The financial markets reached record highs in 2017, reflecting a growing economy.[1] Complex weather events and political and global developments emerged, making the environment challenging for investors to navigate.[2]

Experience has taught us that successful investing requires discipline and patience. A long-term investment focus can help when emotions run high. While balancing ongoing changes can seem daunting, a steady course can help buffer you against turbulence and uncertainty.

To help you overcome these challenges, we've compiled a list of common mistakes and guidelines.

“ACCURATELY CHASING THE MARKET’S TOP AND BOTTOM IS VIRTUALLY IMPOSSIBLE”

MISTAKE #1: BELIEVING INVESTING IS A SMOOTH RIDE

Even though the stock markets have performed well overall, investors need to remember that nothing lasts forever. The dot-com bubble of the 1990s and the Great Recession from the 2000s remind us that, eventually, high markets will fall. However, investors may still find opportunities to grow their money in a choppy market.

To help you stay ahead of market developments, preparing for declines is essential. The desire to pull out of the markets when they tumble can trump long-term goals. Instead of retreating during turbulence, you may need to adjust your investment mix. By remaining flexible, you may take advantage of opportunities to act on underpriced assets, manage risk, and increase return potential.

Active portfolio management enables you to make these types of investment moves. But before you act, a good first step is to create the strategies that will guide your investment decisions. Retreating and starting over each time can make it difficult to catch up.

MISTAKE #2: TRYING TO TIME THE MARKET

When markets rally or pull back, seeking out the top to sell or the bottom to buy may seem tempting. The problem, however, is that investors usually guess wrong, potentially missing out on the best market plays.

For example, between 1986 and 2005, the S&P 500’s* annual compound rate was 11.9%—even while weathering Black Monday, the dot-com pop, 9/11, and more. Over that period, $10,000 invested in 1986 would have grown to more than $94,000 (excluding investment fees and expenses).[3] The average investor’s return during that period, however, was just 3.9%, meaning that same $10,000 grew to slightly more than $21,000.[4]

WHY?

One reason is trying to time the market. When people invest on the high and pulls out on the low, they may miss opportunities by not remaining patient. The problem is that equity gains can often be made in a very short amount of time. If you are not in the stock when it moves, you may miss out on the whole play.

The bottom line? Accurately chasing the market’s top and bottom is virtually impossible. No one can do it consistently. A better approach may be on small adjustments to help you stay the course.

* The S&P 500 is an unmanaged index which cannot be invested into directly. Past performance is no guarantee of future results.

MISTAKE #3: TAKING TOO MUCH RISK

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Not timing the markets is one thing. Another mistake is having too much risk in your portfolio. Risk involves the chance that the investment you choose will perform differently than you anticipate.[5]

During the bull market days of the mid 1990s and early 2000s, money poured into equities—often into risky tech and internet stocks.[6] The value stocks trading low had many of their investors fleeing toward higher returns.[7] When a bear market followed 9/11, the bottom fell out of the tech sector; meanwhile, many value stocks weathered the storm.[8] Investors who took on too much risk—not wanting to miss out on the dot-com boom—most likely saw their portfolios take a severe beating.

Portfolio risk can be insidious. Holding a diverse mix of stocks, bonds, and alternatives may seem adequate for managing risk, but it's just one component. If you correlate these investments—meaning they move in similar patterns—then you could jeopardize your portfolio. If the investments respond to market declines all in the same way, you may increase the risk of losing all your money.

The objective is to take on the amount of risk that still aligns you with your long-term goals. When evaluating your portfolio, ask yourself these questions:

- Are you too heavily invested in one asset class, sector, or geographical region?
- Do you hold too many alternative investments?
- Do you hold many of the same investments or overlap too much?
- Is your portfolio correctly structured for your long-term goals, investment horizon, and appetite for risk?

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MISTAKE #4: TAKING TOO LITTLE RISK

Playing the market cautiously and taking on too little risk may also negatively affect your portfolio. While minimal risk can feel like a safe move, you could miss important market rallies.

During periods of market turbulence, many investors tend to flock to low-risk investments like U.S. Treasuries and cash.[9] This aversion to risk can affect long-term investments as too many fixed-rate investments put a cap on your portfolio's profitability.[10] Inflation is a serious concern in long-term investing and too little growth in your investments can leave you with a shortfall in your retirement years.

Even in both 2016 and 2017, investors pulled billions of dollars out of U.S. stocks—the largest amount since 2004—despite the S&P 500 experiencing record highs.[11] And a variety of factors may be causing investors to act more cautiously, including ongoing global uncertainties and fears from market highs.[12] By trying to reduce portfolio losses, however, investors may be trading one type of risk for others: inflation, high valuations, and greater-than-expected volatility.

While equities can have greater loss potential than short-term, fixed-rate investments, they also can have a greater potential for gain.[13] For many investors, hunkering down only in safe haven investments—ones that retain value during market turbulence—is a luxury but not realistic. With inflation eating away at cash every year, most investors need at least some growth-oriented investments.

