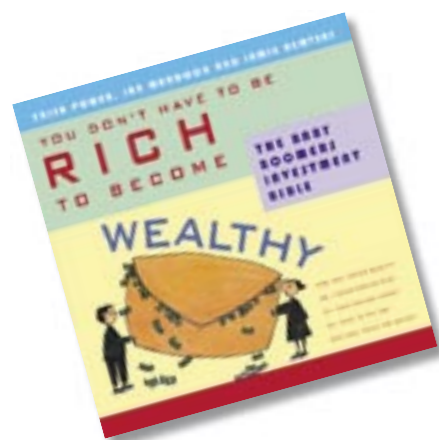


YOU DON'T HAVE TO BE RICH TO BECOME WEALTHY



FACT FILE

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Wealth in experience

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Money's book extract focuses on how to avoid the 15 biggest investment mistakes

Illustration **Christopher Nielsen**

I've often felt there might be more to be gained by studying business failures than business successes. **Warren Buffett**

INVESTORS ARE HUMAN, and humans can make mistakes. Sometimes these mistakes can be financially devastating. Apart from causing financial loss, investment mistakes can also be lessons that make you wiser about investing.

Over the long term, learning from your mistakes can save you tens of thousands of dollars. Then again, why repeat the mistakes of investors that have gone before you? The surest way to protect your investment money is not to make mistakes.

Get smart from the experience of others and avoid the 15 biggest investment mistakes (in no particular order) that we believe are made by Australian investors. We also include words of wisdom from Warren Buffett and other successful investors.

Mistake 1: The art of procrastination
You don't have to be great to get started, but you have to get started to be great.
Les Brown (US motivational speaker)

The biggest mistake by far is not taking the first step on your journey towards wealth accumulation. Don't delay. Read this book. Prepare your strategy and get started.

For some potential investors, the fear of making the wrong decision prevents them from

getting started. We call this personal inertia. Investing can be as simple as deciding to divert your savings to a high-interest bank account, or as ambitious as working towards becoming "independently wealthy" (which means not working for a living, if the term is new to you).

By getting started, your savings can be making money for you immediately. You don't need to be a moneybags to start investing. You can open a high-interest bank account with \$1. You can purchase a parcel of shares with, say, \$500. You can buy units in a managed fund with as little as \$1000.

You can divert some of your before-tax salary to your superannuation fund. And if you don't mind debt and taking out mortgage insurance, you can buy an investment property with only 5% of the value of the property in cash.

Mistake 2: Relying on one basket - lack of diversification

Investors should plan to have portfolios which hold enough stocks to provide a spread of risk through diversification, but are limited to a reasonable number so that the portfolio is compact.

Austin Donnelly (Australian financial adviser and author)

Unless you're willing to lose your shirt, the prevailing wisdom is: "don't put all of your eggs in one basket". The upside of diversification is that it enables you to minimise



losses. Spreading your risk over a number of investments and asset classes means that if one of your investments delivers a poor return or even collapses, your other investments should protect you from devastating losses. Diversifying your assets can also increase your chances of getting stable returns over time. The downside of diversification is that if one of your stocks delivers a mega-return, then only part of your portfolio will benefit from that return. By choosing to put 100% of your investment money into one investment, your wealth accumulation is wholly dependent on the health of that one investment. A recent example of where a lack of diversification hit hard was the collapse of Westpoint and its related companies. Westpoint built apart-

ments, but also raised finance to build these apartments from "mum and dad" investors. Thousands of investors poured their life savings into these high-risk investments with the promise of a high return — but around 4000 investors lost nearly \$400 million. In some cases, investors lost their homes because they had borrowed against them to invest in Westpoint.

Mistake 3: Driving blind - no investment strategy

I can guarantee you one thing. Those who put an investment program in place will have a lot more money when they come to retire than those who never got around to it. **Noel Whittaker (Australian financial adviser)**

Investing without a plan, or what we call patchwork planning, usually means you end up somewhere you don't expect. What's even more depressing is that you usually end up where you don't want to be.

Patchwork planning can be compared to a weekend drive, where you have no destination planned and no map to guide you. You may be pleasantly surprised by your final destination, but you could also be very disappointed. Even more frustrating is that now you have to backtrack, or even return to where you started.

If you're lucky, dabbling in investments can work out financially, but the surest way to accumulate wealth is to build a framework for making investment decisions.

