Seven Common Investment Mistakes

Though investing in the stock market has emerged as a great resource of making money, it always has some risks involved, just like any investing activity. There are some common investment mistakes which can easily be avoided if someone follows the footsteps of the investment legends.

As preached by many gurus and teachers, the fastest way to succeed is to copy the methods of those who have done it. The proven tactics learnt from investment experts are very helpful to achieve quick success in investment. Generally, you could go for some investment books written by the most renowned investment gurus or experts like Peter Lynch, Warren Buffett etc.

The 7 most common mistakes in stock investment

In addition to the lessons from the investment experts, it is possible to derive knowledge from the common mistakes made by other investors, especially those who make retail investments. When we have sufficient knowledge on the most common mistakes and the key factors behind losing money, it becomes very easy for us to get rid of such mistakes that our fellow investors have previously made. It can even help to maximize our profit by applying the opposite strategy.

Let’s have a look at some of the most common investment mistakes:

1. To be in a Hurry to Take Profit

It has been observed that by being in a hurry to take profit, most of the investors sell out the money-making stocks instead of the loss-making stocks. In this process they run out of quality stocks and become a typical accumulator of “rubbish”.

When the investors take early profit they are exposed to a number of mistakes. Hence, the right approaches are as follows:

- Taking early profit should never be applicable for investment-grade stock but may be applicable to stocks meant for trading.
- The investors need to preserve quality stocks instead of the poor quality stocks.
- It is important for investors to adopt a cut-loss strategy as the profit-taking strategy alone doesn’t make any sense.

2. Not Prepared to Take Losses

Generally, investors are reluctant to cut losses and it can be considered as one the greatest mistakes made by the investors. Apart from the emerging investment markets, this phenomenon exists even in the developed markets like that of US where the investors appear to be savvier.

As a matter of fact, the intensity of pain goes higher when someone is confronted with a loss. It is evident from a study that the intensity of pain due to suffering a 30% loss is about 2.5 times higher than the pleasure from having a 30% gain.

As the investors are reluctant to face the pain, they keep their loss-making stocks year after year. They don't feel the pain until they sell these loss-making stocks. It does sound silly but that is the way people deal with pain and pleasure. Sooner or later, you will kind of "forget" about the losing stocks and also the pain associated with it.

It is not surprising at all to find a long list of loss-making low quality stocks in an investor's portfolio. They make the delay in selling these stocks as they believe that it would be possible to recover its cost in the course of time. The hope remains alive until the stock is sold. In fact, there is no underlying principle other than hope in holding onto these poor stocks. The odds of a profit-making company to continue making even more profit is much higher than a poor-performing company to turn the company around.

But the most dangerous thing is that the poor quality stocks may ultimately be delisted as the fundamentals go on deteriorating. The investors may eventually find all their hopes ending in smoke in such a situation where 70% deterioration in price may result in 100% loss.

3. Lack of Specific Goal and Strategy

The lack of specific investment goals and strategy can be considered as one of the most common mistakes among the investors. Despite having different characteristics, investors generally mix up the investment stock with trading stock. It is highly recommended to treat these two types of stocks separately where investment strategy is concerned.

Investors generally purchase trading stock depending on rumor or predictions which ultimately may not turn out to be fruitful. On the other hand, the investment-grade stocks are purchased after reviewing fundamentals which include business potential, earning outlook, growth prospects etc. So, a trading stock needs to be monitored based on the dependability of the information source. The study of charts reflecting the trend of a stock can be very effective for an investor to decide when to sell, to hold on or even buy more.

On some occasions, investors get involved with a low grade stock knowingly with an intention to make some quick gains. But once the stock comes to a loss position, they treat it as an investment-grade stock by holding on for a long period. This is how the gamble of making some quick profits ends up as a pain of holding up some poor stocks for several years.

It has also been observed that some investors initially go for investment-grade stock with a view to make a long term investment after evaluating fundamentals or dividends of such stock. But they panic as the price goes down a little bit. They sell out the stock in fear that the price might go down further. In this process a long term investment now evolves into a short term trade where early profit is concerned.

As long as the investors fail to specify their goals and remain confused between trading and investment stocks, between short term speculation and long term investment, their investment will be in danger. Of course, there are different kinds of investors in the market today and regardless of your investing style (trading, buy and hold, buy based on dividend yield, buy based on profit growth etc), you will eventually make money if you know what you are doing.