To know whether you should take on more risk, consult with your investment representative. Ask yourself the following questions:

- Do I have enough growth-oriented investments in my portfolio?
- Can I afford to take short-term losses for long-term gain?
- Could I afford to live on Social Security or other income in the event my accounts decline in value?
- How comfortable do I feel taking on more risk to potentially achieve higher investment returns?
- Could I live on my investments without taking on additional risk?

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MISTAKE #5: MAKING EMOTIONAL INVESTMENT DECISIONS

When markets swing, emotional decision-making can wreak havoc on the most carefully designed investment strategies.

A large number of investors lost money in the mortgage-meltdown of 2008. Many cashed out near the bottom, fearing that the markets themselves were collapsing. But even as markets rally, some investors still aren't taking on enough risk and have their money sitting on the sidelines.[14]

The memories of the crash run deep. Gen X investors (born between 1965 and 1981) have experienced many market falls, making them more susceptible to emotional investment decisions.[15] Some investors may even still make emotional decisions when working with a professional. According to one study, 57% of investors who work with investments representatives still panic and sell during down markets.[16]

Fear and greed can easily drive our financial decisions. Fear can cause us to abandon an investment strategy when the outcome is not what we want. Greed can cause us to chase investment fads and take on too much risk. As you invest, you can support your long-term strategies by avoiding these emotion-based decisions.[17]

As investment representatives, we can serve as the voice of reason when emotions run high. When markets decline, remember that we can help answer questions, provide reassurance, and show you the opportunities that volatile markets may provide.

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MISTAKE #6: FAILING TO DIVERSIFY

Warren Buffett once said that diversification* is a "protection against ignorance."[18] In other words, no one can know everything about an investment or predict the future.

The first part of a diversification strategy consists of mixing asset classes by holding various stocks, bonds, and cash.[19] You can also include alternative investments, like real estate, that match your goals and investment profile.

By diversifying, you can avoid investing aggressively into one class. If your investments weigh heavy in one area during a market rise or fall, the dynamics could devastate your portfolio.[20]

The second part of a properly diversified portfolio is mixing within asset classes.[21] One critical mistake many working investors make is holding too much of their employer's stock, which can be a recipe for calamity. Imagine that you lost your job and access to your company's stock; you could lose your retirement savings in one fell swoop. Some experts recommend capping them at 10%.[22]

To help overcome this risk, opt into a good mix of small-cap, large-cap, international, and sector-diverse equities.** While a market decline may affect a certain stock or sector, a gain in another might offset the loss.

*Neither diversification nor asset reallocation can ensure a profit or protect against a loss. There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. **Alternative investments may not be suitable for all investors and should be considered as an investment for the risk capital portion of the investor's portfolio. The strategies employed in the management of alternative investments may accelerate the velocity of potential losses. Investing in small-cap companies may involve greater risk in price volatility and potential reward than investing in larger, more established companies. International investing presents certain risks not associated with investing solely in the United States. These include currency fluctuations, political risks, accounting procedure differences and the lesser degree of public information required to be provided by non-U.S. companies.

MISTAKE #7: FOCUSING MORE ON RETURNS THAN MANAGING RISK

Many investors make a big error by chasing performance. Buying an investment due to its past performance is not a reliable way to predict future winners. Popular growth stocks in the 90s experienced great returns before they suddenly went south, taking many investors' portfolios with them. [23]

In short, if a particular asset class continually outperforms for 3 or 4 years, you can know one thing with certainty: You should have invested 3 or 4 years ago. Often, by the time the average investor decides to invest, experienced investors have already rebalanced. Meanwhile, the not-so-savvy money continues to pour in beyond the investment's prime. Don't make this mistake. Stick to your strategy, rebalance, and focus on investments with great fundamentals rather than chasing returns.

MISTAKE #8: IGNORING THE IMPACT OF TAXES

When reviewing investments, one key rule to keep in mind is that you should always look at the after-tax return of an investment.

At first glance, a 5% return beats a 3% return any day of the week. However, if the 5% return was from taxable stock dividends and the 3% came from tax-free municipal bonds, then the situation changes. For example, a hypothetical $10,000 investment might be worth $17,908 after 10 years at a 6% annual return.[24] However, after accounting for hypothetical state and federal taxes (5 percent and 25 percent, respectively), you would only take home $11,228. These taxes push your annual return down to just 1.2 percent. *

Ignoring taxes never pays.

* This example is for hypothetical purposes only. It is not intended to portray past or future investment performance for any specific investment. Your own investment may perform better or worse than this example.

