# Things to avoid when investing

There are more risks and opportunities than ever for investors to navigate in today's rapidly evolving markets. Yet some investment principles stand the test of time. Here we have summarised four approaches we believe every investor should follow.

## 1. Don't pile into cash – stay invested

As we use cash on a daily basis, it's probably the asset class you're most familiar with. There are lots of places where you can hold your cash, with bank and building society accounts typically being the most popular.

The biggest advantage of cash is that it offers relative safety. Cash can help diversify a portfolio during times of volatility and is easy to access in an emergency. With cash you'll be paid interest on the money, which will be tax free where it's in an ISA.

You won't lose any money by putting your money in cash, but it tends to offer lower returns than other asset classes. It's also important to know about the impact of inflation on your savings and investments as it can make a huge difference to how much profit you make. Cash is seen as a short-term safe haven and should not be held over a substantial period of time to avoid the impact of inflation (figure 1).

While it's advisable to have some cash savings for a rainy day, the spending value of your money can fall over time if inflation is higher than the interest rate you receive. For example, if inflation is 2%, this means that the value of goods such as food, fuel and clothing go up by 2% in value each year. However, if the interest rate you are earning on your savings is 1%, this means the buying power of your cash is actually falling.

### Figure 1: Serving up an increase

How inflation has changed the average price of a pint of pasteurised milk over time (pence).


Source: Office for National Statistics.

With interest rates on cash investments at historically low levels, and well below the inflation rate, millions of people up and down the country have seen the value of their savings eroded in recent years. So if you want to make money on your investment, you'll need to find an account or investment that gives you a greater return than the current rate of inflation.

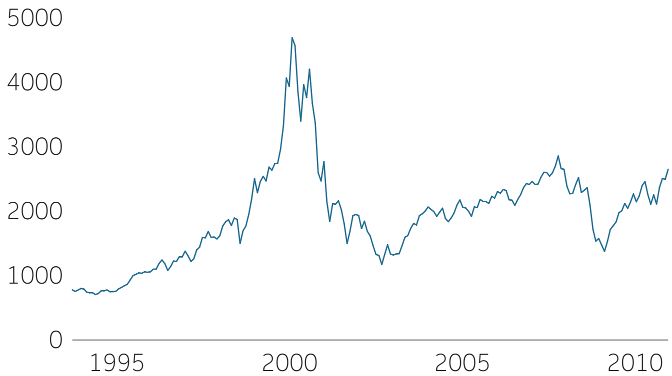
## 2. Don't go chasing fads – think about the long term

Short-term gains can seem appealing for investors, but if you don't want to lose your savings, it's best to not believe the hype about the latest investment craze.

History is littered with economic bubbles, which have seen stocks priced well above their intrinsic value suddenly collapse. For example, the dotcom bubble fuelled excessive speculation of internet-related companies in the 1990s. When it burst in 2000 it triggered a massive sell-off, leaving investors with significant losses (figure 2).

### Figure 2: Chasing returns

On 10 March 2000, the Nasdaq, which is heavily skewed to technology stocks, peaked at the height of the dotcom bubble.




Source: Bloomberg.

Choosing the wrong investment can be a costly mistake. Lots of investors are turning to social media platforms such as Facebook, Twitter, YouTube, TikTok and other unregulated sources for information about investing.

While it may seem tempting, getting investment recommendations this way puts you at significant risk from volatile stocks or even fraud. It's easy to jump on the bandwagon, but momentum is typically falling by the time most people join.

In the recent case of GameStop, its price was artificially inflated by investors in online communities. As word got out, more and more people started to pile into the stock, even though the business had been struggling for years. Just days after it reached a peak its price plummeted, highlighting how quickly losses can hit investors if they're not careful.

If an investment sounds too good to be true it probably is. Any investment opportunity that claims you'll receive substantially more than the well-known stock indexes could be highly risky or even fraudulent.

## 3. Don't put all your eggs in one basket – diversify

One of the biggest mistakes you can make when investing is putting all of your eggs in one basket as it can leave you exposed to fluctuations in the market. If you've invested in one stock and something unexpected happens and it plummets, you could find your nest egg suddenly disappearing.

When investing, one way to lower risk is by spreading your wealth over a wider range of investments so it's not concentrated in one place – known as diversification. By diversifying your portfolio you can reduce the risk that all of your investments will experience the same negative impact at the same time.

If you want to benefit from diversification you need to invest in a range of assets that behave differently to each other. By investing in assets that do not relate to each other, when one investment in your portfolio is falling, the others can make up for it.

Ideally, you should be looking to build a diverse portfolio with a mix of different investments in line with your attitude to risk. A balanced portfolio will contain a mixture of asset classes, such as stocks, bonds and alternatives. Using collective investment funds can be an effective way to invest and achieve the diversified asset mix you are aiming for.

Shares will move up or down depending on how well companies perform, while bonds will be primarily influenced by interest rates. You can spread risk further by diversifying across sectors and geographical regions. Selecting a range of different sectors will protect you if one industry takes a downturn. For example, if healthcare stocks fall, your investments in the financial services sector may do well.

