

Avoiding financial pitfalls

Recognising common mistakes can help protect your wealth

Investing is essential for those looking to grow their wealth over time. Cash alone seldom keeps pace with inflation, as the interest it generates is usually too low to preserve its purchasing power. For beginners or those adopting a DIY approach to investing, recognising common mistakes can help protect them from potential financial pitfalls.

From falling victim to scams to heeding poor investment advice or channelling funds into risky ventures, these mistakes frequently occur in financial markets. By staying informed, you can avoid these pitfalls and maximise the potential of your investments.

BALANCING RISK AND RETURN WISELY

Finding a balance between risk and return is vital, requiring careful planning. This equilibrium depends on several personal factors, such as your investment goals, time horizon and income needs. Additionally, the degree of volatility – fluctuations in asset values – that you are willing to tolerate is significant, and this consideration may evolve over time.

Avoid taking insufficient risks, as this could stifle your growth potential. For example, if you are in your twenties or thirties and focus solely on low-risk investments for your pension, it may limit your long-term gains. Conversely, taking on excessive risk can expose you to market volatility, particularly if you need to liquidate investments in the near term.

CREATING A DIVERSIFIED PORTFOLIO

One way to mitigate risk is through diversification, which involves spreading your investments across various assets. Maintaining a mix of assets that behave independently from one another is a fundamental principle of sound portfolio management. This strategy decreases the likelihood

of incurring significant losses, even when one sector underperforms.

However, exercise caution when relying too heavily on past performance as your sole criterion for selecting investments. While top-performing funds or shares may seem appealing, they often struggle to maintain their performance over time. Instead, focus on long-term metrics, such as the asset's performance over several years, to ensure you develop a genuinely diversified portfolio.

GRASPING THE EMOTIONAL PITFALLS OF INVESTING

Investing with excessive emotion can lead to mistakes, such as chasing trends or panic selling during market downturns. Emotional investing



often results in seeking 'hot' funds with recent high returns while overlooking their underlying value.

It's essential to recognise assets that can protect your portfolio in challenging markets. For example, balancing stock market investments with high-quality bonds offers a fundamental yet effective form of diversification. Although bonds typically yield lower returns than equities, they can provide stability to your portfolio during volatile periods.

PATIENCE YIELDS REWARDS WHEN NAVIGATING MARKET FLUCTUATIONS

The golden rule in investing is often to stay the course. While the notion of buying low and selling high appears appealing, it is much easier said than done. For many, the primary aim of investing is to grow wealth over time or produce a steady income from capital. Attempting to time the market by frequently buying and selling risks undermining the advantages of compounding returns.

Remember that market downturns are unavoidable and unpredictable. Although declining markets can seem unsettling, they present an opportunity to acquire assets at reduced prices. By keeping a steady approach and resisting the temptation to sell out of fear, you can capitalise on the long-term growth potential of the markets.

AVOID PURSUING HIGH-YIELD INVESTMENTS RECKLESSLY

High-income investments can be enticing, but they often carry a higher level of risk. For instance, shares that provide elevated dividends may not maintain these payouts. Likewise, bonds with high yields – indicating greater income potential – also suggest a higher vulnerability to default or loss.

Rather than fixating on the highest-yielding options, consider assets that offer sustainable growth potential. Long-term success frequently stems from choosing companies or funds that consistently perform well, instead of pursuing quick, immediate returns.

MAXIMISE YOUR TAX BENEFITS

Utilising tax-efficient vehicles like ISAs (Individual Savings Accounts) can enhance your investment efforts. ISAs protect you from Capital Gains Tax and Income Tax, making them an effective instrument for creating a substantial, tax-efficient portfolio. For the 2024/25 tax year, you can contribute up to £20,000 across ISAs, and regular contributions – such as monthly payments – can help mitigate market fluctuations.

Pensions offer even greater tax benefits for retirement planning, providing tax relief on contributions at rates of up to 45%. Although pensions offer less flexibility in terms of access, they remain highly effective for long-term savings goals. However, tax regulations can change, so it is important to stay informed.

EXERCISE CAUTION WITH UNREGULATED INVESTMENTS

New investors should steer clear of obscure or unregulated investment opportunities. These often entail substantial costs, inadequate management and even fraudulent schemes. Promises of 'guaranteed' high returns often indicate potentially high-risk schemes or outright scams.

Unregulated investments frequently employ high-pressure tactics to entice victims. This may include unsolicited phone calls, time-limited offers or promises of safety using complex legal jargon. To safeguard yourself, always verify an investment through the Financial Conduct Authority (FCA) register. Remember, if an offer appears too good to be true, it likely is.

SPOTTING AND AVOIDING INVESTMENT FRAUD

Investment scams can take various forms, from cold calls and unsolicited emails to sophisticated promotional brochures. Fraudsters often exploit a sense of urgency to pressure you into making rushed decisions, minimising risks and promising returns that are far superior to anything realistically attainable.

If you receive unexpected contact, approach such offers with scepticism. Hanging up on cold callers or disregarding unsolicited emails can help protect you from becoming a victim of scams. Furthermore, opting for regulated investments ensures that you will benefit from full protection through services like the Financial Ombudsman Service should anything go wrong. ■

LOOKING FOR ADVICE TO START YOUR INVESTMENT JOURNEY OR ENHANCE YOUR CURRENT STRATEGY?

Understanding these common errors can help you make informed decisions if you embark on an investment journey or enhance your current strategy. If you require further guidance or wish to explore suitable investment opportunities, please contact us for expert advice to discuss your specific needs.

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