Eight mistakes to avoid while investing

Investing is not just about picking winners, but also about avoiding mistakes. Retail investors can be better off if they avoid making the following mistakes.

1. **Overconfidence - Don't be unrealistically optimistic**

A bull market makes retail investors believe that they are geniuses - after all, anything they put money into goes up. This overconfidence in their own abilities leads to a complete disregard of the risks involved. Every new generation that invests in the market ignores past experience. These new investors wrongly believe that stock prices only go up.

Don't be overconfident and don't start believing that you have superior skills compared to the market. Recognise that in a bull market you are benefiting because the whole market is going up. If those around you are getting unrealistically optimistic, start managing your risk accordingly. Remember that sometimes markets do come down.

2. **Over enthusiasm to trade - Not every ball should be hit**

Good batsmen realise that some balls outside the off-stump should be left alone. Similarly, professional investors realise that sometimes its better to just stand still than to rush into a stock. Retail investors often make the mistake of "flashing outside the off-stump" because they cannot resist the temptation to trade in every opportunity. And, like an inexperienced batsman, they suffer the same fate.

Too much trading will lead to a lot of churn, extra commissions to your broker and huge tax implications for you. Some of the world's best investors follow a buy and hold strategy - you should too.

3. **Missing the benefits of compounding of capital - Learn from Einstein**

Albert Einstein is reputed to have said that compounding of capital is the 8^{th} wonder of the world because it allows for the systematic accumulation of wealth. Even though any one in class 5 could tell you how compounding works, retail investors ignore this basic concept.

Compounding of capital can benefit you only if you leave your money uninterrupted for a long period of time. The sooner you start investing, the bigger the pool of capital you will end up with for your middle aged and retirement years.

Don't wait to start investing only when you have a large amount of money to put to work. Start early, even if it's with a small amount. Watch this grow to a very large amount with the passage of time.

4. **Worrying about the market - But there is no answer to your favourite question**

Smart investors don't worry about the direction of the market - they worry about the business prospects of the companies whose stocks they own. Retail investors are obsessed with the question "Where do you think the market will go?" This is a wrong question to ask. In fact, no one knows the answer.

The right question to ask is whether the company, whose stock you are buying, is going to be a much bigger business 10 years from now or not? Don't take a view on the market, take a view on long-term industry trends and how your chosen companies can create value by exploiting these trends.

5. **Timing the market - Around 99% of investors will fail in this strategy**

It is very difficult to time the market, i.e, be smart enough to buy at the absolute bottom and sell at the absolute top. Professionals understand that timing the market is a wasted exercise.

Retail investors always wait for that elusive best opportunity to get in or to get out. But by waiting they let great investment opportunities go by. You should use systematic or regular investment plans to make investments. You'll have to make fewer decisions and yet can accumulate substantial wealth over time.

6. **Selling in times of panic - You should be doing the opposite**

The best opportunity to buy is when the markets are falling and there is fear in the minds of investors. Yet, many retail investors do exactly the opposite. They sell when the markets are falling and buy only when the markets are high. This way they end up losing twice - by selling low and buying high, when they should be doing exactly the opposite.

If nothing has changed about the long-term outlook for the company that you own, then you should not sell this company's stock. Use this opportunity to buy more of the same stock in falling markets. Some of the world's biggest fortunes were made by buying when others were selling in panic.

7. **Focusing on past performance - Its like driving forward while looking backwards**

It is a very common perception that because a stock has done well in the past one year, it's the best stock to invest in. Retail investors do not realise that often the best performers will underperform the market in the future because their optimistic outlook has already been priced into the stock.

Don't go after hot sectors that are currently producing high returns. Don't let greed drive your investment decisions. Look forward to see whether the gains produced in the past can get repeated or not. Short-term trends of the past might not get repeated in the future.

8. Investing is all about staying alive

Beyond a point, having too many names in a portfolio can be counterproductive. You might end up duplicating, or end up taking too much exposure to a sector. Over-diversification can upset your portfolio, especially when you have not done enough research on all the companies you have invested in.

If you are an active investor in the stock market, maintain a manageable portfolio of 15-25 names. Instead of adding new names to this portfolio, recognise ideal ones. Then back them with more capital. In the long run, this will produce better returns for you than adding another 20 names to your portfolio. Investing is all about patience and discipline. By avoiding mistakes you can improve the long-term performance of your portfolio, whatever the economic conditions prevailing in the market.