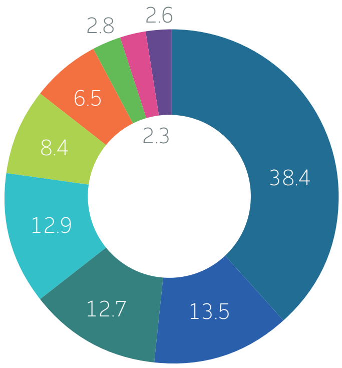
Spreading your investments globally rather than investing in just one market will help shield you from any economic issues in that country. Emerging markets such as China, Brazil and India offer potentially higher returns, but they tend to be more volatile than developed economies such as the UK and the US. The outlook for growth will also vary significantly across countries, with different regions recovering at different speeds depending on the pandemic's path and vaccine rollouts.

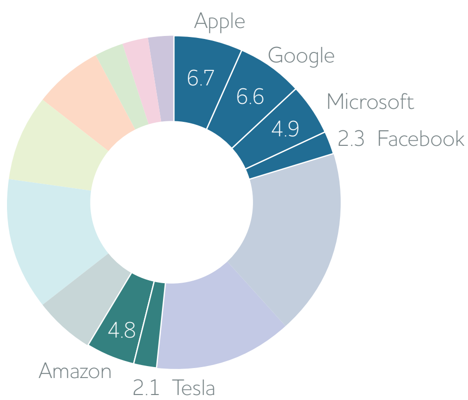
Investing in an index fund could also leave you vulnerable to the downside, especially if it is weighted too much towards one sector. Investors might feel they are well-diversified by investing in global indices, but they could unknowingly be leaving themselves open to stock-specific risks.

Technology stocks are currently the largest sector in the S&P 500, accounting for nearly 40% of the index (figure 3). While having a large US and technology exposure should be of little concern to investors at the moment, if they fall out of favour the S&P could be hit harder.

## Figure 3: A concentrated market

Technology companies have become even more dominant over the past year with the FAAGM stocks and Tesla making up almost a third of the market's value (%).




Technology* | Healthcare | Consumer discretionary | Financials** | Industrials
Consumer staples | Utilities | Energy | Materials

Source: S&P Dow Jones Indices. *Technology comprises the IT, communications and telecoms sectors. **Financials includes the real estate sector.

## 4. Don't do something – sit tight

When markets wobble it can be tempting for investors to sell their shares to avoid any further losses. It's easy to react to short-term losses but the best thing you can do is most often precisely nothing.

Compounding is a powerful tool, which can help make your money work for you without having to do anything. It is the ability of an asset to generate earnings, which are then reinvested with the goal of generating more earnings.

For example, if you put a deposit in a bank, the money will earn interest. That combined money will earn interest on top of that, going up each time.

When you invest in the stock markets, many of your investments will pay a dividend, which is a share of the profits of the underlying company. If you reinvest this income, your returns will be compounded over time in exactly the same way the interest on cash does. So as long as you keep your dividends reinvesting, you can benefit from the power of compounding.

When markets fall, your first instinct may be to sell your investments, but this could cost you dearly. For example, if you'd invested £1,000 in the FTSE All Share in 2001 and left it alone, 20 years later it would be worth £2,828. However, if you'd attempted timing investments and consequently missed the 10 best days (which often come shortly after bad days in markets), the same investment would be worth £1,471 (figure 4).

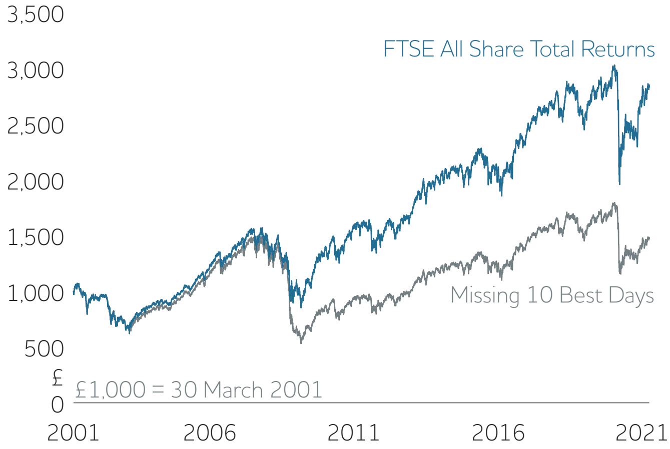
Timing the market involves buying and selling investments when you think they will rise or fall at exactly the right moment. It's a difficult strategy that rarely works and there are too many unpredictable factors.

If you sell into a falling market you will lock in your losses and it could take you years to get back to where you were. While markets can fall sharply, given time they can rebound, so instead make sure you take the long view.

Stock markets have a history of recovering from downturns. If you see your investment drop, don't worry. Just keep your cool and sit tight.

## Figure 4: Keep calm and carry on

Staying invested over the long term means you won't miss out when markets enjoy their strongest periods of performance.




Source: Bloomberg

## It pays to seek advice

A financial adviser can help you work out how to achieve your long-term financial goals, while taking inflation into account so it doesn't eat up your returns. They will also be able to help you put together a robust long-term investment plan that is in line with your objectives.

Your adviser will speak to you about your attitude towards risk and the level you are comfortable with in order to make the right investment choices. Market fluctuations are normal and to some extent even expected. During periods of market turmoil it is easy to panic but speaking to a financial adviser can help ease any worries you may have.

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