You should consider the impact of taxes whenever you:

- Buy or sell investments
- Develop a financial strategy
- Discuss your estate or philanthropic plans
- Give gifts

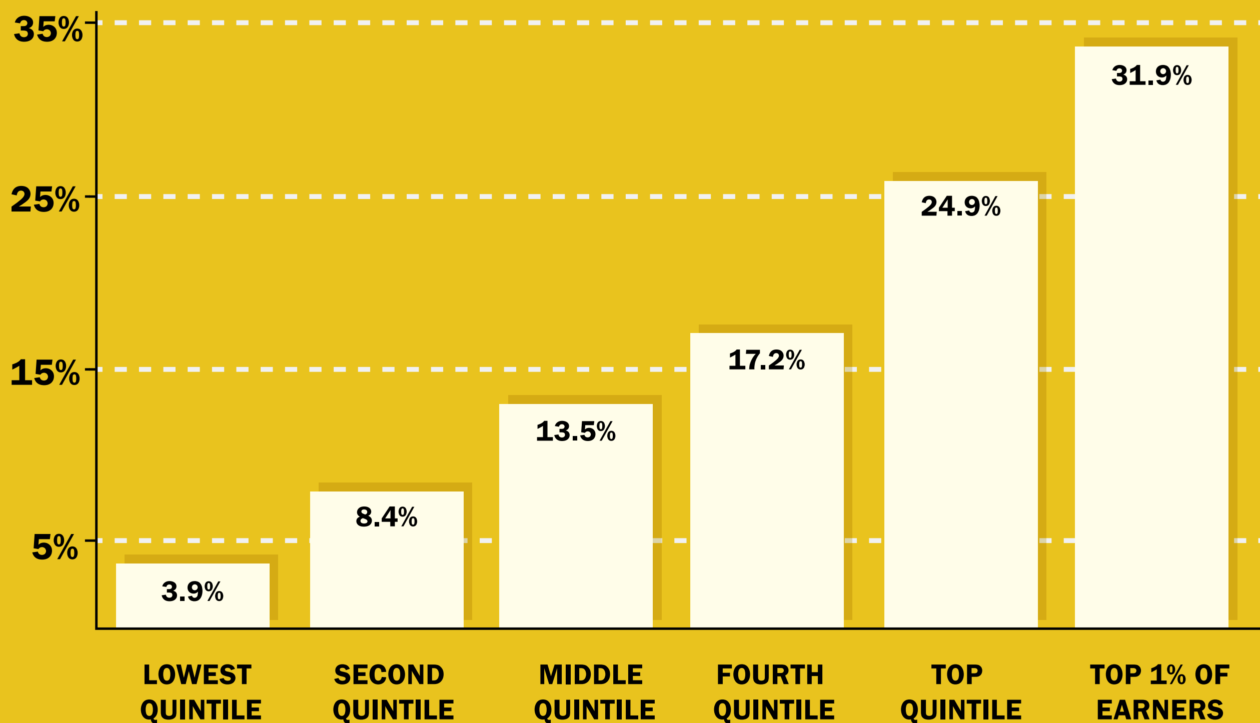
Remember that the federal government taxes investment income like dividends, interest, and rent on real estate, as well as capital gains. Thus, it's critical to efficiently structure your investments to help minimize how much money you lose to taxes.

The chart to the right illustrates how much money American households pay into taxes as a proportion of their income. As our incomes increase, so do our tax liabilities.

To minimize tax obligations, one investment strategy is to shift a portion of investments to assets that generate income exempt from federal taxes, such as municipal bonds.* And while this approach may not work for everyone, it reflects how forward-looking strategies can help you thoughtfully structure your portfolio. If you are concerned about taxes, be sure to discuss these items with your investment representative and tax professionals. They can work with you to determine which options are right for you.

Note: While taxes are not something to overlook, sound investment strategies focus on one's investment goals, appetite for risk, and time horizon.

*Municipal bonds are subject to availability and change in price. They are subject to market and interest-rate risk if sold prior to maturity. Bond values will decline as interest rates rise. Interest income may be subject to the alternative minimum tax. Municipal bonds are federally tax-free but other state and local taxes may apply.



Source: Peter G. Peterson Foundation and Tax Policy Center, as of March 2017.
Effective federal tax rate is calculated as total federal taxes paid divided by cash income.

MISTAKE #9: AVOIDING PROFESSIONAL ADVICE

Being unaware of your own mistakes can lead you down a detrimental investment experience.

For example, in studies gauging people's feelings on whether they are better than the average person at a task, about 90% of respondents will believe that they are. In reality, the vast majority of people can't all be better than average—meaning, many people are not self-aware. And the same thinking applies to people who choose to invest by themselves.[25]

As such, having someone there to help you make sound, logical investment decisions can help you overcome your own irrational perspectives. In fact, Americans are unsure how to even prepare for retirement: 74% of people surveyed agree they need more retirement preparation, but 40% don't know how. But professional guidance can help. People who work with a financial representative report more confidence in their ability to reach retirement goals.

Successful long-term investing requires the ability to position and rebalance your portfolio to ride bear and bull markets. This level of complexity can make working with an investment representative critical to your ability to meet your goals.[26]

Chasing returns and following cookie-cutter approaches on your own is risky. We believe successfully navigating the turbulent investing world of today requires training, prudent management, and commitment to a long-term, active investing strategy.

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9 INVESTMENT PITFALLS

TIPS FOR GUIDING HIGH-NET-WORTH INVESTORS