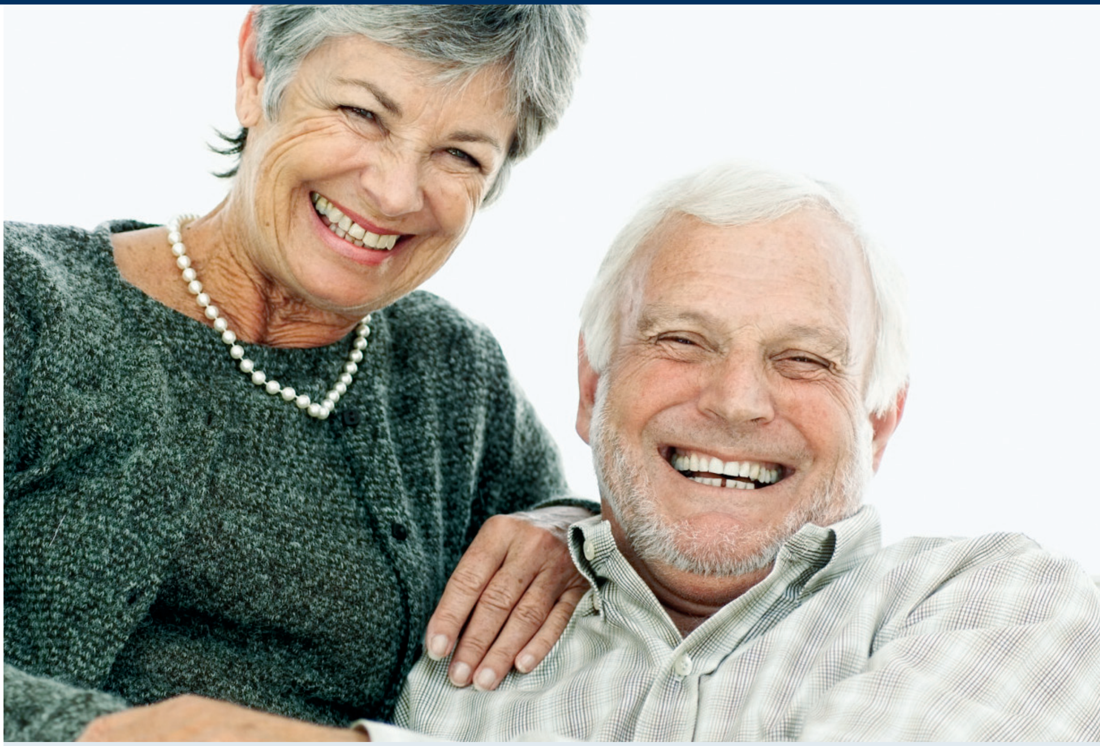
Five common investment pitfalls — and how to avoid them



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As any investor knows, there are no guarantees as to what the markets will do from year to year. But whether markets go up or down, you can significantly increase your opportunities for long-term investment success by avoiding these five common investing pitfalls.

PITFALL #1:

Buying high, selling low

It sounds easy enough — to generate gains, all you need to do is buy low and sell high. In practice, however, it's actually a very difficult task. Some investors tend to hold off until a particular investment or asset class has increased in value, then they buy in. Then, when the market enters a downward phase, they lose heart and sell — often at a loss.

The key to avoiding this pitfall is to refrain from trying to time the market. Selling at the wrong time and missing just a few days of a market recovery could have a significant long-term impact on your portfolio, as the table below shows. A far more effective approach is to stay invested and stick to your long-term investment strategy.

Why it's best to stay invested

Missing just the 10 best days in the market, over the past 10 years, would have reduced the returns significantly.

	Annual returns
Staying invested	7.3%
Missing the 10 best trading days	0.9%
Missing the 30 best trading days	-6.4%
Missing the 50 best trading days	-11.9%

Source: Based on the returns of the S&P/TSX Composite Index for 10 years ending September 30, 2009.

PITFALL #2:

Not diversifying

History has shown that different asset classes, industry sectors and geographic regions generally do not move in sync with one another. Since no one can predict exactly when one type of investment will outperform the others, the most effective approach is to hold a diversified mix of investments. Diversification helps to reduce risk and smooth out returns as lower returns in one asset class or market are often offset by gains in another.

- **Asset class.** Equities provide long-term growth, while bonds and cash provide stability and liquidity.
- **Geography.** Canada represents approximately 5% of world markets — meaning that 95% of investment opportunities lie beyond our borders. Having a globally diversified portfolio also protects your portfolio from downturns in any one market.
- **Sector.** Industry sectors tend to perform differently throughout the economic cycle.

PITFALL #3:

Not rebalancing

Once you have set your asset mix and built a diversified portfolio, it's important to maintain a good mix over time. Market movements can often cause your allocation to drift from the weightings that were initially set in your portfolio. This can lead to a very different allocation (and investment experience) than you had originally intended. Rebalancing is an effective way to keep your portfolio aligned with your investment objectives and tolerance for risk.

PITFALL #4:

Finding reasons not to invest

Short-term events can be unsettling and markets usually react very quickly. Using these events as a reason to sell your investments or stop contributing to your portfolio is often counterproductive. The following table illustrates the short- and long-term market effects that some well-known crises have had on the S&P/TSX.

Reasons to stay invested

Year (event)	Return	Return in the following year	Average return over next 5 years
1974 (oil embargo)	-25.0%	+18.5%	+22.3%
1981 (double-digit inflation)	-10.2%	+5.5%	+13.7%
1990 (Gulf war)	-14.8%	+12.9%	+10.8%
2002 ("Tech Wreck")	-12.4%	+26.7%	+18.3%

Source: Based on the returns of the S&P/TSX Composite Total Return Index.

Short-term fluctuations are a normal part of market cycles, and their effect fades over time as years of strong markets outweigh declines. By investing regularly and staying invested, you can reduce the impact of short-term volatility and increase your likelihood of being a successful investor.

PITFALL #5:

Not reviewing your investment objectives regularly

Your investment objectives should reflect where you are today and where you want to be in the future. But your goals may change dramatically as time passes. For this reason, it's helpful to have an annual review to check that your investment plan is still appropriate.

This is especially important if you experience significant life changes such as a marriage or divorce, the birth of a child or grandchild, a change of job, a change in the status of your health or a death in the family. An effective long-term investment plan should always be aligned with your current circumstances, so make sure your plan is updated whenever there is a significant life event that affects your present situation.

› **Please contact us for more information on how you can avoid the common investment pitfalls.**

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