Mistake 4: Flying blind - investing in assets you don't understand

Never invest in any idea you can't illustrate with a crayon. **Peter Lynch (successful Wall Street share investor)**

Avoid any investment where you don't understand:

- what the business is you're investing in
- how it operates
- how its success is going to translate into profits and eventual dividends or capital gains for you.

During the tech boom of the late 1990s, investors were buying shares in any company that had the word "net" in its name — for example, Davnet, Voicenet — or companies that used the internet to facilitate their business. It didn't matter what the business sold — travel, gifts, or empty promises — provided it involved the internet. Share punters were madly buying shares and driving up the share price.

In those heady days investors lost perspective on the true value of companies and chased "tech" stocks. Most investors didn't appreciate that 99% of the tech companies were never going to make money for anyone, least of all the shareholders. In the frenzy, they forgot about the "blue-chip" companies, which are those companies that run profitable businesses and pay dividends. The secret to share investing is to invest in businesses that know how to make money.

In early 2000, the tech bubble burst and investors lost lots of money. The tech companies shut up shop or suffered a serious reality check in share price. The chief executives of the surviving companies learnt about budgets and cost management and that running a company was about running a business.

Mistake 5: Falling in love with your investments

Buy stocks like you buy groceries, not like you buy perfume. **Warren Buffett**

When considering romance, remember the Beatles' lyrics, "Money can't buy me love". Conversely, buying for love when you are investing won't necessarily make you money. Purchasing a yacht or an antique sports car might make you feel good, but boats and cars are perfect examples of where a lifestyle asset and a love for sailing or cars can become confused with an investment decision.

It's also possible to suffer unrequited love with a share that you buy on the sharemarket. The most common instance of misplaced



love is where the value of a share increases substantially and stockbrokers and fund managers are also recommending the stock. The love affair goes wrong when the share price drops because the company doesn't deliver on its promises or potential, and then the share price continues to drop over time.

Some investors hold on to a forlorn hope that the price will turn around, even when the brokers and managers start recommending that investors sell the share. This type of love affair is particularly common when an individual has invested substantial amounts of money in the stock and doesn't want to make a loss.

Mistake 6: Winning the race before you finish

The supply of fools is not limitless, so the smart thing is to be no later than the second-last fool when the crunch comes and the boom turns into a slump. **Austin Donnelly**

Inexperienced investors who enjoy early success with one or two investments can sometimes get cocky. They mistakenly believe they have the "Midas touch". Investors may then take greater risks and expose their investment portfolio to future losses when they make bad investment choices or when

the market suffers a downturn. Another common example of winning the race before you finish is when investors spend more money on fancy dinners or holidays because their share portfolio has gone up in value, or their investment property is worth more than it was when they bought it.

Unless you sell the asset, these gains are only paper gains so they may fall again. Behaving as if you have that extra wealth in your hand to spend, or to borrow substantially against this paper wealth, is a sure way to lose that wealth.

Mistake 7: Believing the guy in the pub

Basic economic theory suggests that demand falls as prices go up. But in the case of speculative markets, the opposite seems to be true.

Marc Faber (international investment commentator)

If the guy in the pub or your taxidriver starts giving you share tips it's time to get out of the market. Remember, he's probably told everyone he's spoken to today and overheard the tips when a broker was talking to a client on the mobile phone in his taxi. Even more likely, the taxidriver has misheard the investment tip and is giving you incorrect information. Chinese whispers can turn the

original into a very different message by the time you hear about it.

The taxi chatter or dinner party discussions or barbecue chinwag normally focuses on a certain category of stocks. In 2006, it was mining and resource stocks, whereas in 1999 it was technology stocks. In the early 2000s everyone talked about property prices.

Another sign that the property or sharemarket is booming is a proliferation of get-rich-quick seminars advertised in the newspapers. Although investment seminars that explain the investing basics can be extremely useful, it still amazes us that Australians are willing to fork out thousands of dollars for get-rich-quick seminars where the organisers are flogging investments (see Mistake 11, Relying on donkey logic).

You can usually learn a lot more from a book like this than attending expensive seminars.

Mistake 8: Relying on white noise

The ... qualities [an investor ought to have] include patience, self-reliance, common sense, a tolerance for pain, open-mindedness, detachment, persistence, humility, flexibility, a willingness to do independent research, an equal willingness to admit mistakes and the ability to ignore general panic. **Peter Lynch**

Reading the finance section of the newspaper on a daily basis can cause panic or exhilaration, depending on where you have your money invested. One day the newspapers report the property market is about to crash, but the next day they report property prices are going up. The market analysts can't agree on what the sharemarket is going to do in the next 12 months. That's okay: no-one can predict the future, so why do they pretend to be fortune tellers?

