Common Investment Mistakes

In a recent survey, the CFA Institute, which administers the highly regarded Chartered Financial Analyst (CFA) Program worldwide, asked its members for their views on the most common mistakes made by individual investors. Among the most common mistakes cited were:

1. **No investment strategy:** Too often individual investors invest without first establishing a formalized investment strategy that incorporates their financial goals and objectives, investment time horizon, risk tolerance, and other relevant factors.

   At COMPASS Wealth Management, we create an Investment Policy Statement for each client that establishes a customized set of guidelines and parameters for their portfolio.

2. **Buying high and selling low:** Although a fundamental investment principle is to buy low and sell high, emotional decisions often result in buying high and selling low. Many investors are tempted to invest in a stock, mutual fund, or an area of the market that has performed well, assuming that it will continue its recent trend. These "performance chasers" are frequently disappointed when the latest investment fad comes crashing back to earth.

   Our approach, on the other hand, is to maintain a prudent and disciplined asset allocation and diversification strategy. This approach can weather all types of market environments and avoids the temptation of falling for the latest fashionable investment.

3. **Frequent trading:** The temptation to trade can be a costly one. Based on academic studies, investors who actively trade their portfolio tend to underperform the returns generated by investors who follow a buy-and-hold strategy. Why? Active traders suffer from higher transaction costs and incur greater taxes, as well as the drawback of trading on emotion instead of pursuing a disciplined approach.

   We adhere to a buy-and-hold strategy when investing on behalf of our clients. While we certainly do not trade frequently, we do monitor developments that affect each of our clients' investments and make changes when warranted; these changes are communicated to clients in advance. In addition, we rebalance client portfolios to maintain compliance with the investment parameters that were established in each client's Investment Policy Statement.

Saving For College

According to the Social Security Administration, Jacob and Emily were the most popular baby names in 2005, the most recent year for which data has been compiled. In fact, Jacob has been the most popular boy name for the past 7 years, while Emily has been the most popular girl name for the past 10 years. To fully meet the total projected costs of college 17 years from now, Jacob and Emily's parents have quite a bill ahead of them. Assuming an annual inflation rate of 6%, attending a four-year public university, which costs $16,357 on average this school year, will require more than $192,000 for four years of education. Similarly, attending a four-year private university, which costs $33,301 on average this school year, will require an additional $200,000, or over $392,000 for four years of education.

Fortunately, Section 529 and Coverdell accounts are available to help save for educational costs. In fact, last August the federal tax exemption for Section 529 plans was made permanent with the passage of the Pension Protection Act of 2006. Consequently, withdrawals from Section 529 accounts to pay for qualified educational expenses will be federally tax-free into the future. Previously, the federal tax-free nature of distributions was set to expire at the end of 2010. If you could benefit from our education funding expertise, please do not hesitate to contact us.

Written and edited by Louis E. Conrad II, CFA.

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