Three Common Investment Mistakes, And How To Fix Them

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Whether you're working with a broker or advisor, or you're managing your own investments, watch out for these common investment errors. They are: 1) having multiple overlapping holdings (and not being aware of it), 2) having a risky portfolio that's a poor fit with your needs and 3) letting one spouse (often the husband) make all of the investment decisions. *Note: Even if you have a broker or advisor investing for you, these mistakes still may occur.* Here's what to do to fix them.

<u>Mistake #1: Overlapping Holdings in Mutual Funds</u>

Lynn Turner believe she has a diversified investment portfolio because she holds approx. 20 mutual funds. Some have exotic or interesting names – one of the reasons she admits she chose to invest in them. In short, Lynn isn't really sure what she's invested in. When her new advisor analyzed her holdings, Lynn understood she's invested in overlapping US large cap holdings that repeat themselves across many of her mutual funds. Her portfolio is NOT diversified.

<u>What To Do:</u> A Fee-Only Advisor who doesn't benefit from commissioned investments can recommend low cost funds and build a diversified portfolio across asset classes. This approach bypasses the A, B and C share commissioned funds that pay your advisor but weaken your returns due to high fees.

<u>Mistake #2: Extreme Portfolios that Run Counter to Your Financial Needs and Risk Tolerance</u>

The Smiths are both 55. They have a relatively low [risk tolerance] and they plan to retire in 10 years. Their broker never asked them about their financial goals and retirement plans (and he doesn't provide financial planning services anyway because he doesn't have the credentials, incentive or experience to do so). The Smiths' broker created a very complicated portfolio that consists of over 150 positions in different US stocks. The broker frequently traded positions so the Smiths figured he was working on their behalf. What the Smiths didn't realize was that their broker was incentivized to churn their portfolio and put them into commissioned products to boost his income. The broker paid no heed to the fact that the Smiths had a low appetite for risk.

When the Smiths changed advisors they discovered their portfolio was extremely risky – with over 75% of their positions in a single asset class: US large cap value stocks. They held very few bonds, no mid or small-cap US stocks, few US growth stocks, virtually no international stocks (developed and emerging) and no Real Estate Investment Trusts. The Smiths were running the equivalent of a raging fever. Their new advisor did a thorough financial plan for them and reallocated investments to bring down the temperature and foster diversification. Doing this strengthened their financial plan and helped them better understand their investments.

What To Do: The best financial advice combines fee-only (no products sold) financial planning AND investment design/management. If you choose to go it alone, use a system like www.morningstar.com to add up all of your positions and see how they are categorized in terms of asset class size and variety.

Mistake #3: Letting One Spouse (Often the Husband) Make All the Investment Decisions

Studies show that husbands in ¾ of heterosexual marriages become the sole investment decision-maker. In general, men tend to take on more risk and they tend to work more by the seat of their pants when choosing investments. Women, by comparison, tend to be more cautious and they tend to study things before making investment decisions.

Even if you engage an advisor, studies show brokers and advisors (most are men) tend to talk more to the husband – and tend to ignore the wife even when the couple come in together to consult an advisor. If the husband dies, the wife may find she not only has a portfolio she doesn't understand, she may also have inherited an advisor who doesn't know how to bring her into a conversation, doesn't know how to explain things and may talk down to her.

What To Do: Work with a Fee-Only advisor who listens to you, can draw up a financial plan and create an investment portfolio that matches your risk tolerance and your long-term financial needs.

Investing can be complicated. Making prudent investment decisions at any stage of your life helps strengthen your financial plan. At the end of the day, it's all about avoiding outliving your assets. If your advisor can't explain why your portfolio is structured the way it is, find another advisor.