Panic investing is a sign of two extremes: either the investment markets are booming or they are collapsing. Chasing the latest boom based on newspaper reports may bring you returns in the short term, but you need to think long term when accumulating real wealth.

Take note of the white noise in the market but don't throw out your investment strategy because of short-term distractions.

Mistake 9: Picking last year's winners

A study of markets usually reveals that the best time to buy anything is yesterday! (www.greekshares.com)

There's nothing sadder than inexperienced investors jumping on last year's success story, because they are worried about missing out on a boom or skyrocketing share prices.

Last year's winner can be this year's loser, which can make the first investment experience of these investors very unpleasant.

On a more positive note, the success story of last year doesn't have to be a dud, and the past performance of an investment can give you some indication as to the quality of a company. However, it is the future performance of your investment that will determine

Take note of white noise in the market, but don't throw out your strategy for short-term distractions

your returns. When investing for the first time don't panic about missing opportunities — there are always opportunities — and do your research.

Mistake 10: Ignoring super

The amount of money you have has got nothing to do with what you earn ... people earning a million dollars a year can have no money and people earning \$35,000 a year can be quite well off. It's not what you earn, it's what

you spend. **Paul Clitheroe (financial adviser, commentator and author)**

For most Australians, superannuation is the most tax-effective investment vehicle they can use to accumulate wealth. The irony is that many Australians ignore superannuation for most of their working lives.

The earlier you start accumulating super, the less you will have to contribute to it over time, due to the magical effects of compound interest.

Reasons not to ignore superannuation:

- If you're an employee, your employer is contributing the equivalent of 9% of your salary each year to a superannuation fund which is then invested for your retirement.
- Any earnings are taxed at 15%. If you made these earnings outside the fund you would pay tax at your marginal tax rate which can be as high as 46.5%, including the Medicare levy.
- As an employee, you can make before-tax contributions (salary sacrifice), which can reduce your tax bill. If you make after-tax contributions, you may be eligible for tax-free superannuation contributions from the federal government (known as co-contributions). If you're self-employed, you can make tax-deductible contributions.
- When you retire the government rewards you with tax-free income if you choose to take your superannuation benefits on, or after, the age of 60.

Mistake 11: Relying on donkey logic

The first rule is not to lose money. The second rule is not to forget the first rule. **Warren Buffett**

Compared to experienced investors, new and inexperienced investors are more likely to get caught up with risky shortcuts when investing, rather than doing the necessary groundwork.

You can buy books that promise to make you a millionaire in a week or a year, or books that suggest that the secret to riches (as well as a lot of debt) is to purchase 100 properties in as many weeks. In Australia we seem willing to pay thousands of dollars to money gurus

so they can share their secrets about how to become rich quick, but many begrudge paying advisers for financial advice that can set them up for lifelong investing.

If you want to attend a seminar, we recommend you attend those seminars that explain how to put an investment strategy together.

Here's an example of something that won't work for you – the Property Perks master class. Assume you have \$100,000 to invest. And let's say you attend "Property Perks", one of the many property seminars that are advertised around the country. You attend the free seminar and the organisers offer you an opportunity to participate in a Property Perks master class at a cost of \$15,000.

After attending the classes, you now have \$85,000 to invest. The \$15,000 you paid for the class effectively works out to be a 15% upfront fee for considering investing in any properties that Property Perks might offer you as a master class graduate.

Think about this for a moment. Before you

can accumulate wealth you need to make up the 15% you have forked out to learn about property. Assuming you make a return of 15% you will be back where you started in a year. If the return on any property you purchase is 7%, it will take you more than two years to accumulate wealth worth \$100,000 — your original investment amount. Furthermore, you have missed out on two years' worth of returns because you spent so much money on seminars. That's donkey logic.

Mistake 12: Speculating

We believe that according to the name "investors" to institutions that trade actively is like calling someone who repeatedly engages in one-night stands "a romantic". **Warren Buffett**

"Investing" is purchasing an asset with the aim of receiving a return, either immediately or in the future, in the form of capital gains or income. An experienced investor usually researches the health of the business or the property, as well as the financial fundamentals, before investing.

"Speculating" on the other hand is effectively taking a punt on a stock. For example, you may be betting on a price rise based on a rising market, or hoping to benefit from rumours about a company, or getting in early with a company that is a new player in a booming market. During the resources boom of 2005 and 2006, virtually every resources company listed on the stock exchange received a huge amount of interest from speculators.

