consider increasing your allocation of established and emerging international companies with your longer-term investments.

Myth #4 – Good quarterly or annual returns mean the fund has a good strategy.
Reality: If you look at any prospectus or investment marketing material it has fine print that says something about past performance having no correlation with future results. Short-term returns mean very little and a fund that has a good quarter or year is actually more likely to be overvalued than one that has struggled. Long-term returns are a much better indicator.

Instead of focusing on last year's returns, look at the longer-term track record of the fund manager. How did they perform in a down market? How did they perform in a strong market? Go to the fund's website and read the annual report, or listen to or read interviews from the fund manager. Studying the management will give you more useful information than yesterday's performance.

Myth #5 – A more complex investment strategy is better, complex solutions beat the market.
Reality: A buy and hold, value investing approach has done the best over the long run despite its boring simplicity. Also, if a fund's strategy is too complicated for you to understand, how can you ever assess the risk it carries? All of Bernie Madoff's investors have one thing in common besides losing money: they didn't understand his strategy.

Bottom Line

No one said that investing was easy, but we certainly don't have to make it even more difficult. Part of keeping it simple is staying away from investment hype that distracts investors.

Top Investment Myths vs Reality

The reality of strong investment performance is that it is better to limit losses, and make steady progress than gambling your hard-earned money on high-risk, volatile stocks and funds.

A good rule of thumb to live by is: consistent returns during the day, will allow you to sleep better at night!