4. Going for Penny Stocks

Fundamental value has a great significance where investment is concerned. Undoubtedly, the main objective of purchasing stock is to ensure future earnings. In general sense, a stock of 50 cents is cheaper than a stock of Rs10 But the perception is quite different in investment market where a 50 cent stock appears to be more expensive than a Rs10 stock in terms of profit obtained from a share.

The penny stocks are generally known as retail stocks which obviously lack fundamentals. This type of low priced stocks are popular among retail investors but not among the institutional investors. The gamblers and syndicates target these stocks as it is very easy to exaggerate or move up. In fact, the price of these penny stocks is unable to move up without help of the so-called syndicates as no fresh money is involved in lifting the prices of such shares.

On the other hand, price of heavyweight stocks goes up with the improvement of fundamentals which in turn attracts more money including foreign funds as well. Moreover, these prospective stocks having the characteristic of more demand than supply and are generally benefited by strong price support and results in a steady price appreciation over time.

5. Easily Influenced by Tips

It has so far been a popular practice among the retail investors to depend on tips to prosper in the investment market. Unfortunately, the tips didn't work for most of them and the loss was such a huge amount that some of them left the market for good. Though trading on the basis of tips seems to be exciting, the experienced investors would definitely acknowledge that it is not so easy to make money just only relying on tips.

At first, we need to know about 'tips'. It can be a piece of news or information obtained from an insider who has a clear perception on the things that are going to happen. The insider could be someone like company directors, senior member of a management team, corporate lawyers, auditors or even bankers. These types of individuals generally have access to some confidential information. Even the lawyers, analysts, fund managers on any person who have a close contact with senior management of an organization, can be a great source of tips.

Few tips might be very useful but most are pure speculation and the rest are fabricated by the so called syndicates as a part of their gamble. The tips are generally spread in the market through an insider. It is not firsthand information to an investor as it passes down over several hands. If there is any change to the information, the investors are the last persons to know it. By the time they become aware of the scenario, it is too late for any remedy.

6. Becoming Impatient

Impatience of the investors can be treated as one of the most common mistakes. It is more common among the retail investors who generally want to make quick gains. They generally don’t have any interest in the stocks which yields 10% per year. They rather go for those stocks which make 10% within a week or become double within a year.

Moreover, the retail investors mostly rely on tips and keep monitoring the stock very closely immediately after purchasing it. They praise the person for his tips when the prices go up. On the other hand, if the prices don’t move up within a few weeks, they become very impatient. But according to the investment experts, investment grade stocks need to be kept for a long time with minimal monitoring for getting the best outcome.

7. Always Buy High and Try to Sell Higher

As the retail investors are very impatient, they are not interested in buying when the market is down and wait until the prices move up once again. They have a tendency to chase a stock. Since they are keen to make some quick profit, they always like to buy high and sell even higher.

This is a common phenomenon in a bull market. This clearly indicates why the retail investors are seen in a huge number during a bull market. And, such investors are hardly found when prices are low.

Obviously, the risk is higher in a strategy of ‘buy high and sell higher’ than that of ‘buy low and sell high’. The strategy of ‘buy high and sell higher’ is not inappropriate indeed, yet the investors have to quit the market if they make even a single mistake. As a matter of fact, it is very painful for most of the people to cut loss and unfortunately many retail investors get caught in the same trap again and again.

The Lessons to be learnt for Remedy

Before you make any investment, you need to get prepared to accept losses as a business component. At the same time, you need to be rational and consider stocks from an impartial point of view. In case of any mistake, you should not hesitate to take losses and cut the stock as much as possible. You can also choose a small time frame to sell out the loss-making stocks at a slightly higher price. You can trim down those stocks (if any) further, as your main objective should be to get rid of those poor stocks as early as possible.

Another important thing is that there is no alternative to a specific and solid investment plan. There should not be any mix up between investment stock and trading stock. You need to have different strategy while dealing with these two types of stocks with different characteristics. You can’t afford to make a blunder to keep a short term trading stock like a long term investment stock. It is unwise to sell out investment-grade stocks and accumulate speculative trading stocks.

Finally, it should always be remembered that speculative stocks are trading stocks and you need to specify a time frame to make proper utilization of tips. It is always helpful to have a close look at the tips or to make some simple analysis on stocks. This is like a game where win and loss are the natural phenomenon.

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