A company with no history, and possible but unproven potential, is sometimes called a "speculative stock". A speculative stock is high-risk and has an outside chance of delivering returns. The expectation is that if the stock does deliver, the returns will be spectacular (pardon the pun).

Taking a punt on a stock is not necessarily a bad thing, but don't confuse speculating with investing. A "trader" is betting on short-term gains (and sometimes losses) in the market to make their money.

The activities of traders can sometimes cause spikes in share prices and sudden falls as they stampede into a stock and charge out again, usually by the end of the day or week or month.

Share traders love speculating and the short term usually has very little to do with investment fundamentals. Some naive traders resign from their full-time jobs to embark on full-time trading and the expectation of riches. A small minority have been successful but most have returned to employment after taking one too many risks.



Taking a punt on a stock is not necessarily a bad thing, but don't confuse speculating with investing – speculating is a high-risk activity

Speculating is a high-risk activity that can deliver big returns, but nine times out of 10 brings on financial ruin for the unwary investor who fails to appreciate the risks.

Mistake 13: Assuming you're an expert in everything

An expert is someone who knows some of the worst mistakes that can be made in his subject and who manages to avoid them. **Werner Heisenberg (German physicist)**

The investment world is so large that no one (not even Warren Buffett) understands every aspect of how every market works. Due to the size of the market, investment experts tend to specialise in certain areas such as international shares, the bond market, options, Australian shares, China, Japan, infrastructure, small companies, to name a few.

Financial advisers access research from many of these specialists before giving clients advice on specific investments. You don't necessarily have to appoint an adviser to become an active investor, but applying similar principles as the ones advisers use when formulating a financial plan and selecting investments for a client will make you a more successful investor.

Financial advice is like medicine. It can be dangerous to rely on someone else's prescription. Every person is different, especially when it comes to individual financial circumstances. Don't just follow your mate's investment strategy unless you truly believe

Mistake 14: Relying on your emotions

The market right now is moving on nothing more than emotions. Guess what? It almost always moves on emotions. **David Bach (author & former fund manager)**

When you invest you can expect to experience:

- excitement
- joy
- pride
- greed
- fear
- panic
- regret
- depression
- hope
- satisfaction

Keeping to your strategy when you feel panicked or excited means that your decisions are not ruled by your emotions.

When the property market starts falling or the sharemarket drops 20%, it will be tempting to sell before the market falls further. In some cases selling may be an appropriate decision, but in most situations selling in a freefalling market can be financially catastrophic.

Knowing what to sell is as important as knowing when to sell. Following an investment strategy will enable you to identify when to cut your losses by selling, and when to hold on and endure the bumpy sharemarket ride.

Mistake 15: Benign neglect

If you know why you bought a stock in the first place, you'll automatically have

a better idea of when to say goodbye to it. **Peter Lynch**

Benign neglect when investing normally takes three forms:

- Faded glory. After the excitement of buying the property or making the initial share purchases, the excitement wears off. Investors get bored and forget about the other important aspect of investing — monitoring and rebalancing.
- Avoiding bad news. Investors often lose interest when their investments are performing badly. This is precisely the time an investor should take the most interest to ensure the investments held still reflect his or her investment strategy.
- Apathy. Assume a single man in his 20s visits an adviser. The adviser recommends a plan, and then assists the young client to build a portfolio. Over time, however, the client's circumstances have changed. Over the next five years he marries, has two children and starts his own business. The client never returns to the adviser (despite repeated contacts by the adviser), nor does the man review his own portfolio or strategy. The plan he is following has not allowed for life insurance or income protection insurance, neither has it taken into account his now larger mortgage repayments. Never ever forget about your investments, especially when your investment returns are low.



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At a minimum ...

Avoid the 15 biggest investment mistakes

1. Get started now.
2. Invest in more than one asset, and more than one asset class.
3. Create a plan.
4. Only invest in assets/investments that you understand.
5. Understand the difference between a love affair and an investment.
6. Don't overestimate your investment ability.
7. Don't accept investment tips from the guy in the pub.
8. Keep your eye on your long-term goals rather than short-term white noise from the markets.
9. Do your research rather than relying on last year's winners.
10. Make the most of your superannuation opportunities.
11. See reality rather than what you hope to see.
12. Don't trade when you want long-term returns.
13. If necessary, appoint experts to help you.
14. Trust your instincts.
15. Don't forget about your investments.